OUTSTANDING CLARITY AT LAST FOR EMPLOYEE COMPENSATION

SECTION 39 of the Patents Act 1977, which assigns patent ownership of many employee inventions to employers, reflects the assumption that employees are normally suitably rewarded for their inventive efforts by their salary and employment benefits. However, this is not always so. Hence, section 40(1) provides that if such a patent is "of outstanding benefit to the employer" (accounting for "size and nature of the employer's undertaking"), the court or comptroller may award "compensation" to the employee. Section 41 provides that this compensation should represent a "fair share" of the benefit the employer derived (or is reasonably expected to derive) from the patent.

It took 31 years for section 40(1) to be successfully invoked – *Kelly v GE Healthcare Ltd.* [2009] EWHC 181 (Pat), [2009] R.P.C. 12 – and until now there had been no other successful application. The Supreme Court decision in *Shanks v Unilever and others (No 2)* [2019] UKSC 45, [2019] 1 W.L.R. 5997 marks a potential turnaround.

Professor Shanks was employed by Central Resources Ltd. ("CRL") in the 1980s, developing biosensors. CRL was a non-trading research company in the Unilever corporate group. In 1982, Shanks invented a biosensor for diabetics. CRL (being entitled under section 39(1)) applied for UK and EU patents, before assigning them to other Unilever companies. The patents were exploited through licensing to third-party companies, before being sold. The net benefit to the group was around £24 million.

In 2006, Shanks applied to the comptroller for compensation under section 40(1). The hearing officer concluded that £24 million was not "outstanding" given the group's overall profits. This was upheld by the High Court and Court of Appeal.

The appeal to the Supreme Court turned on two issues: A) when is a benefit to the employer "outstanding"?; B) how is a "fair share" of the benefit calculated? Lord Kitchin gave judgment for the unanimous court.

The Supreme Court held that "outstanding" is "an ordinary English word meaning exceptional or such as to stand out", relative to the size and nature of the employer's undertaking (at [39]). The meaning of "employer's undertaking" was contested. Shanks argued the undertaking was CRL's business, while Unilever claimed it was the whole group's business. The hearing officer, High Court and Court of Appeal agreed with Unilever.

The statutory references to an "employer" benefiting plainly meant the *actual* employer – CRL. Nevertheless, Lord Kitchin concluded that an employer's "undertaking" could be broader than the profits accruing directly to that company. He defined an "undertaking" as a "unit or entity which carries on a business activity": in the context of section 40, that means the "undertaking of interest" to the actual employer (at [41]). Lord Kitchin thought this usually would be easy to identify as the benefit accruing to the employer's whole business or to any distinct unit within it. Where the employer is part of a corporate group which exploits the employer's output, however, the issue is more complex.

Lord Kitchin was unhappy with both parties' interpretations of "undertaking". Unilever's interpretation did violence to the statutory wording. It also made it too easy for a company to be "too big to pay", since the contribution of any single product to a large corporate group's overall turnover will necessarily be small. Meanwhile, Shanks' interpretation resulted in the patents granting either little benefit to CRL (since they were assigned for a nominal fee) or an over-inflated benefit (if their benefit to the connected assignee could be taken into account under section 41(2), but not the corresponding value of other assigned patents) (at [48]).

Instead, Lord Kitchin concluded that where the employer is a research company operating for the benefit of others in the corporate group, and assigns patents resulting from the work to others in the group, the benefit to the employer's undertaking is the benefit derived by the group from the employer's patents and from not the unrelated activities taken by the companies in the group. Sometimes, it would be appropriate to assess the benefit by comparing it to the overall profit of the undertaking – particularly where the employer was a small, solo company. The undertaking's overall size might also be relevant in other ways, such as if it affects their bargaining strength in licensing negotiations. However, Lord Kitchin noted that such a simple comparison would be inappropriate if the undertaking's overall profits are derived from many different business activities which have nothing to do with the patented invention. Overall, Lord Kitchin found it "hard to see" how a failure to affect aggregate profits alone could justify the conclusion that the benefit of a patent was not outstanding (at [54]).

In light of the extreme disparity between Shanks' remuneration and the benefit of the patents to Unilver, the lack of evidence that Unilever had any licensing scheme of comparable profit, the high rate of return and the minimal effort and risk involved in exploiting the patents, the Supreme Court found that the benefit was outstanding.

One significant contribution of this decision is that it clarified the factors indicating that a benefit is outstanding, namely whether the benefit: went beyond that normally expected from inventions arising from the employee's duties; involved no risk to the business; represented a particularly high rate of return; and was a new business or unforeseen licensing opportunity (at [51]).

