

COPYRIGHT, DESIGNS AND PATENTS ACT 1988

IN THE MATTER OF an application by
Sterling Fluid Systems Limited under section 247
of the Copyright, Designs and Patents Act
1988 for the settlement of a Licence of Right
available under paragraph 19(2) of Schedule 1
to that Act in respect of copyrights owned by
Andrew Sykes Group Plc.

INTERIM DECISION

1. This application under section 247 of the Copyright, Designs and Patents Act 1988 ("The Act") to settle the terms of a licence of right available by virtue of section 237 and paragraph 19(2) of Schedule 1 to The Act was filed on the 14th February 1996 by Sterling Fluid Systems Limited (formerly Sterling Fluid Products Limited). This however was the start of a long, and I am bound to say, unnecessarily slow and involved process with three preliminary decisions before the evidence rounds even started, two relating to a dispute over the identity of the respondent and another over the order in which the parties were to file evidence. In the third preliminary decision I therefore set a timetable for the evidence rounds and the substantive hearing.

2. The matter subsequently managed to progress more or less on schedule, though the timetable was threatened on more than one occasion. It eventually came before me for the substantive hearing on the 29th and 30th July 1998 when Mr Graham Shipley, instructed by Beveridge Ross & Prevezer, appeared for the applicant and Mr Colin Birss, instructed by Wragge & Co, appeared for the respondent, Andrews Sykes Group Plc. Even then there were still three preliminary issues arising, *viz* whether the respondent's evidence in reply was filed out of time and should not be admitted on that account, whether the respondent's evidence in

NB In this edited version certain deletions, indicated by [*], have been made from paragraphs 33, 34, 36, 37, 40, 43, 44, 45, 46, and 72, and from the Annex for reasons of confidentiality. In addition, in paragraphs 43, 44, 48 and 72 the name of the respondent's supplier has been suppressed, also for reasons of confidentiality.

reply was strictly evidence in reply and should not be admitted for that reason, and whether I should grant an order for discovery which the respondent had formally submitted. I dealt with the preliminary issues orally, and that enabled the hearing to progress to the substantive issues. This decision is primarily concerned with those substantive issues, though for convenience I have summarised my rulings on the preliminary issues too.

3. When this application was first made the owner of the copyright had not been conclusively identified, although it was known to be one or more companies within the Andrew Sykes group. The parties subsequently reached an agreement under which the holding company, Andrew Sykes Group Plc, would be treated as the rights owner even though strictly some of the rights might belong to its subsidiaries, and it is on this basis that I shall treat them as the rights owner throughout this decision.

4. The Respondent's evidence in Chief consisted of an affirmation from Simon Harbridge, its Company Secretary and Financial Controller and one of its Directors. The Applicant's evidence in Answer consisted of statutory declarations from:

- C Brian Millward, its Chief Engineer
- C Christopher Johnson, the Financial Director of its parent company
- C Owen Shevlin, the Managing Director of its parent company, and
- C Terence Vivian Hopcroft, a partner of the auditors of its parent company.

The Respondent's evidence in Reply consisted of a second affirmation from Simon Harbridge and a statutory declaration from Anthony David Parton, an independent accountant. None of these deponents was cross examined, so I have only their written statements to go on.

5. During the course of the hearing Mr Birss and Mr Shipley each handed me a further statutory declaration from one of their respective deponents giving minor corrections to their evidence. Moreover, both parties handed me numerous other documents during the course of the hearing with a view to explaining and expanding on the information contained in the evidence. No objection was taken by either side to the material the other side handed up and I have taken all of it into account in reaching my decision.

The Licence Sought

6. Before coming to the issues, it is convenient here briefly to describe what it is that the applicant wishes to license. The application concerns so-called contractors' pumps which consist of a priming tank into which water is drawn by means of a vacuum pump which evacuates air from the tank. By this means the pump is able to draw water out of holes in the ground, *eg* on a building site. The priming tank contains a float which switches off or otherwise disables the vacuum pump once the tank is full. Water is pumped out of the priming tank and discharged through a non-return valve to an outlet valve by a volute and rotary impeller arrangement. The object is to provide a self-priming pump which will continue to operate, in so called "snoring" mode, even in the absence of water but which will evacuate any water which appears without requiring a separate priming operation. This pumping gear is known as a "pump end". The applicant manufactures and sells pump ends as they stand. It also assembles them with a proprietary diesel engine or other motive power unit to drive the pump, mounts the assembly on a wheeled chassis and sells the whole as a "pump set", sometimes with an added acoustic canopy as well. In this decision I have distinguished between pump ends and pump sets where necessary, but I have also sometimes used the term "pumps" to refer loosely to both.

7. It is worthy of note in this context that under an agreement concluded in 1989 the applicant, or rather its predecessor in title, used to manufacture pumps for the respondent's predecessor in title who held patent rights in the pumps and who sold and rented them to the end users. However this relationship ended in circumstances which have given rise to an action in the Commercial Court which is still pending and following the expiry of the patents the applicant now wants the present licence in order to continue manufacturing and selling the pump ends, pump sets and spare parts on its own behalf.

8. The copyrights which are the subject of this application reside solely in the pump end. The applicant originally wanted a licence to manufacture and sell component parts of pump ends which were specified on a list by part number. That list has been modified during the course

of these proceedings because of disputes about what should and should not be included, but by the time of the hearing the parties had agreed that the list of parts that needed to be covered by the licence was that exhibited to Mr Millward's declaration at "tab 9". However, that is not quite the end of the matter for two reasons:

C Copyright subsists not only in the various drawings of these parts but also in a number of drawings showing assemblies of these parts, and these assemblies are not included in "tab 9". During the course of the hearing Mr Shipley acknowledged that the applicant also needs a licence to assemble the component parts into pump ends or sub-assemblies thereof.

C The design of some parts has been altered by the applicant since the original drawings were made. The applicant accepts that it still needs a licence for these parts. However, in his declaration Mr Millward also contemplated the possibility that some parts might be altered in the future, before the licence expires, and given a new part number. This will need to be taken into account in the wording of the licence.

9. The applicant proposed that the royalty payments should be calculated on the basis of the cost of manufacturing, including manufacturing overheads, the parts in the list. It suggested this because, it says, the proportion of the cost of manufacture attributable to copyright parts in the final pump end or pump set varies enormously, from 2% to 64% in the case of pump ends and from 2% to 56% in the case of pump sets. Further, it says, although it does have a price list of some pump ends and pump sets, it also makes up non-standard pump ends and pump sets to meet specific customer requirements, so it is not possible to produce a schedule of pump ends and pump sets that incorporate copyright parts.

10. There is one other point to note. Because the rights owner was initially unidentified, the parties subsequently agreed that whilst the licence would run from the date of application, royalties would only become due from the date on which Andrew Sykes Group Plc were formally joined as respondent, viz 7th April 1997. This reflects the provisions of section 248 and I am happy to go along with it.

Preliminary Issues

11. I will now run briefly through the three preliminary issues that were dealt with at the hearing. On the first, whether the respondent's evidence in reply had been served out of time, having heard counsel on the matter I decided at the hearing that the evidence should not be ruled out on this account. The evidence was served by fax on the final day of the period for filing, which had already been extended from the 1st to the 8th July, but with one page missing from one of the two statutory declarations and without any of the 12 bulky exhibits to the two declarations. The missing documents were however served the following day and I decided that this short delay did not prejudice the applicant to any significant extent and allowed the evidence to stand.

12. The second preliminary issue concerned parts of the respondent's evidence in reply which the applicant contended were not strictly in reply. After hearing counsel I decided that I would admit Mr Harbridge's second affirmation in its entirety as being properly in reply. The most contentious issue here was paragraph 19 of Mr Harbridge's second affirmation in which he argues that the copyright parts relating to the "priming gear" of the pump is the very essence of the pumps which are the subject of this dispute, indeed what he calls the "jewel in the crown" in the sense of features without which it is simply not possible to produce a pump of the kind the applicant wishes to produce under the licence. Mr Shipley took the view that this was simply Mr Harbridge developing an argument he had first raised in his evidence in chief and that this too should have been raised in the evidence in chief because it was not in reply to anything said in the applicant's evidence. His main concern was that by raising this "jewel in the crown" argument in the evidence in reply the respondent had deprived the applicant of any opportunity to answer the point in its evidence. Mr Shipley argued that either the applicant should have such an opportunity, or the evidence should not be admitted. My view was that the majority of the items that Mr Shipley objected to could be fairly said to be in reply to the argument in the applicant's evidence in answer, in particular in Mr Millward's statutory declaration, that the value of the copyright elements of the pump design is very low. Any other, perhaps marginal points, were of such minor consequence that they do not affect the issue either way and can be ignored. In this respect, I would add that much, if not all, the

evidence in question is not really evidence at all but rather argument and as such is of limited help to me in any event.

