Compulsory Licensing of

Taiwanese CD-R Patents Owned by Philips

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Case Information

Taipei Administrative High Court, 2006 Su-Zi 2783(March 12, 2008)

Summary

The cases discussed involve the leading case in compulosry licensing of Taiwanese patents held by international conglomerate Philips. It is also probably the only compulsory licesne case in the last three decades in the world that was not related to life-saving drugs, but rather ICT technology. Therefore worldwide attention and discussion heeled. The controvercy centers on the interpretation of "reasonable commercial terms and conditions."

Legal context

Based on the misinterpretation of the draft Article 31 (b) of the TRIPS Agreement as allowing only three substantive grounds for compulsory license (CL), namely national emergency, non-profit use for public interest and the failure of the applicant to reach voluntary licensing agreement with the patentee under reasonable commercial terms within a considerable period of time, the 1994 Patent Act under the inititive of the Intellectual Propty Office (TIPO) deleted the general clause for CL against not or insufficient working of patent that has reigned between 1944 and 1994 and recognized only five specific grounds for compulsory licensing: 1. national emergencies, 2. not-for-profit use of a patent for the enhancement of public welfare, 3. failure to reach a voluntary licensing agreement with the patentee, 4. remedy against anticompetitive conduct. Between 1994 and 2012 Section 76(1) and (2) of the Patent Act provided: (1) In order to cope with the national emergencies, or to make non-profit-seeking use of a patent for enhancement of public welfare, or in the case of an applicant's failure to reach a licensing agreement with the patentee concerned under reasonable commercial terms and conditions within a considerable period of time, the Patent Authority may, upon an application, grant a right of compulsory licensing to the applicant to put the patented invention into practice; provided that such practicing shall be restricted mainly to the purpose

of satisfying the requirements of the domestic market. However, if the application for compulsory licensing of a patent right covers semiconductor technology, such application may be allowed only if the proposed practicing is purposed for a non-profit-seeking use contemplated to enhance the public welfare. (2) In the absence of the conditions set forth in the preceding Paragraph, the Patent Authority still may, upon an application, grant to the applicant a compulsory license to practice the patented invention in the event that the patentee has imposed restrictions on competition or has committed unfair competition, as confirmed by a judgment given by a court or a disposition made by the Fair Trade Commission (TFTC).

The provisions on CL of the Patent Act was again revised in 2011, once more under the proposal of the TIPO, which took effect in 2013. Currently, Article 87 largely closes down the possibility of granting CLs upon application to three narrowly defined situations: 1. Non-commercial exploitation for enhancement of public interest; 2. Exploitation of dependent patents; 3. Where a patentee has committed acts restricting competition or unfair competition acts determined by a court or by the TFTC. Article 87 (grounds for CL) prescribes:

(1) In response to national emergency or other circumstances of extreme urgency, the Specific Patent Agency shall, in accordance with an emergency order or upon notice from the central government authorities in charge of the business, grant compulsory licensing of a patent needed, and notify the patentee as soon as reasonably practicable.

(2) The Specific Patent Agency may, upon request, grant compulsory licensing of a patent under any of the following circumstances for which it is deemed necessary:

1. where a patented invention is to be exploited non-commercially for the enhancement of public interest;

2. where a later invention or utility model patent cannot be exploited without infringing upon a prior invention or utility model patent, and where the later invention or utility model patent involves an important technical advancement of considerable economic significance in relation to the prior invention or utility model patent; or

3. where a patentee has committed acts restricting competition or has committed unfair competition acts, for which a judgment has been made by a court of law or a decision has been rendered by the Fair Trade Commission of the Executive Yuan.

(3) Request for compulsory licensing of a patent involving semiconductor technology shall be filed based on the grounds set forth in Subparagraph 1 or 3 of the preceding paragraph.

(4) Request for compulsory licensing of a patent made pursuant to Subparagraph 1 or 2 of Paragraph 2 may only be approved if the requestor has made efforts to obtain authorization from the right holder on reasonable commercial terms and conditions, and that such efforts have not been successful within a reasonable time period.

