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The handling of recent cases involving an avian-flu drug and CD-R disks has left many patent holders concerned about the fairness and transparency of Taiwan's proceedings.

For many multinational businesses, government interference with the operation of free markets is a serious concern on an emotional level above and beyond the commercial concerns involved. An example of such interference is the concept of "compulsory licensing" within patent laws – a subject that is frequently ignored simply because it is so rarely seen in practice. Simply put, compulsory licensing is a means by which a party can ask the government to intervene on its behalf to ensure that it gets access to a patent, usually at a lower-than-market-value rate. The special circumstances giving rise to such requests are normally domestic medical or national-defense emergencies – situations urgent enough to warrant setting aside the patent right that the government has already granted.

Taiwan attracted much attention in 2005 for its proposed compulsory licensing of Roche's Tamiflu patents during the early stages of worldwide awareness of the spread of avian flu. Initially there was talk of making some of the local production available overseas once Taiwan's own needs had been met, but later announcements indicated that Taiwan would limit sales to the local market and even then only seek to satisfy needs above and beyond Roche's capabilities to produce.

At about the same time, several cases regarding key patents for CD-R disks held by Philips, the electronics giant headquartered in the Netherlands, were moving through Taiwan's court system. Gigastorage, a Taiwanese company that had unsuccessfully sought a license from Philips (after a previous license had been revoked on grounds of alleged under-reporting of sales), had applied to the Taiwan government to award it a compulsory license in these patents. In 2004, that request was granted by the Taiwan Intellectual Property Office (TIPO) under the Ministry of Economic Affairs.

Since CD-R disks seem far removed from national health or national security emergencies, what was going on here? With Gigastorage – and Taiwan's CD-R industry as a whole – primarily aimed at the export market, was this a case of protectionism cloaked in technology policy? The answers appear to be of little comfort to technology companies. At the heart of concern by Intellectual Property Rights professionals is whether the Taiwan government's decisions on compulsory licensing are an omen that a technology "Boxer Rebellion" is in the making. In other words, is Taiwan hurting its long-term interests by launching a short-sighted strike at foreign rights-holders?

In Taiwan, the provisions covering compulsory licensing are found in Article 76 of the Patent

Law. The relevant portion of the article states that in addition to such purposes as "coping with national emergencies" and "non-profit-seeking use…for enhancement of public welfare," a compulsory license can be granted "in the case of an applicant's failure to reach a licensing agreement with the patentee concerned under reasonable commercial terms and conditions within a considerable period of time" – with the stipulation that such production be aimed mainly at satisfying the domestic market. And this is where the Philips-Gigastorage situation appears to have slid off the tracks for a wild ride.

What are "reasonable terms and conditions?" From a free-market standpoint, given the active market for licensing technology, including CD-R patents, there were adequate means by which Philips and those who wanted to license its technologies could agree upon terms and conditions that were "reasonable." Philips, of course, had a strong desire to maximize its licensing revenues across a wide range of companies engaged in the manufacture of CD-Rs. With competing technologies for storage moving quickly within the market, CD-R technology would remain the most popular and economical solution only within a limited timeframe, giving Philips strong incentives to hold its royalty rates low enough to keep CD-R products as a competitive part of the market. "Reasonable" here should not mean a low rate desired by the would-be licensee, but rather one that reflects market conditions. As will be shown below, Philips had been carrying out a flexible pricing policy that was responsive to constantly changing market conditions.

What is "a considerable period of time?" This part of the law gets a bit messy. Time is relative, and if there is a phrase with loads of wiggle-room, this is it. But of course, cases normally do not even get to this stage unless there have been problems with the "reasonable terms and conditions."

From the prospective licensor's standpoint, it could certainly feel that a "considerable period of time" has been wasted discussing royalty rates with an exasperating counterparty. But the policy thought behind this rule is that beyond initial posturing (that is, the sort of slightly unreasonable positions a party might take at the start of negotiations to see if its counterpart is a bit dumb), further delays might be intended to unreasonably block others from using a given technology. The wording of the law is an effort to try to prevent such "technology closure."

Unfortunately the law doesn't even specify whose fault the delay should be before one side can rely upon it to ask for government interference. What these provisions mean for technology companies trying to do business in Taiwan is that unsuccessful potential technology licensees can run to the government and ask for intervention if they don't get what they want. And the Taiwan government gets to make the call as to whether the local company was treated "unreasonably" and whether a "considerable period of time" has gone by. Where such broad latitude is given to the government, it is especially important that a great degree of procedural fairness and transparency exists.