Meanwhile, Lord Kitchin's approach to determining the scope of an employer's undertaking is sensible and realistic. Broadening the meaning of "undertaking" to activities by other companies in a group acknowledges the reality of commercial life, avoiding problems in cases where the employer derives only nominal direct profit from their activities.

However, Lord Kitchin's approach does not allow the court to determine the outstanding nature of the benefit by reference to all the group's activities in every case; something which previously made it too easy for courts to find implicitly that an employer was "too big to pay". Importantly, while both the High Court and Court of Appeal claimed there was no "too big to pay" defence, ultimately what persuaded them (and the hearing officer) that the benefit was not outstanding was a comparison to the group's entire operation and profits, including those having nothing to do with CRL or the exploitation of patents. It was this aspect of the hearing officer's decision which the Supreme Court deemed an error of law. If total turnover is always relevant, it is naturally the most notable factor.

Lord Kitchin's approach instead assesses "benefit" by reference to the benefit which *that employer's activities* bring to the corporate group. This allows the court to look beyond the employer's immediate profits, but significantly reduces the relevance of the group's entire turnover unless it is derived from activities sufficiently linked to the employer's activities (which is unlikely for large groups). This makes it less likely that an employer will be too big to pay, and is more justifiable in principle. The purpose of section 40(1) is to identify employees who were not adequately remunerated for their invention's contribution. It is unclear why profits made from unrelated activities would be relevant to this inquiry. Despite being more employee-friendly, however, Lord Kitchin's approach to the employer's undertaking does not "open the floodgates" to masses of compensation claims: the patent must still contribute something exceptional even in this more limited context. Successful compensation claims may now be more likely, particularly against large corporate groups, but should still be quite rare.

The second issue in the case was what represented a fair share of the benefit. The hearing officer set this at 5%, and the Supreme Court could not fault this assessment (at [91]). While the High Court had attempted to lower the fair share to 3%, this was based on a finding of fact which the hearing officer had not actually made. As such, the Supreme Court rejected this lower figure.

The parties disputed whether the fair share should be affected by the benefit's "time value" – the benefit derived from the employer having and using profit from the patent over time – and whether it should be net corporation tax. The Supreme Court concluded that the time value should be accounted for to reflect inflation, disagreeing with the High Court's conclusion that this would cause unnecessary complexity (at [65]–[66]). The court held that corporation tax should be ignored, to avoid double taxation of the compensation (at [58]). The Supreme Court therefore affirmed the hearing officer's finding that the fair share was 5%, which after an uplift for inflation resulted in an award of £2 million.

This aspect of the decision clarifies how fair shares should be calculated, likely providing a high watermark for employee compensation: this being a case where the employee was the sole inventor and the employer did not incur much risk or cost. It is predicted that few, if any, future cases will exceed 5% compensation.

It should finally be noted that amendments to sections 39–41 (applicable to patents granted after 2005) extend these provisions to benefits derived from the invention as well as the patent. Nevertheless, this should not materially alter the approach recommended in this case. Overall, the Supreme Court's decision represents a significant improvement in the clarity of the law in this area.

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SAMPLING AND COPYRIGHT – DID THE CJEU MAKE THE RIGHT NOISES?

MUSIC sampling – the practice of incorporating a fraction or "sample" of a pre-existing sound recording within a new musical arrangement – began in earnest with the advent of commercially available digital samplers in the late 1970s. Five decades later and sampling has become a mainstay of recorded music worldwide. Professional and amateur music producers scour the sound recordings of yesteryear; searching for interesting rhythms, hooks, riffs, refrains, melodies and motifs that can be recontextualised in new compositions. Yet the legality of sampling has long been a source of uncertainty. Books, articles and whole academic theses have been written on the subject. In particular, it has hitherto been unclear whether sampling of sound recordings requires the permission of the holder of copyright (or, in EU terms "related rights") in the recording. Some steps to resolving this question were taken by the Court of Justice of the European Union (CJEU) in Case C-476/17, *Pelham v Hütter*, Judgment of 29 July 2019, EU:C:2019:624.

The case concerned the German music producer Pelham, who, without authorisation, sampled approximately two seconds of a rhythm sequence from a 1977 Kraftwerk sound recording. Pelham incorporated this sample, with minimal changes, as a continuous loop into his new musical composition. Kraftwerk alleged infringement. The legal issues involved necessitated a preliminary ruling from the CJEU. The first key question was whether the two second sample comprised a "reproduction … in part" of Kraftwerk's sound recording for the purposes of Article 2(c) of InfoSoc Directive (Directive 2001/29/EC (O.J. 2001 L 167 p.10)). If so, the second key question was whether the use of the sample fell within an exception, such as the quotation exception in Article 5(3)(d) of the same Directive.