(5) Where a request for compulsory licensing of a patent is made pursuant to Subparagraph 2 of Paragraph 2, the owner of the prior patent may propose reasonable terms and conditions and seek grant of compulsory licensing of the later patent owned by the requestor.

Facts

Philips, Sony and Taiyo Yuden developed CD-R standards through a series of Red and Orange Books, pooled their patents together and started to jointly license the pooled patents in 1992 through a joint licensing agreement (JLA) with one royalty formula: 3% of the net sale price but not lower than 10 Japanese Yen and Philips being designated as the sole contact for licensing. However, the market price of CD-R dropped sharply due to its huge success: from US$10-15/disc in 1996 to US$2.25/disc in 1997. GigaStorage signed a licensing agreement with Philips on 12 October 1999, but later ceased to pay the royalty. On 1 March 2001 Philips wrote to GigaStorage urging it to pay the royalty. In response, GigaSoorage requested Philips reduce the royalty to 2-5% of the net sale price. Philips refused and terminated the licensing agreement in April 2001. GigaStorage continued to negotiate new licensing agreement with Philips between June 2011 and April 2012, of no avail.

In July 2002, GigaStorage filed with the TIPO application for CL against 5 patents owned by Philips[1]. The TIPO set up a committee with

1 In 1999 Taiwanese CD-R manufacturers, Princo among others, filed with the TFTC complaints accusing violation of “no abuse of monopoly” and “no cartel” provisions of the Fair Trade Act by Philips et al. In January 2001the TFTC found the JLA to be cartel in disguise, a decision later not upheld by courts, and forced Philips et al to license their pooled patents separately. As a result, Sony ceased to charge royalty as it turned out that it did not own any valid patents in Taiwan which were necessary for the production of CD-R and Taiyo Yuden agreed to license its

external members to examine the application and granted the CL in 2004 till their expiration dates. Philips appealed the case to the Taipei Administrative High Court (TAHC) in 2006.

GigaStorage and Philips filed with the TIPO applications to annul the CL in April and May 2006 respectively. GigaStorage's motion was on the ground that it would cease to manufacture CD-R in Taiwan and relocate elsewhere; Philips on the ground that GigaStorage violated the CL by exporting more than 50% of CD-R made under the CL. Philips even demanded a retroactive annulment. In May 2007, the TIPO annulled the CL only with immediate effect, because GegaStorage no longer needed the CL, no other public interest was at stake, and Philips failed to provide sufficient evidence proving that there had been violation of the CL.

The annulment of the CL by the TIPO did not have retroactive effect. However the TAHC opined that there existed legal interests for Philips to have the grant annulled retroactively and decided accordingly, which became final when TIPO decided not to appeal given the fact that GigaStorage and Philips entered into an settlement agreement in October 2007.

Reasoning of the TIPO and the TAHC

1. The TIPO

The TIPO took the second application for CL[2] since the enactment of the Patent Act very seriuosly as examplified by its detailed reasoning[3]:

(1) The fact that the applicant has used the patents at issue before filing the application does not in itself invalidate his eligibility of being an CL applicant. The recognition of standing to file for CL does not yet convey anything about whether the application is meritorious and

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patents by charging a certain percentage of the net sale price.

2 The first application which led to a grant of CL dated back in the late 1970s. For more details see, Kung-Chung Liu, Compulsory License and Government Use in Taiwan—A Regress, in Reto Hilty/Kung-Chung Liu (ed.), Compulsory Licensing—Practices and Ways Forward, 2015, 81-82.

3 Taiwan Intellectual Property Office, Zhi-Fa Zi 09318600520 (July 26, 2004)

should therefore be granted.

(2) The term "prior to such use" used by Article 31(b) of the TRIPS Agreement[4]—a term absent from Article 76(1) of the Patent Act — only refers to "other use without the authorization of the right holder" in general and does not mean any use or the particular "use of the patents at issue." Article 31(b) of the TRIPS Agreement requires only that the applicant has, prior to the filing for CL negotiated with the patentee, rather than prior to any use of the patent at issue, on reasonable terms and conditions and failed to reach an agreement. "The purpose of CL is neither to sanction those who have used patents in question prior to negotiating a licensing agreement, nor to deprive them of the standing to apply for CL…Against those who have used patents in question prior to negotiating a licensing agreement, the patentee may exercise his right in accordance with the Patent Act to recover damages, thus making it unnecessary to further deprive them of the right to seek lawful use of the patent via filing for CL."

