Mr Hayward
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PATENTS ACT 1977

IN THE MATTER of an Application by Investronica S.A. for the settlement of the terms of a licence of right under Patent No 1596134 in the name of Gerber Garment Technology Inc.

INTERIM DECISION

Patent number 1596134 in the name of Gerber Garment Technology Inc ("the proprietors"), is a "new existing patent" - as defined in Schedule 1 to the Patents Act 1977 - which became subject to licences of right on the 18th November 1993. The patent expires on the 18th November 1997. Investronica S.A. ("the applicants") applied under section 46(3) on the 1st June 1994 asking the Comptroller to settle the terms of a licence of right. The proprietors opposed the terms proposed in the application, and the matter eventually came before me at a hearing on the 25th June 1996 when the applicants were represented by Mr David Young QC instructed by Kings Patent Agency and the proprietors by Mr Christopher Floyd instructed by Greenwoods and by Urquhart-Dykes & Lord.

The patent relates to an apparatus for cutting layers of sheet material, such as textile fabrics, using a reciprocating cutting blade. In particular it concerns a cutting machine, and a method of cutting, wherein the lateral bending force on the cutting blade is sensed and as the sensed force increases, so the blade is turned to present its relatively stiff cutting edge rather than its less stiff lateral profile towards the force. Thus, the lateral forces which would otherwise bend the blade when cutting multiple layers of, and/or tough, material are resisted enabling multiple layers to be cut out accurately at high speed.

Although all the pleadings and evidence had centred on a licence which would have allowed the applicants to build the sensing and controlling mechanism of the invention into new cutting machines, it became apparent during the hearing that the applicants were in fact only interested in adding, or retrofitting, a suitable control system to existing cutting machines and Mr Young indicated that the applicants would be happy for the licence to be restricted to this end. As Mr Floyd said, this does significantly alter the whole basis of the licence and it is a great pity that this restriction, and the consequent simplification of the outstanding issues of dispute, was not aired much earlier in the proceedings which could I think then have gone forward much more quickly and efficiently. In the event, as I suggested at the hearing, in the face of the substantial redrafting of various terms of the draft licences proposed by the two parties which will now be needed, the most sensible course for me to follow would be to issue an interim decision indicating in outline what provisions should and should not be incorporated in the licence and to allow the parties a period in which to draft agreed terms having that effect and this is what I shall do.

Formal matters concerning the evidence

For the sake of completeness, I should perhaps mention two minor points about the evidence. First, under rule 112 of The Patents Rules 1995 the proprietors filed a photocopy of an affidavit from the late Mr R McCormick which was originally made in the course of a separate infringement action, *viz* the case of *Gerber Garment v Lectra Systems Ltd 1995 RPC 383*. When I queried the evidentiary status of this photocopy, neither Mr Young nor Mr Floyd saw any difficulty with my using the material in the course of deciding the present case. Second, the applicants' evidence includes a declaration from Professor H Henne which had been signed in Germany before a notary but which technically did not comply fully with all the requirements for a statutory declaration or affidavit as required by rule 103. Again, neither Mr Floyd nor Mr Young took any issue with this. Accordingly, and by analogy with the High Court's discretion to accept technically deficient evidence under rule 4 of Order 41 of the Rules of the Supreme Court, I am content to follow what seems to me to be the sensible, pragmatic approach and admit both items as evidence.

The Comptroller has already directed that two items of evidence - giving the current prices of, and gross profit margins on, the proprietor's machines - should be treated as confidential under Rule 94. I have not quoted this evidence directly in this decision so as to avoid having to make parts of the decision itself confidential, but I have certainly made use of it in reaching my conclusion.

The starting point

Notwithstanding the drafting changes which will be needed before a licence can be finalised, it is convenient to use as a framework for this decision the composite draft licence which the proprietors very helpfully provided and which includes, in the form of deletions and additions, the applicants' proposed licence set against the revised terms sought by the proprietors. I shall deal with the issue of royalty first before considering the other terms.

