PATENTS ACT 1977

BLO/113/85

IN THE MATTER OF an application under Section 46(3) by Alpha Controls Ltd for settlement of terms of a licence of right in respect of Patent No 1187269 in the name of Suspa-Federungstechnik GmbH

INTERIM DECISION

Patent No 1187269 is dated 2 October 1967 and is therefore a new existing patent as defined by paragraphs 3(1)(a) and (b) of Schedule 1 of the Patents Act 1977. According to paragraphs 4(2)(a) and (c) of the Schedule, the term of the patent is extended from 16 years to 20 years and, during the extension, licences under the patent are available as of right. The applicants, having been unable to agree the terms of a licence with the patentees, have made the present application for settlement of terms by the Comptroller. The matter came to a hearing before me on 22 July 1985 when Mr J Jeffs QC appeared as counsel for the patentees and Mr R Wyand appeared as counsel for the applicants.

The patent in suit is concerned with a drum suspension arrangement in a washing machine. Claim 1 is the only independent claim and reads as follows: "A washing machine provided with an oscillatable drum system having a normally horizontal axis and supported on a base for resiliently controlled but mechanically unrestrained oscillations by a single pair of resilient struts each equally inclined to the vertical plane including said axis in a static equilibrium condition of the drum system and so disposed that their oscillation-controlling forces lie within or at least adjacent to a plane extending transversely of said axis and through the centre of gravity of said drum system; and further means for resiliently biasing said drum to the static equilibrium condition."

It will be seen that the patent relates to the whole washing machine but the patentees in fact only manufacture spring suspension legs, in Germany, and sell them to washing machine manufacturers to use as the resilient struts in washing machines falling within the scope of the patent claims. It is common ground that the spring legs themselves are not novel and are not the subject of patent protecti

The applicants are manufacturers of control equipment, including programme switchin mechanisms for washing machines, and wish to manufacture spring legs in the UK and sell them to washing machine manufacturers to use in washing machines falling withi the scope of the invention. In this sense, the present application is out of the ordinary since the applicants will not themselves make or sell the machine which

are the subject of the patent. However by selling the spring legs for their admitted purpose they would, if they had no licence, infringe the patent by virtue of Section 60(2) of the Act, and of course their customers, the washing machine manufacturers, would directly infringe the patent. The present applicants are asking that the licence should include terms allowing them to sell the spring legs to washing machine manufacturers in circumstances where they know or can reasonably predict that the customer will use them to infringe the patent and giving freedom for their customers so to use them. This request does not meet with the approval of the patentees. This is one area of contention. The other principal matter in dispute is the rate of royalty and a further matter relates to the patentees' request that the licence should provide for quality control by them.

Dealing with the first matter, Mr Jeffs contended that the form of licence requested was unprecedented and that if a licence is required by a manufacturer, the manufacturer himself should have applied or have been joined as one of the applicants with the present application. As authority for his submission he referred to Hoffmann-La-Roche's Patent (1971) RPC, 311, at page 336, where Mr Justice Whitford had held that where manufacture was to be carried out by an associated company, both companies should join in the application in the first place. Mr Wyand, on the other hand, pointed out that if washing machine manufacturers had to obtain separate licences, the patentees would receive benefit twice over. He also rejected the Hoffman-La-Roche case as a relevant authority. This is a view which I share since that case dealt with a compulsory licence under Section 41 of the 1949 Act where the Comptroller could refuse to grant a licence and would need to know who the licensee or sub-licensee was. In constrast, under the present provisions, any person is entitled to a licence as of right. Furthermo the sub-licence requested in the Hoffman-La-Roche case was for the purpose of allowing others to do the same as the applicant was licenced to do and not, as in this case, to take a known product one stage further for assembly with other components. Nevertheless the fact remains that the patent relates to washing machines and the manufacturers of these machines are not applying for a licence but are trusting in the licence of the spring leg manufacturer to give them the right to manufacture under the patent, and this unusual state of affairs requires further consideration.