13. In relation to Mr Parton's statutory declaration, I decided that paragraphs 55 to 69, and paragraph 70 insofar as it relates to the subject of paragraphs 55 to 69, were not evidence strictly in reply and accordingly should not be admitted. As to the rest of Mr Parton's declaration, it was agreed that we would proceed to the substantive matters as if this were admissible but that in the event that the respondent sought to rely on any disputed elements of this evidence, I would hear counsel on whether that element of the evidence should be admitted. In the event, Mr Shipley did not raise any objections and as I have not had to rely on any of this evidence, the issue falls away.

14. On the final issue of discovery, Mr Shipley agreed to provide certain documents and duly did so over the lunch interval on the first day of the hearing. Although in Mr Birss's submission these were not documents which complied with any part of his discovery request, Mr Birss withdrew certain aspects of the respondent's request for discovery and did not press the remainder because any discovery would require an adjournment and he preferred to proceed without any delay.

Royalty: the starting positions of the parties

15. One rare item of agreement between the parties in this case was that the terms of the licence should be those which would be agreed between a willing licensee and a willing licensor. This has of course been the underlying principle adopted in patent licence of right cases as well as in the copyright licence of right cases which have so far been settled by the comptroller and I am content to proceed on this basis. Beyond this there was little if any agreement. Indeed the distance between the parties is considerable.

16. The applicant offered a royalty of 3% of the cost of manufacturing those parts covered by copyright, that cost to include manufacturing overheads. It argued it did not need a licence to sell or hire pump ends and pump sets which included those parts, which is why it was

suggesting a royalty based solely on manufacture. It also argued that basing the royalty on the individual parts was the only way of coping with the fact that the proportion of copyright parts in the end products varied over a wide range. Its offer excluded any royalty on the cost of assembling the parts, even though Mr Shipley conceded at the hearing that the licence would have to cover assembly.

17. The respondent, on the other hand, argued that the applicant needed a licence not only to make and assemble the parts but to sell the resulting pump ends and pump sets as well. Accordingly it wanted a royalty levied on the invoiced price of complete pump ends and pump sets produced and sold by the applicant, and argued for a royalty level of 19%. (The respondent's pleadings indicated that a royalty of 9% was being sought but subsequently the higher figure was claimed, and this was the figure for which Mr Birss argued at the hearing.) It conceded that certain articles such as complete pump sets which included a higher proportion of non-copyright parts (eg a chassis and diesel engine) should be subject to a slightly lower royalty. However, Mr Birss argued at the hearing that this could be handled by grouping the articles into classes, with an appropriate royalty for each class.

18. Thus, there is a dispute not only over the rate at which the royalty is to be charged, but also over what the particular royalty rate is to be levied upon. Indeed, the latter reflects a fundamental disagreement about what acts ought to be recompensed and I need to consider this first, because what I decide on this point will affect the whole approach I must adopt to the question of royalty.

What acts need to be recompensed?

19. Mr Shipley argued that the only act which other than for the licence would be restricted by the copyright and which need to be paid for in royalties was manufacture (which, as he conceded, should include assembly). In this connection he referred me to sections 17, 18, 23 and 27 of The Act. The relevant parts of these sections are as follows:

17.(1) The copying of the work is an act restricted by the copyright in every description of copyright work . . .

18.(1) The issue to the public of copies of the work is an act restricted by the copyright in every description of copyright work.

(2) References in this part to the issue of copies to the public of copies of a work are to the act of putting into circulation copies not previously put into circulation, in the United Kingdom or elsewhere, and not to -

- (a) any subsequent distribution, sale, hiring or loan of those copies, or
- (b) any subsequent importation of those copies into the United Kingdom;

except that in relation to sound recordings, films and computer programs the restricted act of issuing copies to the public includes any rental of copies to the public.

23. The copyright in a work is infringed by a person who, without the licence of the copyright owner -

- (a) possesses in the course of business,
- (b) sells or lets for hire, or offers or exposes for sale or hire,
- (c) in the course of business exhibits in public or distributes, or
- (d) distributes otherwise than in the course of a business to such an extent as to affect prejudicially the owner of the copyright,

an article which is, and which he knows or has reason to believe is, an infringing copy of the work.

27.(1) In this Part "infringing copy", in relation to a copyright work, shall be construed in accordance with this section.

(2) An article is an infringing copy if its making constituted an infringement of the copyright in the work in question.

20. Mr Shipley argued that section 18 required one to look at where, as he put it, the goods first "leaked out". He drew an analogy with the current position of the respondent, in which it buys in pumps made for it by a third party under licence. Once the pumps had been sold to the respondent, the respondent did not, Mr Shipley argued, need a licence to sell them on because it would be a subsequent distributor under section 18(2). As for section 23, Mr Shipley argued that because the manufacture of pumps would be licensed, the pumps would not be infringing copies under the terms of section 27 and as a result, section 23 did not bite by virtue of the final lines of that section. Thus no licence to sell or let for hire *etc* was needed. On this

basis, he argued, only manufacture need be licensed and this reinforced the applicant's view that the appropriate royalty should be for manufacture alone.

21. Mr Birss did not disagree with Mr Shipley's interpretation of the position under section 23. However he argued that the applicant did required a licence under section 18 to sell or rent the manufactured articles, because the issue to the public did not take place until the applicant sold the pumps on. He suggested the analogy with the respondent's current position was wrong, because the third party was not licensed to issue the products to the public - they were only licensed to make them for the respondent as their subcontractor. I agree with Mr Birss in his interpretation of The Act, and on this basis, I also agree that he is right in arguing that the royalty should reflect both manufacture and sale.

On what should the royalty be levelled?

22. I must now consider whether the royalty should be levied on individual parts, as Mr Shipley suggested. Ignoring spare parts for the moment, by and large what are sold are not the individual parts listed in "tab 9" but complete pump ends and pump sets which include those parts. The applicant's argument that the royalty should be based on the parts, not the end products, stems largely from its claim that what it is selling is an ever-varying range of pump ends and pump sets whose "copyright content" varies enormously and is often quite low. Having examined the evidence carefully, I have come to the conclusion that this is not a fair picture of what it is doing.

23. To support the applicant's case, in his evidence Mr Millward included (at "tab 6") a list of pump sets and pump ends "currently being assembled by Sterling/SPP in the SPP AutoPrime range" - that is, in the range of pumps that use copyright parts. At first glance this list does apparently show wide and non-systematic variations in the alleged copyright content. However, I have attached a rearranged version of this exhibit (with two extra columns, which I shall come to later) as an Annex to this decision. This shows a much clearer picture, because of the 45 pump ends and pump sets in this list, 38 have reference numbers prefaced by SY which Mr Birss argued, and Mr Shipley did not deny, were an abbreviation for "Sykes". In

other words, the vast majority of pump ends/sets in this list were previously sold under the Sykes name, having been made for them by the present applicant. I conclude from this that by and large what the applicant is actually doing is making pump ends/sets that are more or less identical to the respondent's pump ends/sets. To suggest that in the main it is merely using copyright parts to assemble its own pump ends/sets is misleading. Of course, this may not apply to the seven on the list that do not have "SY" reference numbers, and I do not know what proportion of sales these seven account for. I also accept that its product range could change before the licence runs out. However, I am left with the strong impression that pump ends and pump sets which are for all practical purposes identical to those sold by the respondent have accounted for a substantial proportion of relevant sales and are likely to continue to do so during the remaining period of this licence.