It is clear from the authorities that the royalty should be such as to secure for the patentee reasonable renumeration having regard to the nature of the invention, and that in practice this means I have to consider what would be agreed between a willing licensee and a willing licensor - see for example *Allen & Hanburys Ltd's Patent [1987] RPC 327 (the salbutamol case)* at page 376. It is also quite clear, in particular from *Smith Kline & French Laboratories Ltd's (Cimetidine) Patent [1990] RPC 203* (see headnote 3 on p 207), that the preferred way of determining the amounts payable is by using comparable agreements willingly entered into.

Royalty - comparables

Mr Floyd argued that there are four comparable licences which I should consider. These licences (the "McCormick licences") are referred to in, and attached to, Mr McCormick's affidavit. These were not for the present patent but for an earlier Gerber patent concerning vacuum table mechanisms which are used to hold fabric in place in a cutting machine (one of the licenses also covering other patents). The royalty chargeable in relation to the first of the McCormick licences ("Teva") depended on the size of the vacuum table involved and was between \$2000 and \$7000 per table. Teva is said to have sold tables at prices between \$10,000 and \$15,000, though the evidence does not indicate whether these covered the full range of sizes licensed. The second McCormick licence ("Ontario Die") was for vacuum die cutting and covered both the vacuum table patent and three other patents. It involved royalties on a sliding scale, starting at \$9000 and reducing to \$4000 as the patents expired, the royalties applying to vacuum tables which sold at \$20,000. The third and fourth licences ("CSR" and "Cutters Exchange"), like the first, covered only the vacuum table patent and specified the same royalties. The CSR license also included a payment relating to past infringements and legal costs. Mr Floyd submitted that these licenses were equivalent to a royalty rate of about 20%. It is not easy to derive this figure directly from the licences as we do not know enough about the sale price of tables of differing sizes, but since Mr Young accepted that the licences did represent a 20% royalty I shall assume this is correct.

Mr Floyd acknowledged that that the vacuum table technology was fundamental to cutting machines, and hence arguably more valuable than the present invention. On the other hand, he pointed out that the licences were much more restricted than the present licence. For example, they were limited to use in connection with manual cutters and thus could not be used in the much more profitable area of automated cutters. Indeed, because the proprietors concentrated on the automatic cutting machine market, this limitation effectively prevented the licensees from competing with them. He also drew attention to benefits which the licences allegedly gave to the proprietors. He therefore concluded that there were factors pointing in both directions towards higher and lower amounts than the 20% royalty represented by these licences. Mr Floyd did not venture to suggest any precise mechanism which I should use to determine a suitable royalty on the basis of these licences but simply invited me to conclude that they showed that a suitable rate would, as he put it, be nearer to 20% than to 5%. The latter figure is, of course, often quoted as the "normal" amount applicable to mechanical inventions and is the amount which had been proposed by the applicants.

Mr Young on the other hand did not agree that the McCormick licences were in any real sense comparable. He argued that the 20% royalty was charged only on the cost of the vacuum table which was the subject of the patent and not on the much larger value of a complete automatic cutting machine as the proprietors were proposing in this case. He pointed out that three of the four licences were agreed in the context of an infringement action, not in the context of negotiations between a willing licensor and licensee. He also observed that licences were concluded at various times between 1981 and 1986 and there is nothing to indicate that the economic and commercial situation applying to the industry at that time is the same as it is now.