(3) "Reasonable commercial terms and conditions" is a uncertain legal concept and defies any fixed definition, not to mention the fact that commercial terms and conditions are far-reaching in scope, including the extent, area, and time period of licensing, <u>the profitability of</u>

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[4] Article 31(b) stipulates: Where the law of a Member allows for other use—other than that allowed under Article 30, of the subject matter of a patent without the authorization of the right holder, including use by the government or third parties authorized by the government, the following provisions shall be respected: (b) such use may only be permitted if, <u>prior to such use</u>, the proposed user has made efforts to obtain authorization from the right holder on reasonable terms and conditions and that such efforts have not been successful within a reasonable period of time..."

technology, the renown of the technical brand, competition, etc.. Therefore in order to determine the so-called reasonable commercial terms and conditions one shall consider the term of the patents, their market prospect, the social and public welfare as a whole and terms and conditions that the CL applicant could practically afford and pay. Amidst this CD-R royalty controversy, if after taking the text and reasoning of the legal provision, its legislative purpose and the global operation of the CD-R technology into consideration, objective third parties would view the offered terms and conditions as not obviuosly deviating from conditions of relevant technology market and both parties of the licensing contract see the possibility of further negotiation, such terms and conditions would suffice for "reasonable commercial terms and conditions." The TIPO recognises that the asserions the applicant made fulfill the requirement of "reasonable commercial terms and conditions." To substantiate its conclusion, the TIPO points to the three following findings which suggest room for further discussing the reasonableness of royalty calculation method set by Philips: 1. The TFTC found Philips' insistence on charging ¥10/disk and refusal to grant the licensee a chance to negotiate to be an abuse of monopoly power; 2. The US International Trade Commission (ITC)[5] found the fixed royalty to be arbitrary and therefore anti-competitive, and Philips' US patents unenforceable; and 3. The Industrial Development Bureau of the Ministry of Economic Affairs in Taiwan

[5] However, the CAFC rescinded the ITC decision on 21 September 2005, see 61U.S. Philips Corp. v. Intl Trade Comm'n, 424 F. 3d 1179 (Fed. Dir. 2005)

(MOEAIBD) found the current royalty for CD-R indeed too high compared to the 2% to 15% royalty common in the electronic industry.

(4) "The applicant has offered commercial terms and conditions" means that so long as the applicant has offered specific or specifiable royalty calculation method, irrespective whether the offer was made within the validity period of the licensing agreement, it is not to be excluded that "commercial terms and conditions" has been offered. That the applicant of this case has offered between March and April 2001 "to calculate royalty at 2-5% of the net sale price," has not been denied by the other party. In addition, the applicant has provided in the application relevant documents proving the reasonableness of this calculation meathod, and expressed in numerous occasions its willingness to offer 3% of the net sale price as compensation for CL. Therefore the requirement that "the applicant has offered commercial terms and conditions" should have been satisfied.

(5) The term "within a considerable period of time" shall be measured by the average social conception, and not by the unilateral assertion of the applicant or the person against whom the application was filed. The fact that the applicant has fruitlessly tried to reach a licensing agreement with Philips for more than a year (from March 2001 to April 2002), suffices as a considerable period of time.

2.The TAHC

In sharp contrast, the TAHC takes an extremely stringent approach to the determination of "reasonable commercial terms and conditions," reflecting the deep-rooted doctrinal principle that "exception must be construed narrowly, " to which many judges in Taiwan prescribe.

(1) In determining the "reasonable commercial terms and conditions" the TIPO should have taken the licensing conditions offered by the

applicant as a whole against factors, such as the way royalty was calculated, profit concerns of licensor and licensee, the shared risks, the renown of the technical brand, market demand, the scope, duration and technology of the license, competition within the industry, market conditions for licensing and other terms of licensing, and then made an overall assessment. That the applicant proposed a reasoable royalty calculation method alone does not yet suffice for having offered "reasonable commercial terms and conditions."