24. This view is reinforced by the figures in the column headed "% Copyright" in "tab 6", also reproduced in the Annex. These are supposed to be the percentage of copyright parts in terms of the cost of manufacture in relation to the total works cost of manufacture. They are the source of the applicant's assertion that the percentage can vary from 2% to 64% for pump ends and from 2% to 56% for pump sets. If one sorts the list into the different types of product, as I have done in the Annex, the first thing that becomes apparent is that, by and large, the range of percentages within any given type of product is much narrower. For "SY" pump ends other than "high heads", for example, it is 47% to 64%, with an average of 58%. Now at the hearing Mr Shipley handed up full costed bills of materials for five of the products in the "tab 6" list. Mr Birss drew my attention to two important factors revealed by these bills of materials. Firstly, assembly costs had been excluded when calculating the percentages, whereas Mr Shipley had now conceded assemblies were caught by the copyright too. Secondly, with the exception of the priming tank subassembly (which both sides agree is not subject to the copyright), most of the parts that are classified as non-copyright are nuts, bolts, washers and similar standard hardware. As a broad generalisation, I accept Mr Birss's points. The clear implication is that a pump end which is described in "tab 6" as, say, 60% copyright is really pretty close to being a 100% copy. Of course the percentages are generally lower for pump sets, but that is primarily because they include a proprietary engine which accounts for a substantial proportion of the total cost. I note that they are also lower for "high head" pump

ends and pumps and for products without an “SY” reference number, but that does not disturb my general conclusion.

25. My view is further reinforced by exhibit “SH9” to Mr Harbridge's first affirmation, to which Mr Birss drew to my attention. This shows a single page advertising brochure published by the applicant which is headed as follows:

“IMPORTANT ANNOUNCEMENT FOR ALL USERS OF SYKES PUMPS
STERLING SPP has been manufacturing these pumps in the UK for more than a
decade. Until the beginning of last year they were distributed in the UK via Andrews
Sykes Ltd.
SINCE THEN WE HAVE BEEN SELLING THESE PUMPS DIRECT”

It illustrates two pump sets and then goes on to show a third, described as a new product, under the slogan:

“IN THE PAST WE KEPT OUR NAME QUIET, NOW ITS OUR PRODUCT
THAT'S QUIET”

26. In considering the question of what the applicant is and will be doing, I should say that I have not taken into account an exhibit to Mr Harbridge's second affirmation which shows in a series of photographs a side by side comparison of a pump and some of its constituent parts made by each party. As Mr Shipley rightly said, this of itself is not conclusive because it could just be that this one particular product out of many looks the same. Nevertheless, the other evidence that I have cited shows that the applicant is indeed very much interested in producing and selling pump ends and pump sets of exactly the sort produced by the respondent.

27. Mr Birss invited me to look at this from another angle too. He argued that the royalty should go to more than simply the individual copyright parts because the copyright parts represent the very essence of the pump ends/sets the applicant is making and selling - the "jewel in the crown". Mr Shipley on the other hand argued that the "jewel in the crown" was

in reality the mode of operation of the pumping system and that this was the subject of the now expired patents and had nothing to do with the copyright which went only to appearance. To the extent that Mr Shipley was arguing that the copyright goes only to the aesthetic qualities of the pumps, I have no hesitation in saying that he is wrong. From paragraph 19 to Schedule 1 to The Act, and section 51 of The Act, it is clear that the copyright in issue here is concerned with designs of articles "other than an artistic work or typeface", and in this case in particular with the functional aspect of pumps. To the extent that Mr Shipley was arguing that the existence of copyright did not prevent the applicant from manufacturing and selling its own independently conceived design using the same operating principle, he is of course right. However, I do not believe that is relevant because as Mr Birss said, the fact of the matter is that the applicant wants a licence to continue making and selling copies and that is clearly of value to them.

28. In the light of all this, I conclude that the applicant's suggested and unusual approach of levying the royalty on individual parts is inappropriate. So far as pump ends are concerned, in my view, the correct way to look at this case is to say that the copyright characterises, and has therefore has a royalty earning value corresponding to, the complete pump end consisting of the priming tank, float, vacuum pump, volute and impeller and non-return valve. I believe that Mr Birss was right in arguing that this combination is what makes a Sykes pump a Sykes pump and what distinguishes it from, and provides the selling point over and above, other pump designs. This combination of course includes some non-copyright parts, in particular the vacuum pump which both Mr Birss and Mr Shipley agreed was an off the shelf, non-copyright part, but that does not affect the overall position. I conclude that in principle I should be looking at an appropriate royalty to levy on the invoiced price of the whole pump end. I am aware that non-standard (ie non "SY") items and spare parts may need special treatment, but I do not feel that these exceptions should be allowed to dictate the general approach.

29. What, then, of complete pump sets, which differ from the corresponding pump end only in that they have further non-copyright but high-price parts such as a proprietary diesel engine and, sometimes, a canopy? It is tempting to argue that one should discount the value of the

proprietary diesel engine or other power unit when assessing the royalty on a pump set. This was done for the motors driving the wrenches which formed the subject of the licence of right settled by the comptroller in *Roger Bance and R Bance & Co Ltd's Licence of Right (Copyright) Application*. However, this approach must I think be treated with great caution to prevent it turning into a salami slicing operation. If one starts stripping out non-copyright parts where does one stop other than at individual copyright parts which is where Mr Shipley would have me stop? On the other hand, one needs to be wary of including too many non-copyright elements because they could easily double or treble the value, and hence the royalty, even though the contribution from the copyright elements was essentially unaltered. Indeed, Mr Shipley argued this could simply drive the applicant into separating its facilities into those dealing with copyright parts and those dealing with non-copyright parts. In my view, on the facts of this particular case it is not appropriate to adopt the approach taken in *Bance*, if only because whilst in *Bance* there was a single type of wrench with a fixed price, here we have a wide range of pump ends of widely-varying price. There should be a royalty on the invoiced price of complete pump sets, but at a lower rate.

The possible approaches to assessing the royalty rate

30. The two main approaches used in past cases to determine the appropriate royalty are to look at the profits available to the applicant and to look at comparable licences. At the hearing Mr Birss favoured the profits available approach while Mr Shipley submitted that this approach was fundamentally flawed and should not be used.

31. Mr Shipley's argument against the use of profits available was that the willing licensee, willing licensor approach was necessarily prospective in that, by definition as it were, there would be no available profits unless and until the licence was agreed and executed and so the willing licensee and willing licensor would have no established profits record with which to work. Thus, he argued, it was wrong in principle to look to the profits made by, or likely to be made by, the licensee. He further argued that the level of profits depended on many factors other than the licensed copyright. For example, what if the management of a licensee were very poor at the moment the licence was concluded but were then immediately replaced by a

new management who hugely increased the licensee's profitability? In his view the endorsement of the profits available approach in *Pioneer Oil Tools Ltd's Licence of Right (Copyright) Application 1997 RPC 573* was far too enthusiastic.

32. Mr Birss on the other hand argued that the profits available approach simply reflected commercial reality and would in practice be the method used by a willing licensee and a willing licensor, for example on the basis of a business plan in the event there was no history of production. In my view, for the reasons I gave in the decision in *E-UK Controls Ltd's Licence of Right (Copyright) Application SRIS 0/002/98*, this is right. I am aware of the criticism levelled against the profits available approach in the patent authorities but that criticism stemmed from the fact that under the Patents Act the comptroller is required to ensure that the licensor shall receive remuneration under the licence which is reasonable having regard to the nature of the invention which, arguably, the profits available approach does not do. Under Copyright and Design Right legislation however there is no such requirement and I agree with Mr Birss that the profits available approach reflects commercial reality, the more so in this case where the licensee has been producing the pumps in question for some time now. I therefore believe that profits available is an appropriate way of calculating the royalty to be paid in this case, though by that I am not saying that it is the only, or indeed necessarily the best way.

Profits available

33. I have very little direct evidence of the profits the applicant has made, or expects to make, under this licence. This is largely because the applicant has throughout resolutely stuck to the view that the most appropriate basis for the royalty was its costs of production plus appropriate manufacturing overheads, and accordingly evidence of profits available would be irrelevant. However, there are some figures in an exhibit to Mr Johnson's declaration which show the so-called gross profit margin made on seven specific sales, three of pump ends and four of pump sets. The gross profit margin is the actual sale price achieved, less the cost of materials and contributions towards "direct labour" and "production overheads". The cost of "carriage out" is also supposed to be deducted, though in three instances this is shown as zero.

The gross profit margins range, in round figures, from [*]% to [*]% for pump ends and from [*]% to [*]% for pump sets.