For my part I do not believe I can draw anything useful from the McCormick licences. First, there is the question of whether the present invention is as significant as that of the vacuum table patent covered by the McCormick licences. Mr Young argued that the vacuum table invention was fundamental because one could not have an automated CAM cutting machine without it. That view is supported by the judgment in *Gerber Garment v Lectra Systems Ltd* which concerned an enquiry into damages for infringement of two British patents, the first being equivalent to that licensed in the McCormick licences and the second being for a related feature. For example, in *[1995] RPC* at page 388, Jacob J says "There are alternatives to CAM machines covered by these Gerber patents . . . but they have been relatively unsuccessful. The patented CAM machines have dominated the CAM field. . . . So, for the purposes of this enquiry, I can treat the two patents as one, and as being dominating in their field." In contrast, it was common ground that whilst the present invention was at least useful, if not invaluable, for "high ply" cutters - ie machines capable of cutting stacks of material more than 4 cm high - it was less important, and certainly not essential, for "low ply" machines. This is borne out by the fact that the proprietors themselves do not incorporate the invention in most of their low ply machines. It is also clear from the evidence that the number of low ply machines sold worldwide considerably exceeds the number of high ply ones. However, whilst even Mr Floyd accepted that the present invention was not in the same league as the previous one, the parties disagreed as to quite how valuable the present invention is. For example, in his evidence Professor Henne concluded that the present invention was not fundamental but was merely an accessory of use in particular circumstances. This was however disputed by the proprietors' witnesses Mr Allport and Mr Gerber who stated that the ability to cut much deeper layers of fabric more quickly and with less wastage was of very considerable commercial benefit. Unfortunately, I did not have the benefit of hearing any of these three gentlemen cross examined and while I did have the benefit of hearing the applicants' other witness, Mr Puschmann, cross examined, Mr Puschmann made it clear that he had no knowledge of the commercial benefits of the invention. Though it is true, as Mr Floyd submitted, that the commercial facts adduced by Mr Allport in relation to the larger sale price obtainable for machines according to the invention and for the financial savings attributable to their use, and hence their value to customers, have not been directly disputed, I am still left with conflicting evidence as to the significance and import of the present invention which was not tested in cross examination. Nevertheless, on the evidence before me I am satisfied that the present invention is of lesser significance, both technically and commercially, in the cutting machine art than that covered by the McCormick licences, though I accept that within the narrow field of high ply cutters it is of considerable commercial value.

There are also other difficulties. As Mr Young pointed out, three of the four licences were agreed in the context of an infringement action and I accept that this may well have influenced the royalty agreed. That does not, though apply to the fourth licence. Perhaps more important, while the royalties in the McCormick licences represented a high proportion of the costs of the vacuum tables to which they related, there is nothing in these licences which indicates what royalty might have been appropriate for an entire automatic cutting machines including the vacuum table. This is significant, because the price differences are enormous. We are told that tables covered by the first two licenses sold for between $10,000 and $20,000. To put this in perspective, the proprietors say that when they first started selling their automatic machines - some ten years before the Teva licence - they were charging over $500,000, and whilst prices have come down, it is clear from the confidential figures supplied that automatic machines are still an order of magnitude more expensive than the Teva tables. Further, the licensed activities did not compete with Gerber's own activities, and clearly very different royalties might have been agreed had the activities competed. Having said that, I am mindful of the fact that I must consider what willing parties would have agreed and so cannot make allowance for Gerber's unwillingness to permit competition. Finally, to the extent that the proprietors no longer have a monopoly on the use of the vacuum bed technology or on the present invention and are therefore now open to competition, there is every reason to suppose that the economic and commercial situation is now very different from that when the McCormick licenses were agreed.

Each of the factors mentioned in the last two paragraphs could be expected to have a significant effect on the royalty, but neither side gave me any assistance in quantifying that effect. Taking all the factors together, there are so many differences between the present license and the McCormick ones that I find I can derive no assistance from the latter beyond deducing that the present royalty expressed as a percentage of the total machine cost should be substantially less than 20%.

Other information about allegedly comparable agreements was provided by Mr Puschmann. He relied in part on his own experience as a German patent attorney. However, he admitted under cross examination that he has no knowledge of the profitability of this particular market, which appears from the proprietor's confidential evidence to have unusually high profit levels, and so his evidence based on general experience is of no real help. He also relied on a publication about payments made under the German employee inventors scheme in which employee inventors are entitled to rights in, or payments for, their inventions, even where the inventions would be deemed under UK law to have been made in the course of their employment. However, as Mr Floyd pointed out this is different matter from the payments agreed between a willing licensee and a willing licensor in the UK, which is what is involved in the present case. In this respect, Mr Young pointed to the use of the word "inventor" in section 50(1)(b), and as I understood him suggested that, while he did not rely on the point, the use of the word "inventor" means that guidance from payments made to employee inventors could not be dismissed out of hand. I do not accept that it is relevant. Section 50(1)(b) reads :

> "that the inventor or other person beneficially entitled to a patent shall receive reasonable remuneration having regard to the nature of the invention."