(2) The findings of TFTC and the USITC have no bearing on the application of Article 76(1), or at best have bearing only on Article76(2). The finding by the MOEAIBD is only to question the reasonableness of the royalty calculation method set by Philips and no inference can be made therefrom that the offer made by the applicant to calculate royalty based on percentage of specific price qualifies for "reasonable commercial terms and conditions."

(3) The offer made by the applicant in March 2001 to calculate royalty by 3% of the net sale price was in the context of seeking to continue the royalty payment of the first licensing contract which was suspended due to prohibitive royalty. It was obvious that the offer letter was not issued in accordance with CL provisions of the Patent Act as "commercial terms and conditions" for securing licensing of the 5 patents at issue.

(4) The finding by the MOEAIBD that common royalty in the electronic industry is between 2% and 15% does not support the conclusion that any royalty rate suggested by GigaStorage automatically qualifies for "reasonable commercial terms and conditions" so long as it falls within 2-15%.

(5) Even assuming that the royalty demanded by Philips was prohibitively high or unreasonable, no immediate inference can be made that the offer made by GigaStorgae was therefore "reasonable commercial terms and conditions." Given the continuous drop of CD-R price, the fixed percentage of net sale price formula suggested by GigaStorage cannot be considered as "reasonable commercial terms and conditions."

(6) Even assuming that the royalty demanded by Taiyo Yuden was less than 2% of the net sale price (needed to be subsatntiated by GigaStorage), no immediate inference can be made that the offer made by GigaStorgae was therefore "reasonable commercial terms and conditions," because the individual circumstances of cases and licensing arragements other than the calculation of royalty still need to be taken into account.

(7) Even assuming that the numerous negotiations included negotiating new licensing agreement, however the negotiation memo presented by GigaStorage showed that GigaStorage did not propose concrete licensing arrangement. It was therefore not to be concluded that GigaStorage had offered "reasonable commercial terms and conditions." As a consequence, the conclusion that negotiation went on for more than one year and hence the requirement "within a considerable period of time" had been fulfilled was groundless.

Legal Analysis

1. CL as Integral Part of the Patent Regime

The patent system has never been one-sided and unlimited protection of patents and patentees per se. Its true meaning consists in striking a balance between public and private interest. CL is the indispensible tool for striking that balance. The ultimate goal of CL is not to deprive patentees of their rights, but only to function as the last resort to stimulate patentees into working or voluntarily licensing patents. From the perspective of royalty negotiation, CL functions as a shift from entirely ex ante (before use) negotiation to partially ex ante and partially ex post (after use) negotiation. As such, CL does not sabotage but rather accelerate voluntary licensing, because it avoids delays and excessive costs incurred by prolonged negotiation. Moreover, the partially ex post approach to determining royalties can provide parties better basis upon which to estimate the real value of the patents used because concrete outcomes derived from the actual use of patents will be at the parties' disposal[6].

However, decision 2006 Su-Zi 2783 of the TAHC fails to appreciate the legitimate meaning and function of CL to patent regime and imposes upon the applicant onerous burden of proof. According to decision 2006 Su-Zi 2783 of the TAHC, the applicant must first propose to sign a new voluntary licensing agreement, not just to solve the outstanding royalty payment of the existent licensing agreement, with concrete royalty calculation method and other licensing arrangements, before an overall assessment about the reasonableness of the terms and conditions can be made. Only when "reasonable commercial terms and conditions" have been offered by the applicant can a determination of whether the efforts were made "within a considerable period of time" be made. Such

6 For more discussion see Hilty/Liu(ed.), Compulsory Licensing—Practices and Ways Forward, 8.

requirements will inevitably lead the license-seeker to the risk of over-offering and in the end overpaying the patentee.

Whereas in Germany, the Federal Supreme Court (BGH) requires only that the applicant's "commercial terms and conditions" are in accordance with "the equitable standards." In the 2009 "Orange-Book-Standard" decision BGH declares: if the license-seeker alleges that the royalty demanded by the patentee was excessively high to the point of abuse, or the patentee refuses to specify the royalty, then the license-seeker should be allowed to determine a reasonable royalty in accordance with the equitable standards[7].