34. At the hearing, Mr Shipley took three of the sales of pump sets and deducted 12% for the costs of distributing the product and 7% for administrative costs. These two figures come from Mr Hopcroft's statutory declaration, in which he simply says:

“I also confirm that, based on the statutory Accounts of Sterling Fluid Systems Limited for the year ended 30 November 1997, the distribution costs represented 12% and the administrative expenses represented 7% of turnover, ie the total amount invoiced to customers (excluding VAT) for goods supplied by the company.”

The end result of Mr Shipley's calculations for these three pump sets ranged from a profit of [*]% to a loss of [*]%.

35. Having looked carefully at these figures I have to say that I have considerable difficulties with them. My first difficulty is that I find it very hard to accept that the applicant is producing any articles at a loss, particularly in the light of another statement in Mr Johnson's declaration. He states that in many industries the sale of original equipment can be regarded as tantamount to a loss-leader for the sales of spares, but then goes on:

“It is in this respect that the products with which this application is concerned may be regarded as atypical of our product range. The sales of spares is derisory, as is shown on the following table: *[He then quotes some figures and goes on:]* As can be seen, with regard to the products with which this Application is concerned, it is not the case that the sales of spares could be said to subsidise original equipment sales.”

36. This evidence comes from one of the applicant's own deponents, and accordingly I simply cannot believe that the alleged loss of [*]% on one of the sales can be right. Alternatively, if it is right, the sale must be grossly atypical and therefore not a sound basis for calculating profits available.

37. Leading on from this, Mr Shipley just selected three products, and these may not be typical. Indeed I observe that if one takes another of the seven products in Mr Johnson's exhibits, the pump end SY3871039, very different results are obtained. For this product, the standard costs of all the parts, labour and production overheads taken from both Mr Johnson's evidence and from the new evidence handed up by Mr Shipley at the hearing are £[*] and the discounted sale price is £[*]. Deducting 12% and 7% for the costs of distribution and administration gives profit available of [*]%, much higher than the plus [*]% to minus [*]% that comes from Mr Shipley's three examples.

38. I also have difficulty with the deductions of 12% for distribution and 7% for administrative expenses. Mr Birss argued that the 12% and 7% figures cited by Mr Hopcroft related to the whole of the applicant's business and there was no evidence that they were appropriate for the pumps in question. In the absence of other evidence I would be reluctant to rule out using the stated figures as the best available estimate even though the evidence shows that the pumps in question generate only some 4% of the applicant's turnover. However, in the present case, as Mr Birss observed, the exhibit to Mr Johnson's declaration from which Mr Shipley took his figures includes specific entries for "Carriage Out" and as Mr Birss said, carriage out must have something to do with distribution costs. The carriage figures quoted by Mr Johnson, though, are all very considerably less than 12% of the selling price, and in a number of instances are expressly £0. Even the highest figure given is well under 2% of the selling price, and deducting 2% rather than 12% makes a dramatic difference to Mr Shipley's calculation of the profits available. Similarly, it is not clear to me whether the 7% involves some double-counting of the overheads already allowed for in the calculation of "gross profit margin". Thus whilst the 12% and 7% quoted by Mr Hopcroft may well be right in general terms, I am wary of applying them to the figures in Mr Johnson's exhibit without a clearer understanding of just what is and is not already included in these figures.

39. All this causes me to be very cautious of relying on Mr Shipley's calculations. Indeed, I regret to have to say but I have been concerned throughout this case that the figures cited by the applicant cannot always be relied upon. For example, it was not until the hearing itself that the applicant conceded that its calculations of manufacturing costs were all wrong because

they did not include the cost of assembly. In my view the figures obtained by calculating the profits available in the way suggested by Mr Shipley are not only too variable but are too unreliable because of uncertainty about the proper level of deductible costs. In the result, I do not think I can rely on them as a means of arriving at the appropriate royalty.

40. The only other direct evidence I have of the profits available to the applicant is a statement by Mr Johnson that the average profit of the applicant over the last five years as a proportion of turnover has amounted to some [*]%. However, without a lot more information as to how this figure is arrived at and what contributions the various parts of the applicant's business have made to it, I do not find it of any assistance in determining the appropriate royalty rate. In any case, this average figure needs treating with care because it conceals significant yearly variations. As Mr Harbridge points out in his second affirmation, the profit in 1996 was only [*]% whereas in 1997 it was [*]%.

41. With no direct figures for the profits available to the applicant, Mr Birss invited me to derive appropriate figures for profits available from other routes. He identified three possibilities. First, he drew my attention to the applicant's pleadings in the case currently before the Commercial Court in which it alleged that the present respondent had not placed orders for the manufacture of pumps in accordance with the 1989 agreement and that there had been a total shortfall of orders of just over £10 million. It said its gross profit on this £10 million would have been just over £4.3 million, representing a gross profit margin of around 43%. He then handed up some amended pleadings which had apparently been prepared for the Court only recently and in which he said the applicant had shifted its ground and was now calling what had previously been described as "gross profit" a "gross contribution". This was defined as the value-added sum available after the sale price has catered for direct material costs, and out of which payments have to be made for direct labour and factory production overheads before arriving at gross profits.

42. I should say that at the hearing, Mr Birss suggested that the pleadings had only been amended to reduce the profit figure on which the royalty in the present case might be calculated whilst maintaining the claim for damages in the Court. Mr Shipley pointed out that,

far from being a late adjustment designed significantly to reduce the profit figure for the purposes of the present case, the amendment to the pleadings in the Commercial Court case had been foreshadowed as long ago as 1996 as demonstrated by letters from the applicant's auditors which had been exhibited to affidavits filed in the Commercial Court. I can only say that whether or not Mr Birss's allegation is true has no real bearing on my decision

43. Second, Mr Birss drew my attention to the arrangements the respondent's are now using to obtain pumps for their own business. As explained in Mr Harbridge's first affirmation, they are getting them made for them by a company called S, who say they make an average profit of [*]% at the prices they charge the respondent. Adding this profit to the difference between S's price to the respondent and the respondent's end sales price on external sales, Mr Birss calculated a gross margin for the respondent's sales of around 35%. This assumes the applicant can sell at much the same price as the respondent. *Prima facie* this is a reasonable assumption since it would be surprising if two companies were both successfully selling very similar products in the same market but at wildly different prices. In his evidence Mr Johnson does assert that this is not so and that the applicant's prices are similar to those the respondent has to pay S. However, in his second affirmation Mr Harbridge demonstrated, by comparing the prices of specific products, that this assertion was wrong, although he did accept that the applicant is currently undercutting the respondent so as to become established in the market.

44. At the hearing Mr Shipley argued that the [*]% profit made by S was a suitable figure for the profit available to the applicant. Since this is a figure only for the profits available to S from manufacturing, and as I have already concluded that the applicant must also pay for sales, this argument is unsound. S do not have a licence to put copies into circulation under section 18, only a licence to manufacture for the respondent. Clearly S could obtain a licence to put copies into circulation as of right because licences of right are a licence to do anything which would otherwise infringe the copyright, but they have not done so. This is why they are only making a manufacturing profit.

45. Finally, Mr Birss referred me to a calculation performed by Mr Harbridge in his second affirmation in the respondent's evidence in reply in which he uses examples of the applicant's

selling prices, as stated in the applicant's evidence by Mr Johnson, discounted by 10% to reflect the fact that book prices are normally discounted and from which he subtracts the applicant's total standard costs for the relevant items as stated in the applicant's evidence by Mr Millward to arrive at an average gross margin. The figure varies from example to example, but an average taken over 23 products comes out at [*]%.

46. From these three approaches Mr Birss concluded that the best evidence available shows that the applicant's available profit from the manufacture and sale of pumps is between [*]% and 40%. To complete the picture, he then argued that although there was no established or obvious principle which could be applied, there was no reason why one should depart from a 50:50 split of the profits as had been used in a number of the patent cases. He went on to say that in the circumstances of the present case there were four factors, which I will deal with later, which should lead one to uplift the starting royalty by, say, [*]% each. Consequently, he concluded that by starting with a rate of one half of [*]%, and uplifting the royalty by [*]% one arrived at an appropriate royalty of 19% which, in line with his earlier submission, should be charged on the applicant's Net Selling Price.

47. Mr Shipley contested this argument by explaining that the profit figures arrived at by Mr Birss under each of his three approaches were not available profits but gross margins from which significant overheads, to account for administration and sales costs, had to be deducted. It seems to me that in this respect Mr Shipley is essentially correct but that does not I think detract from the fact that subject to corrections to deduct overheads to correct this flaw, Mr Birss' approach is reasonable in the absence of better data, even if far from perfect as he himself readily acknowledged.

