

Service Inventions in China

July 10, 2015

International Employment

China's ten-year plan (2010 – 2020) for mid- to long-term development of talent seeks, among other things, to promote and encourage indigenous innovation. A key area of focus is service inventions. With the publication of the draft Service Invention Regulations (the "Draft Regulations"), the government appears determined to pass legislation to increase the incentives given to employee- and worker-inventors - both in the public and the private sectors - and to improve the protection of their rights and interests in inventions they create in the course of their employment or engagement. State-owned and private enterprises and organizations have been called upon to establish systems for reporting of innovations, management of service inventions, and the rewarding and remunerating of inventors, along with rules that clearly set out the responsibilities, rights and obligations of all the stakeholders.

Current Legal Landscape

A service invention is defined as an invention created in the execution of employment tasks (which is defined broadly to include the provision of services by contractors and dispatched workers) or primarily by using the employer's resources in the form of materials or technology. The intellectual property underlying a service invention belongs to the employer, which has the right to apply for patents or other intellectual property in relation thereto. Employment tasks have been defined very broadly in judicial interpretations to cover not only tasks assigned and undertaken during the course of employment, but also tasks undertaken by the individual in a related field of scientific research or technological development within a period of one year after termination of employment, unless the parties agree otherwise.

The current regime requires that an employer ought to provide the inventor employee with a reward upon the granting of a patent for the relevant service invention, and "reasonable remuneration" based on the economic benefits derived from the invention patent. Remuneration guidelines in the new Draft Regulations, however, contain minimum compensation thresholds that should apply in the absence of any prior agreement or internal company policy governing rewards and remuneration for such service inventions. This represents a departure from the earlier rules dating back to 2000, which imposed reward and remuneration obligations only on State-owned enterprises. Although the current rules make clear that the employer has the freedom to set up its own internal policies that can supersede the default guidelines, this autonomy may be reduced by the new Draft Regulations.

Draft Service Invention Regulations

The Draft Regulations appear to take a more aggressive approach in the protection of employee inventors, arguably adhering more closely to the German model (Germany's Law on Employee Inventions, *Gesetz über Arbeitnehmererfindungen*).

The Draft Regulations call for the employer to establish an internal system allowing employee inventors to report inventions and to apply for intellectual property rights. Unless the parties have agreed otherwise, or the employer already has established such rules, the employee inventor will have two months to report in writing an invention to the employer. From the date of receiving such a report, the employer has two months to determine whether such invention constitutes a service invention, and six months to decide what to do with the service invention: whether to apply for intellectual property rights, to protect it as a trade secret or to make it public. The employer should issue its decisions in writing to the employee inventor.

The employee inventor also has the right to be informed of the progress of the intellectual property applications, and if the employer decides to halt the intellectual property application process or to abandon a claim to intellectual property in the service invention, the employee inventor has a right to be informed and to seek to obtain the rights to such application or intellectual property. The Draft Regulations do not take into consideration factors that may make compliance with this requirement difficult; for example, where the decision to halt the intellectual property application or to abandon the intellectual property is purely strategic, and cannot be disclosed to any third party, including the employee inventor, without impairing the employer's interest.

The Draft Regulations also require the employer to establish a system for rewarding and remunerating its employee inventors, and provide certain default rules that will apply if no system is put in place. While the Draft Regulations expressly permit employers to institute their own alternative rules and policies with respect to rewards, remuneration, procedures and payment timelines, employers will (as indicated above) very likely have to comply with minimum thresholds in the formulae used for calculating rewards and remuneration which are based respectively on multiples of average employee salary and percentages of profits/revenues. Further, the amount of remuneration must take into account the economic benefit derived from the actual invention, and the inventor's contribution to that invention. Such an approach makes it difficult to take into account the long-term investments made by the employer with respect to the research facilities and human talent. However, the Draft Regulations do stipulate that the cumulative remuneration paid shall not exceed half of the cumulative profits derived from the intellectual property, but it is not clear whether salary can be counted as part of the cumulative remuneration.

The Draft Regulations provide for survival of certain rights on both sides even after termination of the employment relationship. Each employee inventor shall remain obligated to disclosure of service inventions and supporting relevant application processes and to maintain confidentiality. In return, the employee inventor shall continue to enjoy the right of attribution, and will also be entitled to continue receiving rewards and remuneration post termination. The latter benefits can be inherited by the employee inventor's heirs or beneficiaries.

Given the government's current focus on scientific innovation and its enthusiasm for incentivizing domestic talent, we believe that the Draft Regulations are likely to be promulgated in the near future.

Going Forward

It would be prudent for employers with China operations that involve the research and development of new and advanced technologies (the “Company”) to take steps to protect their investments in research and development, intellectual property portfolios and long-term technology strategy. These issues need to be tackled from various different perspectives, ranging from human resources policies and procedures and intellectual property protection strategies, to financial accounting and valuation.

To ensure that ownership and all other rights and interests of the Company to the inventions created by employee inventors in the course of employment are fully protected, and in particular, to mitigate the liability arising from or to avoid altogether situations where past or present employee inventors may assert certain rights over service inventions that they have contributed to, the Company should establish a comprehensive scheme for regulating the development, protection and exploitation of service inventions, by developing formal reporting and notification procedures; preparing contract guidelines and document templates; and establishing an equitable inventor reward and remuneration program with an appropriate valuation scheme.

Since the current rules governing service inventions define employment tasks so broadly, all of the above must also apply to dispatched workers, agents or contractors, regardless of whether they are working full time or part time.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our International Employment practice group:

United Kingdom

Christopher Walter	+44 20 7067 2061	cwalter@cov.com
Christopher Bracebridge	+44 20 7067 2063	cbracebridge@cov.com
Helena Milner-Smith	+44 20 7067 2070	hmilner-smith@cov.com

United States

Jeffrey Huvelle	+1 202 662 5859	jhuvelle@cov.com
Lindsay Burke	+1 202 662 5859	lburke@cov.com

China

Grace Chen	+86 10 5910 0517	gchen@cov.com
------------	------------------	--

This information is not intended as legal advice. Readers should seek specific legal advice before acting with regard to the subjects mentioned herein.

Covington & Burling LLP, an international law firm, provides corporate, litigation and regulatory expertise to enable clients to achieve their goals. This communication is intended to bring relevant developments to our clients and other interested colleagues. Please send an email to unsubscribe@cov.com if you do not wish to receive future emails or electronic alerts.