In India, the Intellectual Property Appelate Board, Chennai in the 2013 Bayer v. Natco case upholding the grant of CL against Bayer's patented drug "Nexavar" by the Controller recognes that the applicant had made reasonable effort with reasonable terms and conditions to acquire voluntary licensing from Bayer by requesting that Bayer grant a voluntary license to Natco to manufacture and market the product on such reasonable terms and conditions which would not prevent it from making the drug available to the public at the affordable price of less than Rs. 10,000 per month as Natco projected[8] and the requirement of Section 84(6)(i) of the Patent Act has been fully met[9].

2. Limited Legacy of the TIPO's Decision to Grant CL

Although the grant of CL against Philips was annulled by the TIPO without retroactive effect and later retroactively rescinded by the TAHC, one aspect of the TIPO's grant remains unchallenged and therefore commands precedential effect for later CL applications. It is namely that the standing to file for CL will not be affected by the applicant's use of the patent at issue prior to the filing.

3. The standard of "appropriate remuneration"

In its grant of CL against Philips the TIPO did not touch upon the

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7 BGH KZR39/06, paras. 38, 39.

8 Bayer v. Natco, decided by the Intellectual Property Appellate Board, Chennai on March 4, 2013, Order No. 45 of 2013, paragraphs 12-16.

9 84(6)(i) of the Indian Patent Act requires that "In considering the application field under this section, the Controller shall take into account,—as to whether the applicant has made efforts to obtain a licence from the patentee on reasonable terms and conditions and such efforts have not been successful within a reasonable period as the Controller may deem fit.

sensitive issue of appropriate remuneration since the object of the application for CL was limited to the grant of such. As a matter of fact, no agreement on this issue had ever been reached between GigaStorage and Philips. However, Article 88(3) of the Patent Act now mandates that the decision on a request for CL shall be made in writing and shall indicate the reasons, scope, duration, and the required remuneration. Accordingly, the determination of remuneration becomes inevitable when grating a CL. There are at least three separate methods to determine the reasonable compensation, which can be used individually, alternatively and/or cumulatively.

(1) Looking into the Original Licensing Agreement

Oftentimes some readily available proxies for a fair compensation can be found by looking into the original licensing agreement between the parties at dispute. In the Phillips CD-R cases, as opposed to ¥10/per disc the other agreed method of calculating royalty is 3% of the net sale price and could be regarded as reasonable prima facie. If the patentee rebuts such assumption, the burden of proof shall rest on him/her.

(2) Benchmarking

Royalty rate can also be fixed by comparison with relevant rates charged by the patentee or others in the industry for similar licenses. According to Article 28 of the Act on Patents Invented by Employees, the German Arbitration Panel shall resolve the disputes between employees and employers if they cannot agree upon the reasonable compensation for employees. In order to discharge its duty, the Arbitration Panel has been active and effective in proposing acceptable suggestions, out of which a volume of "Licensing Rates for Technical Inventions" has long been published and widely used in Germany[10]. By collecting licensing agreements of all areas and classifying them according to technologies, industries, major licensors etc. we can easily get a fairly good picture of how the reasonable compensation should be for a specific licensing agreement. In addition, there is much literature[11] and even online

10 Otwin Hellebrand/Gernot Kaube/R. von Falckenstein, "Lizenzsätze für technische Erfindungen," 3 Aufl., 2007.

11 Russell Parr, Royalty Rates for Licensing Intellectual Property, Intellectual Property Research Associates, Inc., 4th ed., 2010.

services[12] available on the market, which provide such information[13].

(3) 25% Rule

Lastly, a fairly simple "25% Rule" of the licensee's expected profits for the product that incorporates the patent at issue could serve as the tentative baseline at the outset of the hypothetical negotiation and is "subject to revisions by experts in accordance with the Georgia-Pacific factors and other available sources of information in order to arrive at a reasonable royalty. Such available sources of information include possible non-infringing alternatives, the Book of Wisdom (experiences), statistical collections of licensing terms by industry, and precedents of well-accepted judicial opinions[14]." The 25% Rule has been established and adopted by some US courts over the last 40 years[15]. Focus of the 25% Rule is placed on long-term and fully-loaded profits[16]. Like the other two methods, the 25% Rule would not work in all instances, especially not when the licensee is in need of several licenses of different owners of complementary patents.