48. On this basis, I feel I need to look at the three approaches separately to work out the appropriate deductions. The 43% "gross contribution" claimed by the applicant in their Court case apparently allows only for direct material costs. On this basis, I can (with slightly more confidence in this instance) deduct from it Mr Hopcroft's 12% and 7%, giving an available profit of 24%. The proper deduction to be made from the 35% calculated via the S approach is less clear because the figure for S's profit already takes their overheads into account, but it

clearly needs to be somewhat less than 12% +7%. We are probably looking at an available profit figure somewhere between 20% and 25%. For the third approach I am back in the difficulty I had with Mr Shipley's calculations, because there appear to be some overheads already built into the applicant's "standard costs", so I cannot really deduce what is the appropriate deduction here, though I accept that we are probably looking at a net figure of under 20%. Taking a very rough average of the three approaches suggests the profits available are of the order of 20%.

49. As to what this says for royalty, although a 50:50 split has often been used of available profits, particularly in the patent cases, Mr Birss accepted that this was not based on any established or obvious principle. For my part, whilst a split as high as 50:50 may represent what willing parties would agree in some specialised areas such as pharmaceuticals, where the licensee's market entry costs are relatively low compared with the huge profits available, I believe that the splits of between 25:75 and **a:b** which have been used in a number of cases are much nearer to the likely outcome in any negotiations between willing licensees and licensors in more normal technical areas. This would produce a royalty rate of between 5% and **6b**%.

Comparable licences

50. As I stated previously, another accepted method which can be used to determine royalties is that of comparable licences agreed between a truly willing licensee and licensor. The problem with this approach is the fact that it is rare to find any properly comparable agreement. In the present case, only two possible comparables were discussed before me.

51. The first is the 1989 agreement between the predecessors in title to the parties to this dispute, and this was discussed only to the extent that both sides agreed it was not comparable. In my view this is right because the 1989 agreement was royalty free and involved a large up-front payment, essentially because it was primarily concerned with the splitting of the businesses, their assets, rights and obligations and thus had little if anything to do with arms' length willing licensee/willing licensor terms for a piece of intellectual property.

52. The second is what was called the Sweepax agreement. This was referred to by Mr Harbridge in the respondent's evidence in chief and is a series of agreements involving a licence recently entered into between the respondent and Sweepax International Ltd in relation to a hydraulic submersible pump. Sweepax own the patent (and possibly other) rights to this pump and the respondent has a licence with a royalty of 5% of its net selling price. In his evidence Mr Harbridge points out that the deal included other benefits for Sweepax, that as a new pump they would have to develop the market from scratch and that Sweepax were unable to market themselves, all suggesting the royalty might well have been higher in other circumstances. He acknowledges that this deal was not (or not just) concerned with design copyright, but says their interest was in marketing the product and they would have been willing to pay that royalty whatever rights were involved.

53. Mr Shipley argued this agreement was not truly comparable because Sweepax were a small company who had had some difficulties and were being rescued by the respondent. Mr Birss responded by arguing that had Sweepax been stronger then the royalty would have been higher because Sweepax are the licensor, not the licensee. In my view this argument clearly has some merit. In the result, and bearing in mind the other factors mentioned by Mr Harbridge which might affect the royalty rate, the 5% royalty in Sweepax suggests to me that a royalty figure somewhat higher than 5% would be appropriate in the present case.

Other approaches for assessing the royalty rate

54. I have to say that, like Mr Birss, it was not at all clear to me by what route the applicant had arrived at its suggested 3% royalty rate. The figure appeared to have been plucked from the air on the basis of the applicant's argument that the value of the copyright was low and 3% was low, so 3% would do. Indeed, Mr Millward more or less says just this in his evidence. However, the allegation that the value of the copyright is low seems to stem from another part of Mr Millward's evidence, in which he says the applicant could easily redesign all the copyright parts and thus avoid the need for a licence. He gave the figure of £275,000 as the cost of redesign which, it was said, could be amortised over a period of 10 years, thus amounting only to a £27,500 charge against annual profits. Mr Shipley suggested that this

indicated how low the value of the copyright was. Mr Birss argued that this was not relevant because a normal licensee would incur that expenditure in any event in preparing drawings. Mr Birss acknowledged that in this case the applicant already had drawings from its past association with the respondent but argued that this should be discounted because the royalty should be based on the situation of the normal willing licensee.

55. I think Mr Birss's argument is unsound because there is a difference between redesigning the pumps and simply preparing drawings of an existing design for production purposes. However, I think Mr Shipley's argument is also unsound because there is no convincing justification for amortising the cost over as long a period as 10 years. Indeed, I think it is arguable that because the applicant could continue making the old designs with impunity once the licence expires, the redesign is actually only necessary for the period of the licence. On this basis one could quite reasonably say the £275,000 should be amortised over just the 2¼ years for which the licence is needed. This would work out at about £120,000 per year, not £27,500.

56. It seems to me that the cost the applicant would incur if it did not take out a licence is a valid pointer to the level of royalty it would be willing to accept in negotiations between a willing licensee and willing licensor. I recognise it is not the whole story and could give the wrong answer in some cases. For example, if the cost of avoiding a licence was very high, the high royalty rate implied by this might be uneconomic for the potential licensee to the extent that it would simply have to stay out of the market if it could not negotiate a lower rate. Conversely, even if the cost of avoiding a licence were low, implying a low royalty, the potential licensee might nevertheless be willing to pay more because of the market advantages in being able to copy an established design. Notwithstanding these dangers, in the circumstances of the present case I feel the cost of redesign is relevant. I also feel my suggested figure of £120,000 per year is closer to the cost as it is likely to be perceived by a willing licensee than Mr Shipley's £27,500.

57. To deduce a royalty from the cost of redesign we need to know the likely annual turnover in the relevant goods. We have a pointer to this in "tab 9" of Mr Millward's declaration, which

indicates that the “manufacturing costs” of all copyright parts used by the applicant in 1997 amounted to roughly £450,000. It is clear from the various figures I have been given that on a typical cross section of the relevant products the “manufacturing costs” figure will be less than half the corresponding figure for invoiced sales, so the £450,000 must represent sales of relevant pump ends, pump sets and spare parts in the order of £1 million. Thus if the cost of redesign were taken as £120,000 per annum, on the 1997 figures even a 12% royalty on all relevant sales would not be so high as to make redesign clearly the better option.

58. I recognise that sales levels may vary from year to year, that my £1 million is no more than a ball park figure and that there is room for argument on the £120,000, but it is sufficient to confirm that a royalty level substantially above the 3% of manufacturing costs offered by the applicant would be reasonable. 3% of £450,000 is only £13,500, whereas the applicant could arguably be saving something like ten times this amount in redesign costs. If it was a “willing licensee”, I am quite sure it would be willing to settle for a much higher royalty rate than this.

59. Having said this, and notwithstanding Mr Birss's submission that the royalty rate should be 19%, 12% is a fairly high royalty rate which might well be bordering on the uneconomic for the applicant. I also recognise that in the normal course of continual product development some of the parts will, as Mr Shipley suggested, get redesigned anyway, thus reducing the savings in redesign costs. Counterbalancing this, there are clear market advantages to the applicant in being able to continue marketing the successful “Sykes” pumps, without having to withdraw from the market for a period whilst they redesign the copyright aspects. Taking all these factors into account, and bearing in mind the rough-and-ready nature of my 12% figure, in my judgment the redesign costs point to a royalty somewhat below 12%, but substantially above the figure offered by the applicant - perhaps somewhere in the range 6% to 9%.

60. All this assumes the figure of £275,000 for redesign costs is right. In his second affirmation Mr Harbridge asserts that the figure is probably an underestimate, but since he provides no evidence to back up this assertion I can attach little weight to it.

61. The only other approach to assessing the royalty rate which was considered at the hearing was that of established norms for royalties. It is often said that there is a norm of 5 - 7% for patent royalties for essentially mechanical artefacts, such as the pumps in question. As I said in *E-UK Controls Ltd's Licence of Right (Copyright) Application SRIS 0/002/98* I am uneasy about working from the mechanical patent norm. Moreover, even in patent cases the norm has tended to be used only when all else has failed simply because the circumstances of each case are so different. Further, there have only been three copyright licences of right settled by the comptroller and these have been settled at rather different rates so it is hard to see what the copyright "norm" might be. I am therefore reluctant to use norms as a basis for assessing royalty.