Thus the use of the word inventor is qualified by the reference to the beneficial owner and may be nothing more than a recitation of the alternatives stemming from section 7(2) which states that :

> "A patent for an invention may be granted -
>
> (a) primarily to the inventor or joint inventors;
> (b) in preference to the foregoing, to any person or persons .... entitled to the whole of the property in it ..."

In any event, whatever the reason for the use of the word "inventor", section 50(1)(b) simply requires that the beneficial owner should be compensated and as I indicated earlier, the authorities make it clear that the compensation should be that which a willing licensee and a willing licensor would agree. Thus, because I do not think that Mr Puschmann's evidence about the payments made to employee inventor under the German scheme can provide any useful guidance as to royalties agreeable between willing licensees and willing licensors in the UK, I do not think it can help me in this case. That this is so was I think confirmed by certain of the figures cited in the guidance which showed that the rates involved were out of line with those applying to licences in this country. For example, and as Mr Floyd pointed out, the guidance suggested payments of between 2 and 10% for the pharmaceutical industry whereas very much higher royalties are paid under pharmaceutical licences in this country.

Consequently, I do not think I have any comparable agreements which can assist me in setting a royalty in this case. As a result, is necessary for me to explore further ways which may help me to arrive at a suitable royalty.

It is convenient here to note that when discussing the McCormick licences during the hearing, Mr Young suggested for the first time that it would be sensible to follow those licences by setting a royalty as a fixed amount per unit. He argued that a fixed rate would among other things, avoid the uncertainties about the selling prices to which a percentage royalty might be applied. Mr Floyd indicated that he too was in favour of a fixed unit royalty in principle. While I also believe that this is a sensible way to proceed in the circumstances, especially now that the licence is to be limited to converting existing cutting machines, I would observe that I can only arrive at a figure by considering percentage royalties because all the evidence and submissions were based on percentages.

Royalty - "section 41" approach

Another approach which has been used in setting royalties is a section 41 approach which stems from the judgment of the Court of Appeal in the *salbutamol* case at p 376 where the court decided that the approach adopted for determining royalty payments under compulsory licences granted under section 41 of the Patents Act 1949 was of use in settling royalties under licences of right. However, Both Mr Floyd and Mr Young were agreed that there was simply no evidence in this case on which such a calculation could be based and I am also satisfied that I can derive no assistance from it.

Royalty - profits available

Another method is the profits available approach, which both Mr Floyd and Mr Young commended to me. This involves making an estimate of the likely profit available to the licensee through exploitation of the invention and how that profit might be divided between the licensee and the patentee. In the *Cimetidine* case Falconer J split the profit available into two shares, one which gave the applicants a return on sales equal to their general level of profitability in all their trading, and another which represented the residue to be returned to the patentees as royalty. The approach was however criticised in the Court of Appeal because the resulting royalty was dependent on the licensee's reasonable remuneration rather than on the proprietors' as is required by section 50(1)(b). As a consequence, the profits available approach has generally only be used as a last resort, though it has been used as a cross-check on results derived in other ways. In this case however, since I have been unable to establish any other basis for determining the royalty, I must look carefully at the profits available. I also note that Jacob J accepted the profits available approach when considering the damages in *Gerber v Lectra*.

Mr Floyd's submission was on the footing that whilst the cost of fitting the additional parts required to retrofit an existing machine so that it operated in accordance with the invention was a mere $2000, the commercial benefits of the modified machine were enormous. Throughout his submissions Mr Floyd strongly emphasised that what really mattered was what the invention was worth in the commercial sphere, and I accept that this is right. Thus Mr Floyd drew my attention to the evidence that the invention can save a clothing manufacturer £40-60,000 a year in fabric wastage alone, that between 1988 and 1991 they themselves sold cutting machines with the invention for $50,000 more than one without. He also drew attention to the proprietor's confidential figures for gross profit percentages over a number of years which, he said, showed higher levels for machines with the invention. Further, he referred me to Mr Archer's evidence in which he states that at a meeting with the applicants, the applicants indicated that incorporating the invention in a cutting machine increased the price obtainable for that machine by 28% in return for a negligible increase in costs. Whilst at first glance this figure might seem extraordinarily high, it is clear from the proprietor's confidental evidence that the gross profit margins on automatic cutting machines are substantial. It is also clear that they are even higher for high ply machines incorporating the invention, though by how much is difficult to tell in the absence of more background data.