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12 E.g. www.royaltyource.com, www.tenkwizard.com

13 Arguably this method will not work for standardized technology that may be covered by a number of complementary patents held by different patentees and each patentee may be tempted to charge the monopoly price for the whole technology which creates a "tragedy of the anti-commons." In that case, the compulsory license needs to take the involved multiple patents as a whole and turn to the other two methods for help.

14 Robert Goldscheider/John Jarosz /Carla Mulhern, Use of the Twenty-Five Percent Rule in Valuating Intellectual Property in Russell Parr (ed.), Royalty Rates for Licensing Intellectual Property, 2007, 31.

15 However, on 4 January 2011, the US Federal Circuit, in Unilock v. Microsoft, held that 'the 25% rule of thumb is a fundamentally flawed tool for determining a baseline royalty rate in a hypothetical negotiation." Unilock USA, Inc. v. Microsoft Corp., 632 F. 3d 1292, 1315 (Fed. Cir. 2011). But as convincingly argued by the leading proponent of the rule, Robert Goldscheider, the Classic 25% Rule is never meant to be a wooden and inflexible shortcut and with no further analysis. It is therefore not a rule of thumb and possesses flexibility. R. Goldscheider, The Classic 25 % Rule and the Art of Intellectual Property Licensing, 6 Duke Law & Technology Review 14 (2011).

16 Goldscheider/Jarosz / Mulhern, Use of the Twenty-Five Percent Rule in Valuating Intellectual Property, 34.

Commercial or Industrial Significance

Taiwan is famed for its world-class OEM (original equipment manufacturers) and ODM (original design manufacturers) capacities in electronics and information technology industry and serves as an active and important interface between industrialized and industrializing countries. It also contributed to the worldwide proliferation of CD-R as its PC manufactures adopted CD-R players as standard feature of the PCs they made.

However, an increasingly ailing CD-R market in Taiwan was clearly recognizable alongside the development of the legal cases. Taiwan held the largest worldwide market share for CD-R since around 1998, which peaked in 2003 reaching 80%. However, Taiwan's total output decreased sharply since then, down to 36% in 2004, 33% in 2005, and 28% in 2006. Presumably, two factors were responsible for the decline: the difficulties of getting speedy royalty reduction proportionate to the free fall of CD-R prices, and the 'unfair competition' from CD-R made in other countries where Philips did not have patents and could not charge royalties for patents.

Having no other choice, Gigastorage ceased manufacturing CD-Rs in Taiwan and relocated its production to countries where Philips has no patents and cannot charge royalty. Another Taiwan-based CD-R manufacturer, Prodisc, once ranked as the fourth largest of its kind in the world, was also forced to discontinue the production of CD-Rs in Taiwan in August 2007, due to Philips' unwillingness to reduce the royalty to accommodate falling prices[17]. Had the function and relevant provisions of CL been properly recognized and applied, a win-win situation for GigaStrorage could have been achieved.

Last but not least, as a small local company, GigaStorage perhaps picked up too big an opponent. In addition to file for annulment of the grant of CL which it fought hard to acquired, GigaStorage "settled" with Philips and agreed to pay a huge settlement fee around US$ 31 million, over one third of its capital[18].

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17 See B2, 7 May 2008, United Daily and Economic Daily News（both published in Taiwan and in Chinese）.

18 Although the actual sum of the settlement fee was kept confidential, its rough figure could be calculated from the loss GigaStorage had to disclose according to Taiwanese Stock Exchange Act. GigaStorage reported a NT$ 3.42 loss per share

for the third quarter of 2007, in which the settlement was reached. NT$ 3.42 (loss per share) times the registered capital of NT$ 3 billion equals NT$ 940 million which could be converted into US$ 31 million at the exchange rate of 30 to 1 between US$ and NT$.