O/2/93

PATENTS ACT 1977

IN THE MATTER OF an application under Section 46(3) by Farmpower International Limited for settlement of terms of a licence of right in respect of Patent No 1436673 in the name of Irene Ida Down

DECISION

Patent No 1436673 is dated 28 November 1974 and by virtue of Schedule 1 of the Patents Act 1977 its maximum term was extended from 16 to 20 years, during which extension licences under the patent are available as of right. The patent is concerned with a "dual purpose" towing hitch which can be used with a tow bar having either an eye or a socket for attachment to the hitch. For the purposes of this decision it is not necessary to consider the invention in greater detail.

Farmpower International Limited ("Farmpower") sought a licence from the proprietor of the patent, Mrs Irene Down, successor in title to her late husband, and, having failed to reach an agreement, applied to the Comptroller on 24 June 1991 for settlement of terms under section 46(3)(a) of the Patents Act 1977. Evidence has been filed by Mrs Down herself, by Mr Christopher Kempton, the Managing Director of Sparex Limited ("Sparex"), a company granted an exclusive licence under the patent, and by Mr John Price, the Managing Director of Farmpower. The matter came to a hearing before me on 29 October 1992, when Mr D R Cowan of E N Lewis & Taylor represented Farmpower and Mr I S Harrison of Withers and Rogers represented Mrs Down.

During the evidence stages the status of certain statutory declarations and matters raised in correspondence was contested and it was agreed that this would be dealt with as a preliminary matter at the hearing. Accordingly at the hearing I reviewed the situation with the assistance of Mr Cowan and Mr Harrison and decided that, in addition to the normal three rounds of evidence comprising Mr Kempton's first declaration (sworn 23 December

1991) with exhibits, Mr Price's first declaration (sworn 29 January 1992) and Mr Kempton's second declaration (sworn 31 March 1992) with an exhibit, there should be admitted to the proceedings Mr Price's second declaration (sworn 3 June 1992) with an exhibit, Mrs Down's declaration (sworn 12 June 1992) and Mr Kempton's third declaration (sworn 17 June 1992).

I also ruled that another declaration sworn by Mr Kempton on 17 June 1992 and described as supplementary to that above should not be admitted to the proceedings and that any matter raised solely in correspondence should be disregarded.

During the evidence stages a question of confidentiality arose in relation to a supplementary declaration sworn on 23 December 1991 by Mr Kempton (as distinct from the declaration of the same date referred to above). At the hearing I reviewed this matter and Mr Harrison confirmed that this supplementary declaration had been withdrawn as evidence. As a consequence, I held that the second paragraph of Mr Kempton's second declaration should be disregarded.

I now turn to the main matter before me, the settlement of the terms of the licence between Mrs Down and Farmpower. The only area of dispute between the parties is in respect of the royalty to be paid by Farmpower.

In their draft licence filed with the application to the Comptroller to settle terms Farmpower offered a royalty of 5% of their own net sales price, though in correspondence to the other party filed in evidence they stated that they were prepared to go up to 60p per hitch. The draft licence covers the authority to make, use, exercise and vend articles the subject of the patent, and Farmpower have indicated that it is their intention to manufacture hitches. In her statement of objection the proprietor proposed £1 per hitch, the royalty then paid by Sparex under their existing licence, to be reduced according to a formula based on the total royalty derived by the proprietor from both Sparex and Farmpower. The formula was not specified.

It is convenient at this point to review the commercial history of the patent as it appears from the evidence. Mr Down, the original proprietor of the patent, settled a first agreement with

