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German Federal Patent Court outlines detailed guidelines for royalty rates

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In a recently published decision, the German Federal Patent Court outlines in detail which aspects they consider relevant to arrive at a royalty rate (ruling by the Federal Patent Court dated November 21st 2017, published in GRUR 2018, 803). It is one of the rare decisions where a German Court analyzes in detail which aspects are relevant for setting a royalty rate, and this ruling will thus be a useful guideline for any practitioner negotiating royalty rates.

The ruling concerned a case where the defendant was the proprietor of a patent relevant for HIV therapy. The plaintiff marketed products allegedly making use of the invention of this patent. The plaintiff requested a compulsory license for using the invention at the Federal Patent Court. According to § 24 Abs. 1 of the German Patent Law, this is possible when the license seeker unsuccessfully tried to obtain a license under reasonable terms, and there is a public interest for granting the compulsory license. Further, the plaintiff also requested a preliminary injunction allowing them the immediate use of the invention, which is also possible when the immediate use of the invention is urgently necessary in the public interest (see § 85 Abs. 1 of the German Patent Law). In a previous decision on the present case (3 LiQ 1/16 (EP) published in GRUR 2017, 373), the Court granted the plaintiff the immediate use of the patented invention, and, after an appeal by the patent proprietor, the German Federal Supreme Court confirmed this decision (decision in X ZB 2/17 dated July 11th, 2017, published in GRUR 2017, 1017). After that decision, a Board of Appeal of the European Patent Office revoked the patent. Thus, there was a dispute between the parties as to whether or not a fee had to be paid by the plaintiff for the time where the compulsory license was in place (and before the patent was revoked), and (if yes) how high such a fee would be.

As regards the first question, the Court ruled in the affirmative (i.e., that a fee had to be paid), and thus also had to rule on the amount of the fee. While the ruling on the first question is interesting, the ruling on the second question is of great practical relevance, as the Court elaborates in detail which aspects are relevant for arriving at a reasonable royalty rate. These aspects are discussed below. More particularly, the Federal Patent Court considered some aspects to be of high or medium relevance (see items A1 to A9 below), other aspects to be of minor relevance (items B1 and B2), and still further aspects to be generally relevant, but not for the present case (items C1 to

C5).

A. Aspects of high or medium relevance for the royalty rate

A1. General range of royalty rates

Generally, the royalty rate should be an adequate compensation for the patent proprietor, and should also allow the licensee to maintain their business.

For the present case, the Court considers royalty rates of 2% to 10%, and more particularly 5% to 10% to be the usual ranges, while noting that for pharmaceuticals, also 5% to 15% may apply. The royalty rates are calculated based on the net sales of the licensee with the patented product.

A2. Market situation

The licensee marketing the patented product and generating a substantial turnover with it increases the threat of a sales stop for the licensee, and thus **increases** the royalty rate.

The patent proprietor marketing a competing product also **increases** the royalty rate.

A3. Particular customer retention

A further aspect to be considered is the customer retention. If a patented product needs to be bought repeatedly over a long period of time and if there are particular reasons for a customer to stay with a certain product (as is the case for a pharmaceutical once it has proven tolerable for a patient), this leads to an **increase** of the royalty rate.

A4. No other solution for licensee

The licensee having no alternative solution to the patented product **increases** the royalty rate.

A5. Technical progress by the patent

The greater the technical progress introduced by the patent, the **higher** the royalty rate is to be set. More particularly, the Federal Patent Court differentiates between "finished" and "unfinished" inventions. Put differently, the more developments the licensee has to make to arrive at their product (when starting from the disclosure of the patent), the more "unfinished" an invention is and the lower the royalty rate.

A6. Licensee also using their own patents

When the licensee also uses their own patents (when using the invention patented by the licensor), the royalty rate **decreases**.

A7. Risk of patent revocation

Further, the risk of patent revocation for the patent proprietor **increases** the royalty

rate, if the licensee is allowed to challenge the validity of the patent. Conversely, if the licensee agrees not to attack the validity of the patent, this will decrease the royalty rate.

A8. Whether the license is compulsory

A patent proprietor being forced to grant a license (as with a compulsory license) also **increases** the royalty rate when compared to a patent proprietor agreeing to a license of their own volition.

A9. Exclusiveness of license

An exclusive license **increases** the royalty rate.

B. Aspects of minor relevance for the royalty rate

B1. Secondary obligations

The amount of secondary obligations also impacts the royalty rate, e.g., the right of the patent proprietor to audit the licensee.

B2. Obligation to use the invention

The licensee being required to use the invention may **decrease** the royalty rate.

C. Aspects of general relevance for the royalty rate (but not for the present case)

C1. Reference value

The reference value may impact the royalty rate as well. That is, when only a component of a product is patented, but the entire product is sold, the royalty rate is different depending on whether the reference value is the entire product or only the patented component. Generally, the smaller the part of the licensed product in the entire sold product, the smaller the royalty rate would be.

C2. Turnover by licensee

The licensee's turnover based on the patented product may also impact the royalty rate – generally, the higher the turnover, the lower the royalty rate. The rationale is that the higher the turnover, the more well-known the licensee and their trademark, and thus the lower the impact of the patented invention.

C3. Broadness of claims or license

A further aspect is the broadness of the claims for which a license is granted. Generally, the broader a claim, the higher the royalty rate. However, this does not apply in case a license is not granted for a claim as such, but only for a certain product (or certain products).

C4. Duration of license

Still further, the duration of the licese agreement may be considered.

C5. Right to adjust or terminate the license agreement

The rights of both parties to require the license agreement to be adjusted or terminated may also impact the royalty rate.

In the above case, the Court found a royalty rate of 4% to be adequate. The Court mainly based their finding on the market situation, the particular customer retention, the lack of alternative solutions for the licensee, and on the aspect that the license was compulsory (see items A1 to A4 and A8 above), all of which are arguments for a high royalty rate. However, the Court also considered that the invention as outlined by the patent was unfinished and that the licensee thus had to make additional developments to arrive at a product (see item A5 above). In this regard, the Court considered the contribution of the patent to the final product of the licensee to be on the order of 1/10, this being a strong argument for a relatively low royalty rate.

While the case was particularly related to a compulsory license, and thus to particular circumstances, the above considerations may have a relevance going beyond this particular case, and may thus provide useful arguments for any license negotiation.

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