In Mr Floyd's submission however, the matter went further than that because machines were in fact sold as part of a package involving service and training contracts and the supply of spare parts and as a result, there were additional profits available which should be taken into account and which a willing licensee would be prepared to pay for. He also observed that in *Gerber v Lectra* Jacob J had taken these ancilliary benefits into account. His proposal to this end was to charge the royalty on the whole value of the package. The position on spares was however changed to some extent following Mr Young's indication that all that was wanted was a licence to retrofit existing cutting machines whereupon no new machines with an associated contract for spares and service would now be sold by the applicants under the licence. Nevertheless, Mr Floyd still maintained the view that it was appropriate to charge royalty on spares because the retrofitting of existing machines might deprive the proprietors of the sale of new machines and with them the sales of spares.

Mr Young's view of the profits available was rather different. He sought to argue that in assessing the commercial benefits of the invention it was necessary to bear in mind that the large differences in the prices of the proprietors' machines with and without the invention were unlikely to be solely attributable to the commercial benefits of the invention but would reflect the significant cost increases incurred in constructing larger machines. He also had a rather different view of Mr Archer's evidence in relation to the meeting between the parties and the figure of 28% for the increase in the price of cutting machines attributable to the invention which the applicants are alleged to have suggested. While Mr Young hinted that he did not believe that this evidence of what he claimed were "without prejudice" discussions should be admissible, he did not in fact take any point on that. Instead he disputed that the increase of 28% in price referred to was the result only of including the invention in an existing machine. Moreover he argued that in any event, even if one were to accept that the 28% increase in price was achieved solely through the invention, then it was clear from *Gerber Garment v Lectra Systems Ltd* that the proprietors were only entitled to 25% of the increased profit accruing from this price increase. Thus Jacob J said at page 420 :

> "As to how the "available profits" were to be split, absent the extra profits from spares *etc* it was agreed that the split would be 25% to the patentee."

On this basis, Mr Young submitted that the most the proprietor would be entitled to was 7% and that this did not take into account the increased costs of installing the invention and making the other changes which he had argued were necessary before the 28% increase in price could be realised.

In the face of the criticism levelled at the profits available approach by the courts, I am all too aware that it must be used cautiously. In this case there are additional concerns in that the only real evidence I have of the profits available to the applicants is the 28% figure cited by Mr Archer. Unfortunately, I did not have the benefit of hearing this evidence tested in cross examination and there is no other evidence or means at my disposal for extracting any more concrete or certain information about this figure. What Mr Archer said was :

> "However, in the course of the discussions on this point it was stated by the representative of the Applicants for settlement, in response to a direct question from General Counsel for the Respondents, that the mark-up or price differential produced by incorporation of the invention in question into the relevant product produced a marketplace increase in the price of the product (the entire cutting machine) of approximately 28%, with a negligible increase in manufacturing cost."

On that basis it is I think clear that Mr Archer is saying that it was accepted that the only costs incurred were the small manufacturing costs, which were put by Mr Allport at $2000. In the absence of any conflicting evidence, I must accept that this is so and reject Mr Young's submission that there are other significant costs involved. On the other hand, I reject Mr Floyd's submission that sales of spares and other ancillaries should be taken into account. It is clear from the evidence that the machines are initially costly and have a long life. In those circumstances I think it is fanciful in the extreme to suppose that those of the applicants' customers who have the present invention retrofitted to their existing machines would see the purchase of a new machine from the proprietors as an alternative.

If I accept the 28% figure and 25:75% split agreed in the Lectra case, the appropriate royalty for a new machine can easily be calculated. If the price of a machine without the invention is £A, the price of a machine with the invention would be £1.28A and the extra profit available is £0.28A less the extra costs. I can assume that the cost of fitting the invention is tiny in relation to the cost of the machine - probably just 1-2% of A - and Mr Young did not attempt to argue with any conviction that the applicants would incur significant development costs. Thus I shall work on the assumption that the extra profit available is £0.26A. Taking 25% of this figure gives me £0.065A which as a percentage of the total cost of the fitted machine (ie £1.28A) is 5%.