In deciding this question, I think one must look at the nature of the industry concerned and useful background information is provided in the evidence of Mr Ludwig Stadelmann, Technical Director of the Patentee company. It is apparent that the development of washing machine suspension units has been a specialised activity undertaken by companies who concern themselves with such units but do no

make the finished machine. They manufacture and sell the parts, in this case the spring legs, to the washing machine manufacturer and thereby, it appears, they exhaust their rights, should any exist under a patent. In other words, the washing machine manufacturers do not have to take a licence and do not have to pay a royalty, as such, for the washing machine. The present applicants wish to do the same as the patentees and the licence will not be of any use to them if the washing machine manufacturers will not buy the spring legs because they need to pay additional sums as royalties under separate licences. They can hardly be expected to do so when they can buy the legs from the patentees and proceed without any further complication or expense. Since I think it would be wrong to impose a term which would make it impossible for the licensees to enter the market and thus render the licence ineffective, I decide that the licence shall include the term requested by the applicants in this matter.

I turn now to the question of royalty and not surprisingly there is a wide divergence between what is proposed as a suitable royalty by the two parties. The applicants consider that a royalty of 1½% of the net selling price of the sprin leg is a reasonable figure whereas the patentees contend that the royalty should be based not on the value of the spring legs but on the value of the whole vibrating system of the washing machine. This system is defined as comprising the housing, drum, motor, drive, base, spring legs and any damper. They also initially proposed a royalty of 2% of this system but subsequently conceded that such a rate would make it uneconomic for the applicants to enter the market. A revised figure of 2DM per machine, equivalent approximately to 25p per leg, was then presented as a reasonable rate (see Mr Stadelmann's affidavit, paragraph 22). To see how this compares with the applicants' 1½% it is necessary to consider the likely selling price of the spring legs. The relevant information is provided by Mr Stadelmann who states that each spring leg will on the German and foreign markets usually cost the washing machine manufacturer between 3.7 and 4.5 DM or its equivalent. Taking an exchange rate of 4DM/£1.00, as did Mr Jeffs, this corresponds to between 93p and £1.13, centering roughly on £1.00. The royalty proposed by the applicants comes therefore to about 1½p.

To arrive at this figure Mr Wyand began on the assumption that the profit obtained by the patentees on their sales of the spring legs to the washing machine manufacturers is of the order of 8-10%, the estimate given in the first statutory declaration of Mr J C H Peirce, the Managing Director of the applicant company. This has not been disputed by the patentees except insofar as they consider that a sum in respect of research and development at 2½% should be added on. With no other evidence available I will therefore accept that the profit is of the order

of 10½-12½% of the price to the washing machine manufacturers. This of course includes the manufacturing profit which must comprise the greater amount so the percentage which is left for a notional royalty must be small, in the applicants' view about 1½%.

Mr Peirce has also, in exhibit JCHP1, provided an estimate of his company's costs of production and overheads, the total being 92.29p per leg. Even taking into account some minor adjustments arising from Mr Jeffs' querying of the figures, the sum of 92p may be taken as the applicants' cost. On this basis, Mr Peirce concluded that they could manage a price of about £1.00 with a royalty of the order of 5%. I take this then as a movement upwards by the applicants in the royalty they are prepared to accept.