The basic level of royalty - summary

62. From the profits available approach I have deduced that the royalty rate should be between 5% and 6½%. From the Sweepax licence I have deduced that the royalty should be somewhat higher than 5%. From the savings in redesign I have deduced that the royalty should be between 6% and 9%. Whilst I have declined to rely on norms, I observe that none of these figures is out of line with the range of royalties settled in previous design copyright cases.

63. Of course, all these calculations are approximate and subject to many assumptions. That is inevitable when, as is so often the position in licence of right cases, the evidence is not as full as one might like. However, the fact that they all point in much the same direction is encouraging and, taking them together, I conclude that the basic royalty should be 6½%.

Factors warranting an adjustment to the level of royalty

64. Having reached this point I now need to consider whether there are any factors which should cause me to adjust this basic level of royalty either up or down. Both sides put forward a number of suggestions.

65. Mr Shipley argued that the designs in question were rather old hat now and moreover, that it had been the applicant who had been the driving force in establishing the market for, and reputation of, the pumps in question. Not only had the applicant been the sole manufacturer of the pumps for a long period under the 1989 agreement but that agreement gave the applicant marketing rights in large parts of the world. To a large extent this is the mirror image of the counter-arguments put by Mr Birss that these pumps are well established and have a ready market and that the applicant wishes to make straight copies of this established design which makes a licence to produce and sell all the more valuable. Mr Shipley however pointed out that the applicant's evidence suggested that the designs had a limited remaining marketable life and the applicant wanted a licence because having made the pumps for the respondent for many years, and having all the facilities to make them, it was convenient to continue to do so for the few remaining years that they would be saleable. It seems clear to me that "Sykes" pumps are indeed a well known and well established item and to that extent Mr Birss is right in saying that the licence has some value. Equally, I see some merit in Mr Shipley's arguments. On balance, I have decided that I should not make any adjustment in either direction on this point.

66. A second factor cited by Mr Birss was that because the respondent hires pumps as part of its business it is very likely that other hire companies would be reluctant to obtain pumps from a direct competitor when they could get them from the applicant. Thus he was arguing that there was a part of the market which was open only to the applicant and not to the respondent and that the respondent should be compensated for that. Mr Birss pointed to the fact that this argument was considered in *Pioneer Oil Tools Ltd's Licence of Right (Copyright) Application 1997 RPC 573* and led to an uplift in the royalty payable. Mr Shipley disagreed with Mr Birss's submission, arguing that whether or not the respondent chose to sell to hire company competitors was simply a question of company policy. Further, in their evidence both Mr Millward and Mr Shevlin suggest that hire companies have the opportunity to make extra sales to people who start off by hiring and then want to buy.

67. On balance, I am not convinced the applicant has access to a significantly wider market than the respondent. Further, the circumstances here are different from those applying in

Pioneer. In this case the limitation is more to do with the normal realities of the market whereas in *Pioneer* the problem came about through restrictions imposed on United States companies as a result of the political policy of the US Government. In my judgment, the normal operation of the market, and the fact that the existence of the licence may inevitably mean that the licensee may take some market share from the licensor, is something which is an inevitable part of there being a licence in the first place and not some addition, externally imposed constraint as in *Pioneer*. Consequently, I see no reason to make any change to the royalty rate.

68. A third possible factor, mentioned in the respondent's evidence, is that it has had to put a heavy investment into training customers in the use of its pumps, including producing a comprehensive training manual, and that the applicant could now ride on the back of this. The applicant countered by saying that it has had to train its customers too and write its own manual. Having looked at the arguments from both sides, I do not feel there is anything in this to justify an adjustment of the royalty.

69. Another factor mentioned in the evidence, though not pursued at the hearing, is the claim that sales of pumps can lead to sales of ancillary equipment. In his first affirmation for the respondent, Mr Harbridge says purchasers of pumps often want to buy hoses and dewatering services as well. However in his statutory declaration for the applicant, Mr Johnson says it no longer sells hoses and does not offer other ancillary services. In these circumstances I consider that any uplift on this account would be inappropriate.

70. There is also a suggestion in Mr Millward's evidence that the royalty in respect of some of the drawings should be reduced because they have been modified by the applicant since the drawings were originally made. Since the applicant accepts that these drawings are still subject to copyright, I cannot believe that the modifications are substantial and accordingly feel a reduction in royalty is not justified.

71. Finally, Mr Birss argued for an uplift on the royalty rate to take account of the fact that sales of spare parts generate higher profits than does the sale of original equipment. In

responding to this argument Mr Shipley indicated that he was not going to address me on the impact of the judgment in *British Leyland Motor Corporation and Others v Armstrong Patents Company Limited* [1986] RPC 279 because the applicant's sales of spare parts were so small that they should not really enter the equation, so I shall proceed on the basis that sales of spare parts will be subject to royalty.

72. In an exhibit to Mr Harbridge's first affirmation for the respondent, S say that whilst they make [*]% profit on assembled pumps, they make [*]% on spare parts. In his statutory declaration for the applicant, Mr Johnson says that “as a rough and ready guide, the profits on spare parts are about 3 times those on original equipment”. Thus both sides are agreed that there is a much greater profit available on spares, and in my view this justifies a higher royalty rate. This could be achieved by having a specific royalty rate for spares which was higher than that for assembled pumps and pump ends - eg 9% if I adopt the 2% uplift for spares suggested by Mr Birss. This of course is what was done in *Bance*. However, since the evidence suggests that sales of spares are not likely to be massive during the period of this licence, I think it would be administratively easier to achieve much the same end result by giving an uplift to the basic royalty rate and not then differentiating between sales of spares and sales of pump ends. Mr Johnson's evidence suggests spares are likely to account for 10% of the total turnover in relevant goods. To reflect this, I shall increase the basic royalty rate to 7%.

How to deliver this royalty rate

73. On the basis of the various findings I have made so far, the royalty rate of 7% should clearly apply to ordinary “SY” pump ends, to subassemblies of pump ends and to spare parts. However, as I indicated previously I consider the royalty on pump sets should be lower, whilst special consideration needs to be given to non-standard items such as “high head” pump ends and pump sets and non-SY articles. Before looking at these points further, though, I need to consider what mechanism to put in place to deliver this royalty, because there is more than one option, and in particular there is one that would not require me to differentiate between different end products.

74. One possibility is to go back to the mechanism proposed by the applicant and levy a royalty on the “standard costs” of the individual copyright parts listed in Mr Millward's “tab 9” at such a level as to deliver the same amount, in cash terms, as 7% on the invoiced selling price of pump ends. That means the actual percentage levied would, of course, be considerably higher than 7%. (I have not worked out what it would need to be, but from a quick calculation on a couple of typical products, it seems to me that the 3% on manufacturing costs offered by the applicant translates into something like 1¼% on the invoice price of a pump end and under 1% on a pump set. Working in the other direction, therefore, the 7% will need a very considerable uplift if it is to be based on manufacturing costs.)

75. This mechanism has the advantage that it would make it unnecessary to have separate royalty rates for pump ends, pump sets and non standard items. A flat royalty on copyright parts would automatically take account of the fact that pump sets and non standard items have fewer copyright parts and therefore the payments on them ought to be less. However, I would need to consider whether it reduced the payments on pump sets and non standard items by more than is reasonable. More importantly, it has the disadvantage that it is very much more difficult for the respondent to audit in order to check that it is being paid the right amount. In particular, as Mr Birss submitted, the definition of “standard costs” is wide open to interpretation and dependent on the policies used by the applicant to account for overheads, and it is therefore very difficult to determine whether the costs are fair.

76. I believe these disadvantages are significant. In my view this mechanism is unnecessarily complex, too liable to error, wide open to dispute and may not provide a fair royalty on both pump ends and pump sets. The respondent also argued that a willing licensor would never agree to a complicated, difficult-to-police mechanism like this, and I think there is some force in that too. Some of the difficulties could be overcome by working on a fixed list of prices, as suggested by Mr Harbridge in his second affirmation, but I still consider this mechanism to be unsatisfactory unless there really is no workable alternative.