Sparex on 25 June 1975 under which Sparex paid a royalty of 40p per hitch sold, to be reviewed at two yearly intervals in accordance with a "cost of living" formula, in return for a worldwide licence to manufacture, use and sell hitches covered by the patent or by any corresponding patents abroad. At the time of the agreement it appears that there were pending patent applications in the United Kingdom and Canada, as well as a registered design application. The licence was exclusive, subject to Sparex selling not less than 2500 hitches each year or paying Mr Down the balance of royalty equivalent to that number. There was no admitted evidence as to the numbers of hitches sold annually under the licence, but both parties have appeared to proceed on the basis that exclusivity had been maintained. The licence expired on 31 March 1985, and on 29 January 1987 Sparex and Mrs Down signed an agreement maintaining the original licence, the royalty continuing to be calculated according to the original formula. Mr Harrison confirmed that royalty payments continued to be paid to Mrs Down during the hiatus between the two agreements. The second agreement included a clause whereby during the final four years of the life of the patent the royalty paid by Sparex may be adjusted so that any licence granted to a third party should not be on more favourable terms than the royalty rate calculated according to the agreement. At the hearing it was confirmed by Mr Harrison that this was intended to mean that Sparex need not continue to pay a royalty any higher than that agreed for any other licensee during the final four year period when, by virtue of the licence of right provision, Sparex's own licence would in effect cease to be exclusive.

In practice, although the licence would permit manufacture, Sparex only sell hitches under it, at least at this stage, though Mr Harrison was unsure whether they originally manufactured as well. (I would add as an aside that neither in the evidence nor at the hearing was the question addressed by either party of who does now manufacture the hitches sold by Sparex, and under what terms). As I have already noted, Sparex's current royalty under the licence is £1 per hitch. From Mr Kempton's and Mr Price's evidence it appears that hitches according to the patent are being sold by Sparex in a variety of ranges. "Standard Duty" hitches are priced at between £12.53 and £15.85 per hitch, dependent upon the quantity sold, "Heavy Duty" hitches are priced at between £15.01 and £17.78 per hitch, and "Super" hitches are priced at between £16.64 and £18.94 per hitch.

At the hearing Mr Harrison modified the proprietor's request for £1 per hitch, indicating a willingness to accept 85p per hitch. The original proposal for a reduction formula based on the total royalty derived from both Sparex and Farmpower was not apparently maintained. As I understood Mr Harrison's argument, the new figure was reached on the basis of about 7% of an assumed licensee's selling price of £12, that in turn being derived from an assumption that the 60p offered by Farmpower in correspondence was equivalent to the 5% they had offered both in correspondence and in these proceedings. In this analysis it appears to me that Mr Harrison accepted the broad principle, expressed for example in Shiley Inc's Patent [1988] RPC 97, that the range of 5-7% represents a level of royalty which is common in the mechanical engineering field. He maintained that the royalty in the present case should be at the upper end of this range since the proprietor, or perhaps more correctly the exclusive licensees, had established a market for the product. He conceded, however, that there was no evidence relating to the establishment of the market, and Mr Cowan made the point, validly in my view, that it is the proprietor's circumstances, rather than those of the exclusive licensees, which I must take into account. Whatever the justification or otherwise for Mr Harrison's assumption and submission, by the end of the hearing the difference between the parties was only that between 60p and 85p per hitch. In my experience of licence of right royalty settlements, this represents a very small difference indeed.

It is well established that the royalty that I should settle is that which would be agreed between a willing licensor and a willing licensee with a view to securing a reasonable renumeration to the patentee having regard to the nature of the invention. It was confirmed by the Court of Appeal in Smith Kline and French Laboratories Ltd's (Cimetidine) Patents [1990] RPC 203 and accepted by both Mr Cowan and Mr Harrison, that the best guide to this is what other licensors and licensees have agreed in comparable cases, the comparability or otherwise of any particular case being a pure question of fact for the decision of the Comptroller. It is clear to me, therefore, that the Sparex agreement, which relates to the product in suit and is plainly comparable in many respects with the licence sought by Farmpower, provides the best guidance I have as to what Farmpower should pay. However, it is equally clear to me that, in considering the comparability of the Sparex agreement as a question of fact, I must seek to make adjustment for any significant factors in respect of which the Sparex and Farmpower licences or circumstances differ. The general "5-7%"

guideline afforded, for example, by <u>Shiley</u>, applies primarily, in my judgement, when no better comparable exists, but in the present case will provide a useful check on whether the royalty that emerges from the comparability consideration lies within the normal range of mechanical royalties.