The patentees approached the matter from an altogether different angle. They say the patent is for a washing machine, not spring legs, and the principle factor determining the royalty should be the value of the invention to the washing machine manufacturer, and this they evaluate in the following manner. The spring leg type of suspension system comprises not only the two leg system to which the present invention is directed but also 3- and 4- leg systems which the patentees have developed but for which they have not sought patent protection in the UK. According to Mr Stadelmann the 2-leg system has distinct technical advantages over the others although these still do have a market. There are furthermore the obvious economic advantages to be gained. Firstly, there is the saving of DM 3.7-9.0 as against the 3- and 4- leg systems for the spring legs alone. There are also the costs of providing and fitting additional brackets and the necessity of having different spring legs in a 3-leg system. All in all, Mr Stadelmann estimates that the savings to a washing machine manufacturer who adopts the patented invention are, per machine, between DM 6.5 and 7.75 as compared with the 3-leg system, and between DM 11.8 and 14 as compared with the 4-leg system. (In sterling this corresponds approximately to a total range of £1.50-£3.50 per machine or 75p-175p per leg). On this basis, it is argued, if the washing machine manufacturer was required to pay a royalty of DM 2.00 per machine (say 25p per leg), he would still enjoy a very substantial cost advantage over the other royalty-free spring leg systems and Mr Stadelmann considers that this could be absorbed by either the spring leg supplier, the washing machine manufacturer or both. That is the basis then for the revised figure of 25p per leg proposed by the patentees. I should qualify this by pointing out that this sum is based on a particular sterling/DM exchange rate and it would be more accurate to use the range used by Mr Jeffs of 22-27% of the cost of the leg.

An additional factor which I was asked to take into account was the alleged competitive disadvantage suffered by the patentees as compared to a UK manufacturer in having to bear shipping and importation expenses as well as the servicing and distribution organisation. Mr Stadelmann says this could amount to 14-18% of his costs. However since he has not given a breakdown of his company's costs and profits and since he has not disputed the applicants' estimates of either his company's profits or the applicant company's projected costs, I do not consider that I can take this additional factor into account but must base myself on the figures already discussed.

The patentees have also referred to an infringement action in Germany when a company by the name of Miele settled for damages of slightly over DM 1.00 for each unlicenced machine. This sum, corresponding to 12 or 13p per spring leg, is of course only half of what they are proposing now as royalty but they point to it as a demonstration that the applicants' proposal is, in their view, derisory. They claim that had a licence for future operations been negotiated with Miele, a royalty considerably higher than DM 1.00 per machine would have been demanded. This seems to me to be highly speculative and in any case Miele is now, on the evidence of Mr Stadelmann, a customer of theirs and presumably paying the same price as others. This price cannot, on the figures available, comprise a notional royalty of 12 or 13p per spring leg.

In supporting his argument for a royalty based on the whole system, Mr Jeffs drew my attention to the unreported Lancer Boss v Henley Forklift case where Mr Vivian Price QC conducted an enquiry into damages for infringement of a patent relating to side-loading forklift trucks in which the invention concerned only the mast traversing mechanism forming part of the truck. Damages were awarded based on the whole of the truck. It would appear that the present case is analagous but there are in fact clear distinctions. In the case of the forklift truck where the traversing mechanism was itself novel, there were claims for that mechanism as well as for the truck and the damages were awarded for infringement of both groups of claims. The position would be analagous here if there were a claim for the complete suspension system (independently of the washing machine) and if it were that system which was the subject of the licence. A corollary of that would be that the patentees themselves supplied these complete suspension systems. However, by supplying only the spring legs they have undermined their position. Nevertheless I do not reject the proposition that consideration should be given to the contribution made by the invention to the washing machine industry.

For his part, Mr Wyand referred me to Cassou's Patent (1971) RPC, page 91, where the invention claimed was an injection gun fitted with a replaceable sheath and the

applicant for a licence of right was concerned only with the sheaths. The hearing officer held that since the novel feature of the invention was the provision of the sheaths, the royalty payable should be calculated on the basis simply of the number of sheaths sold. In the absence of evidence or argument to the contrary, he agreed to the figure of 5% proposed by the applicant, saying that it was one which was commonly seen in commercial agreements of this nature. In view of the one-sided nature of that case, the patentees not being represented, it lacks the force it might otherwise have but I think the figure of 5% taken together with the underlying comment, is worthy of note.