77. The more usual approach would be to levy the royalty on the applicant's invoiced selling price, excluding VAT and excluding the reasonable cost of delivery if that is shown separately

on the invoice. Although this approach would not enable me to avoid having to set separate royalty rates for different classes of product, it is simple, not dependent on accounting policies and relatively easy to audit. On several occasions Mr Shipley protested that the applicant could not determine from its invoices which goods contained copyright parts and which did not, conveying the impression that the applicant could not actually calculate royalties this way. However, Mr Shipley never actually said this approach was unworkable, and Mr Birss several times pointed out that as a BS 5750 (ISO 9001) company the applicant must have a system for identifying what is in each product it sells. In their evidence both Mr Millward and Mr Johnson say their invoices do not identify whether the products sold contain any copyright parts. That may be so, but it does not mean they cannot access the information in other ways, and there is a hint in Mr Johnson's evidence that they could.

78. Accordingly I propose to adopt this approach subject to one proviso. If within two weeks of this decision the applicant can provide evidence that they really cannot calculate royalties this way, or can only do so with a quite disproportionate amount of effort, I will reconsider the position. I feel it necessary to make this proviso because nearly half the licence period has already passed. Thus it is not simply a question of requiring the applicant to set up procedures to calculate royalties in this way in the future - they actually have to be able to calculate them for past sales too, and it would obviously be foolish of me to impose a mechanism that could not actually be implemented. Having said that, I find it difficult to believe that any responsible company, knowing it was liable for royalties on what it was doing and knowing that royalties are nearly always based on invoiced selling prices, would have gone on for a year with no system in place to enable royalties to be calculated on this basis. The applicant's own proposed basis for royalty calculation is most unusual and was bound to be contentious, so whilst it might have hoped to persuade me to adopt it, it must have realised all along that there was a substantial chance I would not do so. In short, I shall need some pretty convincing evidence before agreeing to adopt a different mechanism for assessing the royalty payments due.

79. I turn, then, to the question of what royalty rates to set on pump sets and non-standard items. Mr Birss suggested late in the hearing that I should divide the applicant's products into

five categories, Pump Ends, Pump Sets, High Head Pumps, Canopy Pumps, and all other items including spare parts. He then suggested that the final four categories should have royalty rates only slightly lower than the first because of his “jewel in the crown” argument and the fact that these products could still only be sold with a licence, no matter how low the copyright content.

80. I feel the Annex to this decision points to a slightly better breakdown and a better basis on which to assess the royalty levels of each category. In looking at this Annex, which is derived from the applicant's evidence, I am aware that the absolute values of the figures in the “% copyright” column are, for the reasons I have given earlier, misleading in that a pump end marked as, say, 60% in this column is, for all practical purposes, close to being a 100% copy of a Sykes pump, but I consider there is still useful information in the relative values of these percentages. I have also added a column which gives the price of each pump set as a multiple of the price of the corresponding pump end, so far as I can identify a corresponding pump end.

81. From the Annex, then, I observe that the price of a pump set without a canopy is between 2.1 and 2.5 times the price of a pump end on its own - say 2.3 times on average. The extra price is all attributable to non-copyright parts, but on the other hand the copyright parts play their part in allowing profit to be made on the extra price. That suggests the royalty on a pump set without a canopy should be lower than that on a pump end, but not by as large a factor as 2.3. I therefore conclude that the appropriate royalty should be half that on a pump end, viz 3½%. By similar reasoning, the price of a pump set with a canopy is around 3½ times the price of the pump end, and I conclude that an appropriate royalty would be 2½%.

82. To deal with the remaining items, it seems the only thing I can do is to base the royalty on a necessarily rough estimate of the copyright content of the parts involved. “High head” pump ends have a much lower copyright content than normal SY pump sets, and accordingly I conclude that the royalty on any high head pump end or pump set should be half what it would otherwise have been. Non-SY pump ends and pump sets have a rather variable, but relatively low, copyright content, and here I feel I have little choice but to resort to rough justice and set the royalty at a flat rate. 1½% seems appropriate.

83. Finally, to minimise the risk of confusion or dispute, I realise I may need to clarify exactly what counts as a non “SY” pump end as distinct from a non-high-head standard one. This may be necessary because the applicant could, if it were so minded, take an “SY” pump end, modify it very slightly, give it a different (non SY) product code and then class it as a non-standard item. I am not suggesting the applicant would do this deliberately simply in order to reduce the royalty, but on their own admission this could happen for other reasons.

Accordingly if either party so wishes I will be willing to define in the licence what counts as a non-high head SY pump end to which the basic royalty of 7% applies in such a way as to ensure minor variations are not excluded. Before finalising any definition I will be willing to consider any definitions the parties may suggest. For example, it may be possible to base a definition on the proportion of copyright parts calculated on the same basis as in the Annex - anything over 40%, say, counting as an “SY” and anything under counting as non-standard. However, if both parties are content to leave the term undefined, that will be fine by me.

84. I am aware that the basis on which I have arrived at these scaling factors is simplistic and crude. However, royalty rates in licence of right disputes can rarely be arrived at by means of precise calculations, any more than they can be in negotiations between willing parties. I am as satisfied as I can be on the evidence available that the rates I have arrived at are reasonable and close to what would have been reached in negotiations between a willing licensee and willing licensor.

85. In summary, then, royalty should be paid on the applicant's selling price, exclusive of VAT and of the reasonable cost of delivery if this is shown separately on the invoice, as follows:

(A) On SY pump ends (and as indicated above, this may need to be defined), subassemblies thereof and any copyright parts sold as spare parts, 7%, subject to (C) below.

(B) On SY pump sets, and any other pump set which includes an SY pump end, 3½% if it is sold without a canopy and 2½% if it is sold with one, again subject to (C)

below.

(C) On high head SY pump ends and pump sets, and any other pump set which includes a high head SY pump end, one half of the royalty that would otherwise be payable under (A) or (B).

(D) On all other products including at least one copyright part, 1½%.

Other licence provisions

86. Apart from the dispute over the royalty payable, there are a number of other issues on which there has not been an agreement over the particular terms of the licence. To identify these Mr Birss very helpfully handed me a copy of a composite draft licence which distinguished between terms which were and were not agreed, and for those which were not agreed, gave the two sides' alternative suggestions. The first remaining issue in which there is a dispute is Clause 2.2 which sets out the records that the licensee must keep and which, in the respondent's version, would require the licensee to identify to the licensor the identity of any subcontractors used by the licensee in working the licence. It is I think clearly right that the licensee should keep such records as are necessary to enable the proper working of the licence to be checked and independently audited and Mr Shipley indicated that there was no difficulty there. For the rest however he suggested a compromise whereby the identities of subcontractors could be disclosed in confidence to those charged with auditing the working of the licence. Mr Birss pointed out that this suggestion had been rejected in *Bance* where, he said, the circumstances were similar in that the parties having had at one time had a working relationship had fallen out leading to a good deal of mistrust between them. This is of course true but there is an important difference between this case and *Bance*. In *Bance* the licensee proposed to work the licence solely by subcontracting. In the present case there seems to be no question that the licensee will make many, if not most, of the parts and will assemble the pump ends and pump sets itself. All it is likely to contract out is the manufacture of some of the parts.

87. In these circumstances it seems to me that what Mr Shipley proposes is reasonable and adequate. The only justifiable reason it seems to me why the respondent's would want to know who was acting as a sub-contractor would be for the purposes of checking that the sub-contractors were not cheating and, as Mr Birss put it, sending pumps out of the back door of the factory without paying royalty. Since it seems unlikely that subcontractors will be assembling pumps, the risk of this seems low. Mr Birss's concerns can be met perfectly well by confidential disclosure to an independent accountant and this would avoid the applicant having to disclose understandably sensitive information to an arch competitor. Consequently, this is what I shall provide.

88. The next issue arose in Clause 4(1)(b) which was a provision which allowed the licensee to decide that certain goods were to be treated as licensed goods which, Mr Shipley said was necessary for the applicant to bring goods which were made before the licence agreement commenced but were sold after that date to be counted for royalty purposes. Though Mr Birss had great difficulties with the drafting of this Clause, which I share, it is the case that the provision is only needed if royalty payments are triggered on the manufacture of the items in question or upon their withdrawal from store prior to sale and as I have decided that the royalty will in fact be triggered by sales of the end products, there is no need for the clause.