There are a number of differences between the Sparex agreement and the intended Farmpower licence which I must examine in order to determine whether they should be reflected in a difference in royalty. First, Sparex have, at least in principle, a worldwide licence, though I was shown no evidence that there are in fact any live corresponding patents anywhere outside the United Kingdom, and Mr Cowan did not seek to identify this as a significant distinction. I conclude that this does not of itself justify a difference in royalty. Similarly I do not regard the reference in the Sparex agreement to a registered design as of any significance in relation to royalty.

Second, Sparex only now sell the hitches, whereas Farmpower apparently intend to manufacture them. However, both licences cover both activities, and there are no grounds here for a distinction on royalty.

Third, the Sparex licence was, at the time it was negotiated and throughout the unextended term of the patent, exclusive. I have seen no evidence to form a basis upon which to determine whether exclusivity carried a premium in royalty in this case, and if so how large, but I am satisfied that as a general proposition a willing licensee would expect to pay a higher royalty for the advantages to be gained from exclusivity. That proposition appears to be supported by the fact that the proprietor is now willing to accept a royalty from Farmpower somewhat lower than that currently being paid by Sparex. I will therefore allow for this factor in determining royalty.

The fourth and final factor which might suggest that Farmpower's royalty should differ from that being paid by Sparex concerns the commercial relationship between Sparex and the proprietor. Mr Cowan drew attention to the fact that Mr Kempton, in his first declaration, stated that his company had been seriously considering continuing to pay a royalty to the proprietor after the patent had ceased, depending on commercial circumstances. Mr Cowan also pointed out that, under the terms of paragraph 4(2)(b) of Schedule 1 to the Patents Act 1977 (although he did not refer expressly to this provision), Sparex were not obliged to pay any royalty during the extended term of the patent. In reply Mr Harrison said that he was not aware of any special relationship. He thought that Mr Down, as a farmer with some mechanical expertise, had been pleased to find a local company prepared to take a licence under the patent. (It appears that at the time of the original agreement both Mr Down and Sparex were based in Devon, and Sparex were still there in 1987 when the second agreement with Mrs Down was completed, though they have subsequently apparently transferred to Shropshire). He did not seek to speculate why Sparex might have been prepared to pay royalty in circumstances when this was not required by law, though I suppose that his argument of local goodwill might apply just as well this way round as well. He acknowledged that it might be argued that this did not represent a businesslike approach by Sparex. Whatever the reason, I infer from Sparex's willingness to consider paying in such circumstances that there has been, in dealings between Sparex and the proprietor, a greater preparedness on the part of Sparex to protect the interests of the proprietor, at some financial cost to themselves, and presumably therefore to their customers, than would normally exist in arms-length dealings between willing licensor and willing licensee, notwithstanding Mr Harrison's contention that the relationship was and is at arms length. This indicates to me that a royalty agreed between willing licensor and willing licensee ought to be set somewhat lower than that paid by Sparex. For me to reach any other conclusion would, I consider, entail a lack of proper regard of the public interest in determining what constitutes reasonable remuneration to the proprietor having regard to the nature of the invention, as required by section 50(1)(b).

To summarise, I find that both the exclusivity of the Sparex agreement and the nature of the commercial relationship between Sparex and the proprietors, original and present, are factors pointing towards the conclusion that Farmpower should pay a royalty somewhat lower than that currently being paid by Sparex. I have been shown no evidence to indicate with any precision how large the difference should be, but I conclude, having regard to all the circumstances, that there should be a 25% discount on the Sparex royalty.

Before concluding how this should be represented as a royalty term in the licence, I need to address certain other arguments that were put to me. First, Mr Cowan contended that, in view of the different prices charged by Sparex for their hitches, a percentage royalty rate would be easier to administer. He also said that the profit margin on higher priced hitches must be higher than on lower priced hitches and that a percentage royalty rate would properly reflect this difference in profit margin in the income to the patentee. Mr Harrison, however, observed that Farmpower have offered no evidence as to what their pricing policy will be and, although he speculated that they might charge in the region of £12 per hitch, he suggested that Farmpower could make the hitch a loss leader or perhaps start at a low price during the life of the patent and then raise the price when the patent expires. He also suggested, correctly in my view, that a fixed price royalty is far simpler to administrate. I conclude, for reasons of simplicity and certainty, that the royalty paid by Farmpower should be based upon a fixed price per hitch sold rather than upon a percentage royalty rate, just as is Sparex's royalty, despite the wide range of prices they charge. Although the Sparex agreement includes a cost of living review, Mr Harrison accepted that this was not necessary in Farmpower's licence in view of the short remaining life of the patent, and I agree with him.