Having summarised what I believe are the main arguments put before me on the question of royalty I find that the practices which were cited of earlier cases are of little assistance in the peculiar circumstances of the present case. It has been held that a proper principle to apply in determining royalty is that which would be agreed between willing licensor and willing licensee but no evidence, other than that of the Cassou case, has been produced as to what has been agreed in this type of case. What is, to my mind, evident is that the royalty rate should be such that the licensee is able to enter the market and compete with the patentees. Mr Peirce has stated that with a royalty of the order of 5% he could manage a price for his unit of £1.00. He exhibits a letter from Servis Manufacturing Ltd, a major manufacturer of washing machines, who state that they would be interested in discussing business at 97p but definitely not at 115p. With due allowance being made for a bargaining position, I take this as an indication of the sort of price the applicants can contemplate. The price of £1.15 is that which, according to Mr Peirce, he would have to charge if he had to pay the 25p per spring leg demanded by the patentees and this would exclude him from the market. A royalty of 25p per spring leg in any case is, to my mind, grossly excessive. It would mean that the patentees would receive in royalty far more than they themselves make from exploiting their invention, at least twice as much if the figures we have are anywhere near the mark, and I do not believe it car be right to produce such a situation. This position can to a large extent be laid at the door of the patentees themselves. Had they been washing machine manufacture. granting a licence to another washing machine manufacturer, they could perhaps have obtained a royalty which reflected the value of the invention to the final machine. Alternatively, in their present capacity, they might have demanded from the manufacturers a royalty of the order that they are now saying is a reasonable payment for the advantage gained by the invention. As it is, all they receive from the washing machine manufacturers is a price which appears to give them little, if anything, more than a (spring leg) manufacturer's profit.

Mr Peirce's implied offer of 5% happens to coincide with the figure in the Cassou case. While I would endorse the hearing officer's comment in that case that 5% is one which is commonly seen, it is in my view at the lower end of the range. Furthermore I think, as I have already indicated, that some weight should be given to the advantages gained by washing machine manufacturers from the invention, but bearing in mind the high price of the machine, this weight must be fairly modest in view of the low priced article with which we are concerned. The royalty which appears to me to offer a reasonable compromise in all the circumstance is one of 7% and I therefore decide that this shall be the rate, based on the licensee's selling price.

The question of quality control remains to be settled. This comes into two parts. Firstly, the patentees ask that the applicants sell only those units which they themselves have manufactured and secondly that they, the patentees, be allowed to exercise quality control over the spring legs sold by the applicants. Mr Wyand opposed these demands very strongly and to my mind rightly. The spring leg is not itself the subject of the patent and may take a variety of forms. It is not a product over which the patentees have any proprietory right and they cannot expect to be able to exercise any quality control over someone else's competing product. In any case the market place will in the end be the most effective control. Insofar as this raises the question of the suitability of the applicants it is not a relevant issue. As in the Cassou case, the licence being available as of right, consideration of suitability of the applicant is excluded.

Having settled those terms which were in dispute I make the following observations. Since the date of the hearing, the House of Lords has issued decisions concerning licences of right as applied to new existing patents by paragraph 4(2)(c) of Schedule 1 of the Patents Act 1977. One of these decisions is that no such licence of right is capable in law of taking effect until all the terms upon which it is granted have been settled either by agreement between the patentee and the applicant or, in default of such agreement, by the comptroller. This has changed the situation which was thought to exist at the time of the hearing. Both parties should therefore act without delay and the procedure should be as follows:

Within 4 weeks of the date of this decision the applicants should submit a draft licence which takes account of the terms of this decision. At the same time a copy of the draft should be sent to the patentees who should within 4 weeks of

receipt submit such comments as they wish for consideration. Failing agreement on the terms of the licence, I shall decide any matters remaining in dispute subject to the right of the parties to be heard.

Dated this 22nd day of August 1985

N G TARNOFSKY
Superintending Examiner, acting for the Comptroller

PATENT OFFICE