89. The next dispute arose over Clause 4(5) and the frequency of the accounting for, and payment of, royalty. The applicant wanted half-yearly, or even yearly as Mr Shipley argued briefly, whereas the respondent wanted quarterly returns and payments. As quarterly is the generally accepted standard that is what I shall provide in this case.

90. There was also a continuing dispute over a provision in Clause 4.7 in which the applicant wanted to be able to set off royalty payments against debts owed to the licensee by the licensor or any of its associated companies. Mr Shipley argued that this was a necessary precaution against the possibility of the Commercial Court ordering the respondent to pay damages to the applicant in the ongoing court action. In my view this licence is quite independent of any other court action and there is no reason to make any provision of this sort. Accordingly I shall not do so.

91. There was nominally a dispute over the provisions of Clause 4.8 which provided that at the end of the licence there should be a royalty payment by the licensee for all licensed item manufactured and held in stock but unsold and therefore unaccounted for in royalties. Mr Shipley however indicated at the hearing that in the event that the licence triggered royalty payments on sale, he accepted that a terminating provision of this sort would be necessary. Suffice it to say that I agree that this is right and that such a provision should be made.

92. Finally, in Clause 5 the respondents were proposing that the applicant should be obliged to mark all its products so as to identify their provenance, on the basis that because many of the applicant's products were either marked with SY part numbers, because of the past association between the parties, or were so similar to the equivalent Sykes parts, there would be confusion and unfairness if the users of the applicant's products mistakenly approached the respondent for repairs or replacements. At the hearing Mr Shipley pointed out that this could require the applicant to mark such things as a retaining pin worth 61p. In response, Mr Birss offered to limit the requirement to marking "when reasonably possible to do so" or maybe to just marking to cast parts. Though I sympathise with the respondent's argument in the particular circumstances of this case, I do not see sufficient justification for a marking requirement. The licence has been in operation already for over a year during which no marking has been effected and will last for less than another year after which no marking will be required. Further, even if I imposed a marking requirement just for cast parts, that would require the applicant to stop all production whilst it altered all its castings. In these circumstances it would unduly onerous and impracticable to require the licensee to mark its products, and I decline to do so.

93. There is one other issue to sort out - the Schedule to be attached to the licence. As indicated previously, the parties are now agreed that it should be the list of parts in "tab 9" of Mr Millward's declaration. However, it will also need to take account of the possibility that parts altered in the future but still subject to the licence might be given a new part number.

The way forward

94. Having thus decided on all the outstanding issues in dispute between the parties it remains for me to finalise the actual licence. There was some discussion of how this should be done at the hearing with Mr Shipley accepting that it would be sensible for me to give my decision in principle on all the points at issue and then give the parties a period to produce an agreed text for the licence. Mr Birss was somewhat dubious about this process, I understand because of concerns over delay. However in the circumstances it does seem sensible to me, especially since I have throughout been concerned about the difficulty of producing a workable practical scheme for implementing my decision on the royalty payable. In any case, I have already said that I will allow the applicant two weeks in which to confirm that they can actually calculate the royalties due on the basis I propose, so I cannot finalise the wording of the licence at this stage.

95. Accordingly:

- C If the applicant considers that it really cannot calculate royalties in the way I have proposed, or can only do so with a quite disproportionate amount of effort, it has two weeks from today in which to provide evidence to this effect. In this case, and assuming I am convinced by the evidence, I shall look for an alternative mechanism and will be willing to take account of any suggestions the parties may wish to make. Any alternative mechanism will in principle need to produce much the same amount of cash at the end of the day, though if it is likely to increase the respondent's auditing costs significantly, I will have to take that into account.

- C Otherwise I shall allow the parties a further week - ie until three weeks from today - to provide me with an agreed suggested draft for the licence giving effect to the conclusions I have set out in this interim decision. 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 that I consider appropriate. It would, I must say, be helpful to have an electronic copy of any draft.

96. In my oral preliminary decision of 5 December 1996 I ruled that I would make no award of costs in respect of the proceedings up to that stage. If either side wishes to make a submission on costs for the proceedings since then, they should do so within three weeks, though I should say that I shall need some persuasion if I am to depart from the comptroller's normal practice in these cases, which is to make no order.

Dated this 2nd day of September 1998.

P HAYWARD

Superintending Examiner, acting for the comptroller.

THE PATENT OFFICE

ANNEX

“Tab 6” of Millward, re-arranged

PRODUCT	Description	Cost		% Copyright	
SY PUMP ENDS					
SY3801054	100-60/PUMP END/STD	[*]		61	Non high heads. Average 58%
SY3811080	100M-25 PUMP END/SPI SPEC	[*]		64	
SY3821067	150-25/PUMP END/STD	[*]		62	
SY3821077	150-60/PUMP END/STD	[*]		56	
SY3821101	150A-60/PUMP END/SPI SPEC	[*]		59	
SY3831061	150M-60/PUMP END/STD	[*]		60	
SY3841029	200-60/PUMP END/STD	[*]		60	
SY3841051	200-60/PUMP END/SPI SPEC	[*]		59	
SY3841053	200A-60/PUMP END/SPI SPEC	[*]		62	
SY3871037	100 PUMP END/STD/SPI SPEC	[*]		53	
SY3871039	100-60/PUMP END/SPI SPEC	[*]		47	
SY3811078	100HH-25/PUMP END/STD	[*]		20	High heads. Average 21%
SY3811082	100HH-60/PUMP END/SPI SPEC	[*]		21	
SY3831101	HH150-60/PUMP END	[*]		23	
SY PUMP SETS WITHOUT CANOPIES					
The fourth column here and below shows the price as a multiple of the price of the corresponding pump end					
SY3811051	100M-25/TR2/ES/4WHCH/STD	[*]	x 2.4	39	Non high heads. Average 40%
SY3811052	100M-25/TR2/ES/HST/STD	[*]	x 2.4	41	
SY3811058	100M-25/TR2/HS/2WHST/STD	[*]	x 2.3	40	
SY3821071	150-25/TS3/ES/4WHCH/STD	[*]	x 2.4	40	
SY3821078	150-60/TS3/ES/4WHCH/STD	[*]	x 2.3	40	
SY3821084	150-60/TS3/HS/2WHST/STD	[*]	x 2.2	41	
SY3821102	150-60/TS3/HS/2WH/BRZ/I-COT	[*]	x 2.3	44	
SY3831067	150M-60/TR2/ES/4WHCH/STD	[*]	x 2.3	39	
SY3831068	150M-60/TR3/ES/HST/STD	[*]	x 2.4	38	

SY3831075	150M-60/TR3/HS/2WHST/STD	[*]	x 2.1	41	
SY3831079	150M-60/TR3/HS/2WHST/BRZ	[*]	x 2.2	43	
SY3841047	200-25/CD4/4WHCH/STD	[*]		25	
SY3861012	50/75-6AD1/2WHST/2 VANE	[*]		31	
SY3861015	50/75-6/EM/BEDPLATE/2 VANE/LVP	[*]		56	
SY3871032	100-18/TR1/ES/2WHST	[*]		34	
SY3871034	100-18/5.5KW EM/BEDPLATE	[*]		54	
SY3871036	100-18/TR1/HS/2WHST/STD/H-P	[*]		36	
SY3811077	100HH-25/CD4/SKID	[*]	x 2.5	11	High heads.
SY3831102	150HH-25/CDT6/SKID	[*]		9	Average 10%
SY PUMP SETS WITH CANOPIES					
SY3811084	100M-25/LPW3/HST/CANOPIE	[*]	x 3.8	14	Average 16%
SY3811085	100M-25/LPW3/4WHST/CANOPIE	[*]	x 3.6	16	
SY3831113	150M-60/LPW4/HST/CANOPIE	[*]	x 3.3	16	
SY3831114	150M-60/LPW4/4WHST/CANOPIE	[*]	x 3.1	18	
NON-SY PUMP ENDS AND PUMP SETS					
150AF25	150AF-25/PUMP END	[*]		15	Pump ends.
200AF60	200AF-60/PUMP END	[*]		13	Average 10%
200BF60	200BF-60/PUMP END	[*]		13	
300AF60	300AF-60/PUMP END	[*]		6	
300CF60	300CF-60/PUMP END LESS NRV&P/TANK	[*]		2	
E17252	300CF-60 PERKINS 2006/SKID	[*]		2	Pumps.
E17953	200AF-60/CDT4/SKID	[*]		4	Average 3%