At the hearing Mr Cowan pleaded that the patent was of low technical merit and commercial importance and pointed out that there was no specialist market for the hitch and no specialist manufacture needed. Mr Harrison argued that Farmpower have indeed created a market of a relatively special nature, and suggested that Sparex's interest in the hitch indicated that it is commercially valuable. My conclusion on this point is that there is nothing in the evidence to support a view that the invention is technically or commercially out of the ordinary run of mechanical engineering inventions. In any case, even if Mr Harrison were justified in his view, any such special factors would already have been taken into account in the Sparex agreement and, since this has formed the basis for my comparability consideration, they would also already have contributed to my determination of the Farmpower royalty. I would add here, in view of an argument that I understood Mr Harrison to submit, that even were I to be empowered to take account of any special efforts on the part of the exclusive licensees, as distinct from the proprietor, to establish a market for the invented product (and I do not believe on the authorities that I am so empowered), I was shown no evidence of any such efforts which I could in any way regard as out of the ordinary.

At the hearing, Mr Harrison effectively proposed that protection of the proprietor's overall remuneration level should be a factor to be taken into account. His concern seemed to lie in the fact that if a royalty rate lower than that currently paid by Sparex were to be settled, the overall renumeration to the proprietor may well be lowered if the existing market were shared between the parties. He did, however, concede that if the new licensee succeeds in enlarging the size of the market, then in spite of receiving a lower royalty from one or both parties, the proprietor's renumeration could even increase. Mr Harrison sought to distinguish the present proprietor's position from that of the patentee in, for example, Allen & Hanburys Limited's (Salbutamol) Patent [1987] RPC 327, where the Court of Appeal held that if the patentee manufactures the invention himself he is not entitled, in relation to a royalty settled under section 46(3), to compensation for loss of sales where the market is static. He argued that the proprietor does not have ways of protecting her position against lost sales, for example by making internal economies, that would be available to her if she were a manufacturer.

In response Mr Cowan noted that there was no evidence from the proprietor as to whether the total market would remain static or increase when Farmpower moved into it. He countered Mr Harrison by arguing that the present proprietor's position is in fact better than that of a patentee who is also a manufacturer, since she does not stand to lose manufacturing profit, and can appoint as many licensees as she wishes. He considered that the loss of sales point from salbutamol only applied when the patentee was the manufacturer. In this respect it appears to me that he agreed with Mr Harrison in distinguishing the present case from salbutamol.

I consider that, in regarding the salbutamol dictum concerning loss of sales as of direct relevance only when the patentee himself is also manufacturer, both Mr Harrison and Mr Cowan are correct. I am not, therefore, precluded from considering the potential loss of total royalty to the proprietor, and I accept, with Mr Harrison, that protection of the proprietor's royalty income is a proper consideration for me, since this relates to her position qua proprietor. However, Mr Cowan is correct in his observation that I have no evidence as to the likely effect on the total market of Farmpower's entry, and in particular no evidence to suggest that the market is at present saturated by Sparex's products. Furthermore, in considering what constitutes reasonable remuneration to the proprietor I have to take note that the intention of the legislation, as set out in paragraph 4(2)(b) of Schedule 1, is that an existing licensee should not be required to continue paying royalties beyond the end of the sixteenth year. It seems quite possible to me in any case that the total sales of hitches in accordance with the invention will increase when Farmpower begins to produce them, and this might even result in the proprietor's total royalty income increasing, dependent in part upon what arrangement continues to operate between the proprietor and Sparex. It is quite clear to me that, in reaching my conclusion on royalty, I am not empowered to take account of any possible loss of sales suffered by the formerly exclusive licensees. In summary, there is nothing in this consideration which requires me to enhance the royalty to be paid by Farmpower above the level that has emerged from the comparability analysis.