The next question then is 5% of what - ie what is "A"? As I have already indicated, I am handicapped here by the absence of any evidence as to the price the applicants charge for their machines. To combat this, Mr Floyd suggested that I should use the prices quoted in the Mr Allport's confidential evidence for <u>their</u> machines, and Mr Young did not dissent from this. Mr Floyd invited me to use the highest price quoted. It is not as simple as this. The prices given cover a very wide range and I cannot arbitrarily pick the highest rather than, say, the lowest. However, we do know that the invention is of greatest benefit in "high ply" machines, which means it is most likely to be fitted to the applicant's 7cm model (the CV 070) rather than their 0.5 and 4 cm models. Thus the most appropriate price to use is the basic list price for a 7 cm machine. The proprietor has two, the S7200 and the S91. I have no indication of which corresponds most closely to the CV 070, so I shall use for "A" the average of these two prices. From the confidential price information given, it is then easy to calculate what 5% of this price is, though I shall refrain from quoting the actual figure here.

However, I believe a further adjustment is necessary to take account of the fact that the applicants will only be retrofitting existing machines. As I have already indicated, I do not believe that retrofitting will compete with sales of new machines by the proprietors, and neither will it generate new sales for the applicants. Indeed, the licence will do little more than enable the applicants to retrofit one year earlier than they could have done had they not sought the licence. In these circumstances I believe that a willing licensee and a willing licensor would agree on a lesser figure. I have no evidence on which to base any such reduction so I am forced to estimate this as best I can. In my judgment, after making that adjustment this "profits available" approach leads me to the conclusion that an appropriate royalty per machine to which the invention is retrofitted is £6,000.

Royalty - conclusion

I have been unable to arrive at a royalty by considering comparables, other than concluding that expressed as a percentage of the total machine cost it should be substantially less than 20%. The section 41 approach is not open to me. The best I have been able to do is arrive at a figure of £6,000 per retrofit by considering profits available, and this is the figure that should be provided in the licence. I am aware that this figure is built upon the shaky foundation of the "28%" figure, but I have been forced to use it by the paucity of the evidence and I see no reason to apologise for that. I am also aware that the figure is several times larger than the actual cost of the retrofit, but this is a merely a reflection of the very high profits available.

I now need to consider the other terms that should appear in the licence.

The Rights Licensed

The basic right given by the licence will be the right to retrofit to cutting machines which have already been installed before the date of the licence. It was agreed at the hearing that the parties would attempt to agree the terms of a provision to this end to replace clause 1.1 of the proprietors' composite draft licence so I need say no more about that here.

Clause 1.2 of the composite licence would prevent the licensee importing from outside the European Economic Area. It was hinted at the hearing that limiting the licence to retrofitting made this clause academic, but given the contributory infringement provisions of section 60(2) I am not sure this is correct. This is not a clause the Comptroller would normally impose where, as in the present case, the patentee is working the patent by importation from outside the EEA, but as the applicants are willing to allow the clause as a voluntary restriction on the licence, I am content for it to remain.

Clause 1.3 prevents exports to any country where the licensor has a corresponding patent. The applicants did not resist this clause and I shall include it in the licence.

Clauses 1.4 and 1.5 prevent the licensee assigning the licence or granting sub-licences. These were agreed in principle at the hearing, subject to a drafting change to protect the end users of the retrofitted machines from infringement action.

Accounts and Payments

Clauses 3.1 and 3.2 of the composite licence cover arrangements for keeping accounts and paying royalties. They will need amendment to reflect the limitation of the licence to retrofitting, but otherwise these clauses are uncontentious and should remain.

Clauses 3.3, 3.5.1, 3.5.2 and 3.6 contained a number of provisions allegedly aimed at ensuring that - to put it bluntly - the applicants don't cheat. The applicants had opposed these provisions for a number of reasons which, on the whole, struck me as quite justified. However, I do not need to go into these reasons because, towards the end of the hearing, both sides accepted that an adequate safeguard could instead be provided by requiring the licensee to provide the proprietors with the serial numbers of machines which were retrofitted under the licence. I agree that such a provision should be included in place of these clauses. It might most conveniently be included as part of clause 3.2. It would also be appropriate, following the tenor of clause 3.5.2 and as agreed by Mr Young at the hearing, to require an officer of the licensee to certify the royalty statements as accurate.