I return, then, to my finding that the royalty to be paid by Farmpower should be 25% less than that currently paid by Sparex. According to the evidence, Sparex currently pay £1 per hitch sold, and it therefore follows that I find that the appropriate royalty to be paid by Farmpower is 75p per hitch sold by them. I note, on the uncorroborated assumption that Farmpower will sell at £12 per hitch, that this represents a royalty of 6.25% of their sales, well within the 5-7% range commonly relied upon in the absence of a useful comparable licence.

Although the parties were not in dispute as to any other terms of the draft licence, I reminded them at the hearing that it was necessary for me to satisfy myself that they contained nothing which, to my knowledge, was unlawful and that they were appropriate to a licence settled by the Comptroller. I pointed out at the hearing that the preamble to the licence needed to reflect that the terms of the licence were settled by the Comptroller.

I expressed doubt that a clause in the draft licence which provided that, if the licensee were unable to maintain price or sales volume in the face of infringing competition, the royalty settled by me could be varied by arbitration or by the Court. While both parties appeared content to retain this clause, I am satisfied that, since it is for the Comptroller to settle terms including royalty, it would not be in accordance with statute for this to be variable by arbitration. The Court has, of course, implicit powers to vary the terms I settle, for example on appeal. I conclude therefore that the clause in question is inappropriate, and have omitted it.

I suggested at the hearing that a clause which obliged the licensor to maintain the patent in force by payment of renewal fees seemed out of place, since the effect of the patent ceasing for non-payment would be that the licensee would no longer be obliged to pay a royalty. It was agreed, I believe, that this clause made sense only in the context of an exclusive licence, and I have omitted it.

Both parties also agreed with me at the hearing that a clause which terminated the obligation to pay royalties if the licensor did not institute timely proceedings against the infringer was otiose in view of section 46(4), and I have omitted it also.

It is established that "most favoured licensee" clauses are not appropriate in licences of right the terms of which are settled by the Comptroller, and I have deleted such a clause from the draft submitted by Farmpower.

The draft licence included a clause agreeing to refer to arbitration "any question or dispute arising out of or in relation to (the licence) including the question of its existence or validity". At the hearing I expressed doubt that it could be in accordance with statute for a third party to arbitrate on the "existence or validity" of a licence when statute itself decreed that the licence was available on application. Even the Comptroller has no powers to determine whether or not there should be a licence, but only to settle its terms. I am satisfied that this provision should not be included. Similarly, and consistently with my finding above concerning arbitration when there is infringing competition, I do not consider that it is appropriate for an arbitrator to have powers to vary terms of a licence settled by the Comptroller in accordance with statute. In my judgement the Court alone has such powers. It appears to me that the only legitimate place for a clause broadly of the proposed type might be in relation to interpretation of the terms of the licence. Neither Mr Harrison nor Mr Cowan addressed me at the hearing on the wording that a clause limited in this manner might take, and I am reluctant to attempt to draft one myself in the absence of general experience of law and practice relating to arbitration. I am, however, prepared to include such a clause if both parties are able to confirm in writing to the Patent Office within one month of the date of this decision their joint agreement to the text of such a clause, provided that such text is acceptable to me in the light of the above comments. In the absence of such confirmation the licence will contain no clause of the type proposed.

Having now covered all points of dispute and satisfied myself that the draft licence as amended contains nothing which to my knowledge is unlawful, I order that the proprietor grants to the applicant a licence of right in the terms appended hereto, with effect from the date of this decision, subject only to the outcome of any action consequent upon the preceding paragraph of this decision.

Neither party made any substantive submission as to costs, and I follow the conventional practice in cases of this kind of making no order as to costs.

Any appeal against this decision must be lodged within six weeks after the date of the decision.

Dated this 4 day of JANUARY 1993

PATENT OFFICE

DR P FERDINANDO

Superintending Examiner, acting for the Comptroller

THE PATENT OFFICE

LICENCE OF RIGHT

THIS LICENCE is made between Irene Ida Down of Holland Crosspark, Bridgetown, Totnes, Devon (hereinafter called "the Licensor" which expression shall where the context admits include its successors and assigns) of the one part and Farmpower International Limited of Ennerdale Road, Harlescott, Shrewsbury, Shropshire (hereinafter called "the Licensee" which expression shall where the context admits include its successors and assigns) of the other part.

WHEREAS

(A) The Licensor is the registered proprietor of Patent No 1436673 of the United Kingdom of Great Britain and Northern Ireland and the Isle of Man in respect of an invention relating to "Dual Purpose Trailer Towing Attachment" (such patent being hereinafter referred to as "the Patent").

(B) Licences under the Patent are available as of right by virtue of Schedule 1 paragraph 4(2)(c) of the Patents Act 1977.

(C) Upon application by the Licensee the Comptroller has settled the terms of a Licence of Right as herein set forth, to come into effect on the date of the decision to which this Licence of Right is appended.

NOW

Licence is granted as follows:

1. Licence

1. The Licensor HEREBY GRANTS to the Licensee full but nonexclusive Licence and authority under the Patent for the unexpired term thereof to make, use, exercise and vend articles (hereinafter called "the Products") the subject of the Patent in the United Kingdom of Great Britain and Northern Ireland and the Isle of Man.

2. Royalty

The Licensee shall pay to the Licensor a royalty at the rate of 75p per product sold or otherwise disposed of by the Licensee.

3. Accounts and Payments

3.1 The Licensee shall within 30 days after the end of every usual quarter day render to the Licensor a statement showing the details of sales and dispositions of Products and the sum for royalties due and the Licensee shall at the same time pay the sum due.

3.2 The Licensee shall keep proper books of account and record and the supporting vouchers showing all matters connected with the manufacture, sale and disposition of the Products and the amount due in respect of royalties and shall allow the Licensor by its duly appointed officer or accountant at all reasonable times to inspect and take copies of or extracts from such books, records, vouchers and any other relevant or apparently relevant book, account, record or voucher as may be reasonably necessary for the purpose of verifying the amount due in respect of royalties. Such inspection may be made notwithstanding termination of this Licence whilst any outstanding claim remains unsettled in the view of either party.

4. <u>The Patent</u>

4.1 The Licensor shall not amend the specification of the Patent without first advising the Licensee in writing giving particulars thereof.

4.2 If the Patent shall in any action for infringement or proceeding for revocation be declared to be invalid on any ground whatsoever all royalties payable hereunder shall as from the date of the Order cease to be payable but if the decision of the Court making such declaration shall be reversed on appeal or by way of other review procedure in or towards a court of last resort the said royalties shall again become payable together with all royalties which would have been payable but for the adverse decision.

5. <u>Termination</u>

5.1 If the royalties due hereunder in respect of any quarter have not been paid within the time allowed by this Licence or if the Licensee shall commit or allow to be committed a breach of any of the other covenants, promises or undertakings herein contained and on its part to be performed or observed and shall not have remedied such breach within 28 days after notice is given to it by the Licensor requiring such remedy or if the Licensee shall have a receiver appointed of the whole or any part of its assets or an order is made or a resolution passed for winding up the Licensee (unless such order is part of a scheme for reconstruction or amalgamation of the Licensee) then the Licensor may forthwith terminate this License without being required to give any or any further notice in advance of such termination but such termination shall be without prejudice to the remedy of the Licensor to sue for and recover any royalties then due and to pursue any remedy in respect of any previous breach of any of the covenants or agreements herein contained.

6. Ancillary Provisions

6.1 Any notice required or permitted to be given hereunder may (without prejudice to the use of any other method) be given by sending the same by prepaid post to the last known address for the time being of the addressee or to the Receiver or Liquidator (if any) appointed to manage or wind up the affairs of the party to whom such Receiver or Liquidator has been appointed, and any notice so sent shall be deemed to have been given two working days after the same was posted.

6.2 This Licence shall be construed and governed according to the laws of England.