Clause 3.4 requires the licensee to provide some security for the payment of royalty. Mr Floyd argued that even though both parties were based in the European Union, because there was no established business relationship between the parties some form of guarantee or security for royalties was necessary. Mr Young resisted this, pointing out that enforcing any judgement against the applicants would not cause a problem, even though they were based in Spain, because of the Civil Jurisdiction and Judgements Act 1982. While provisions of this kind have been included where they were agreed between the parties (eg see *Shiley Inc.'s Patent [1988] RPC 97*), I know of no case where they have been ordered. Indeed, requests for security have been rejected in *Pfizer's Patent 1257180 (SRIS O/78/87)* and in *Hilti's Patent 1217908 (Bauco's Application) (SRIS O/170/86)*. In the present case I can see no justification or need for such a provision and will not include it.

The Patent

It was agreed at the hearing that the applicants' proposed clauses 4.1 and 4.2, respectively stating that royalties would cease to be payable if the patent were revoked and that royalty payments would be reduced in the event that the licensee's sales revenue fell, should be omitted but there was a dispute over the proprietors' proposal that there should be a clause allowing the licence to be terminated in the event the licensees challenge the validity of the patent. Mr Young argued that such a provision was unreasonable especially if, once the licence had been settled, the proprietors then alleged infringement for past acts. In these circumstances the licensee would have to choose between the licence and lodging a counterclaim of invalidity. Mr Young therefore proposed that the clause should be restricted so as to allow termination in the event the licensee challenges validity other than by way of a counterclaim to an action brought by the proprietors. Mr Floyd on the other hand argued that termination-on-challenge clauses were normal and had been accepted and that in these circumstances the licensee simply had to choose whether to attack the patent or to continue with the licence. Though it is indeed true that clauses of this kind have been approved by the Patent Office and the courts - eg see *Schering's Patent 1193998 (ABM Chemical Ltd's Application* (SRIS O/133/87) and *DuPont de Nemour's Patent 1393011 (Enka BV and other's Application) 1988 RPC 479 at 497* - I believe that Mr Young's argument is right, and I am reinforced in this view by section 46(3A) which reads :

> "An undertaking under section (3)(c) above may be given at any time before final order in the proceedings, without any admission of liability."

This clearly contemplates that a person alleged to have infringed a patent may simultaneously defend the infringement action by challenging validity while undertaking to take out a licence and thereby limit the damages which might be awarded. Against that background, to include a clause of the form proposed by the proprietors would be to put the licensees in a worse position than an alleged infringer who had not yet attempted to take out a licence, and I do not believe that would be right. Moreover, to the extent that any infringement action brought against the licensee related to acts not covered by the licence, as would be perfectly possible in this case where the licence is limited to retrofitting, the licence and the infringement action are essentially quite separate and in these circumstances I see no reason why the licensee should be put to the choice of keeping his licence or defending the infringement action by challenging validity. I would therefore agree that a termination-on-challenge clause should be included, but restricted in the way Mr Young proposed.

Other matters

Clauses 5 and 6 of the proprietors' composite draft licence were agreed at the hearing and I agree that they should be included in the licence. For the rest, no provisions for a date at the beginning of the licence and signatures at the end are in fact necessary since the licence is a statutory licence which will come into effect when I finally settle all the terms.

The Next Steps

Having now decided in outline what provisions should be included in the licence, as suggested at the hearing I now hereby allow the parties two weeks from today to provide me with an agreed suggested draft for the licence giving effect to those provisions. I shall then issue a final decision settling the terms of the licence. Insofar as the parties are able to agree appropriate wording between themselves, I shall be happy to incorporate that wording in the licence. Insofar as they cannot agree, I shall draft the licence in terms I consider appropriate.

Neither side has asked for costs, and indeed, it is the comptroller's practice not to make any award of costs in licence of right cases in relation to substantive matters. I see no reason to depart from that practice in this case.

Dated this 9th day of July 1996

[redacted]

PATENT OFFICE

PETER HAYWARD
Superintending Examiner, acting for the Comptroller