For the domestic market

Article 76 also stipulates as a general principle that use of a compulsory license "shall be restricted mainly to the purpose of satisfying the requirements of the domestic market." But in the next paragraph it then states an exception "in the event that the patentee has imposed restrictions on competition or has committed unfair competition, as confirmed by a judgment given by a court or a disposition made by the Fair Trade Commission of the Executive Yuan." In such cases, regardless of whether the purpose of the production is for domestic consumption, "the Patent Authority still may, upon an application, grant to the applicant a compulsory license to practice the patented invention."

Gigastorage has apparently always produced primarily for the export market, which makes it odd that Taiwan would accept the argument that the compulsory license was in compliance with Patent Law requirements. In order for its production to be devoted primarily to the relatively small Taiwan domestic market, Gigastorage essentially would have had to totally dominate the market, vanquishing all the other major producers. If, on the other hand, the determination was based on "restrictions of competition" or "unfair competition" on Philips' part, there should have been a final, confirmed ruling to comply with the requirements, which Taiwan clearly did not have.

In documents that became public through litigation between Philips and Gigastorage in the United States, Gigastorage appears to have submitted data to the U.S. court showing a far higher level of export sales than included in the market information presented to the Taiwan government. Given the stringent penalties in the U.S. system for false testimony, it seems fair to assume that the data given to the U.S. court was more in line with actual business activity. Considering the export-driven nature of the market in this product segment, it is strange that the Taiwan government had simply accepted the figures provided without further investigation.

Some WTO considerations

As a member of the World Trade Organization (WTO), Taiwan is a party to a key mandatory agreement regarding intellectual property, the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). The relevant provision of TRIPS covering compulsory licensing, Article 31, addresses unsuccessful efforts to reach "reasonable commercial terms and conditions" within a "reasonable period of time," while laying out numerous other requirements implying that there cannot be "prior use" by the requestor before a compulsory license is granted. Article 2(1) adopts substantial portions of the World Intellectual Property Organization (WIPO) Paris Convention of 1967, including its elucidation regarding the backdrop against which a government might be entitled to interfere with market forces:

Each country of the Union shall have the right to take legislative measures providing for the grant of compulsory licenses to prevent the abuses which might result from the exercise of the exclusive rights conferred by the patent, for example, failure to work.

"Failure to work" here hints at the real problem: the possibility of technology closure. Reading the Paris Convention and TRIPS together, as it is necessary to do, one sees that the clear intention is to allow compulsory licensing in situations designed to fulfill the public interest through the avoidance of abusive practices. Within the larger framework of the WTO, TRIPS Article 31 and the Paris Convention cannot be read as carving out an opportunity for local parties to demand intervention on their behalf by their home governments against foreign rights-holders.

Was the Philips situation a matter of "technology closure?" The evidence indicates otherwise, in that the company was very actively engaged in licensing efforts with local industry, handling its program in a very non-legalistic, business-oriented way. Contrary to some reports, the Philips licensing rates were not locked in but in fact changed rapidly to meet a market situation in which memory sticks, USB storage devices, and ever-smaller hard drives were rapidly expanding the portable options available to consumers.

Prior to 2001, the Philips royalty rate was calculated at 3% of net selling price or ¥10, whichever was higher. The Japanese Yen figure of course fluctuated, but according to industry lore the local companies had requested a fixed formula of this sort to simplify payments. It should be kept in mind that when the first CD-R disks came out, the selling price per piece was about US$50, but that figure slid down fast as more producers entered the market on a mass scale. By the time Taiwan got into the industry, the price was about US$3 per disk, resulting in a royalty of about US$.09 or ¥10 per disk. Starting in 2001, Philips went to a US$.06 rate, which was lowered further to a US$.045 "compliance rate" for companies willing to make basic commitments such as doing their reporting on time, paying on time, providing an auditor's statement, and so on.

But even under these "compliance rates," it was still estimated that massive underreporting of 50% or more was occurring regularly. Further cuts brought the rate down to about US$.035 in 2005-2006, and then with the introduction of Veeza CD-R technology the rate dropped even further to US$.025. With disks now going for about US$.10 ex-factory, that means an official rate of about 25% (i.e., US$.025 charged for each US$.10 disk). If factored in with the estimated underreporting in the 50-70% range, the result is an effective rate of only about US$.0075 to $.0125 per disk. While underreporting was surely a serious concern for Philips in the midst of this controversy, it seems clear that Philips was not at all being unreasonable or inflexible in its approach in trying to work things out on a business level with so many local market players. Over the past four or five years, CD-R manufacturing has gone through numerous changes. With the increase in oil prices, the cost of plastics doubled at the same time as a major exodus of Taiwanese manufacturing firms made its way across the Strait to China and to other countries in the region to take advantage of the cheap

labor. CNC, Ritek, and ProDisk have all set up huge plants in China, and Daxon has set up a big plant in Malaysia. What this means is that the top "Taiwanese" companies have become the top "Chinese" manufacturers of CD-R products, so that the compulsory licensing grants, if intended to preserve the Taiwanese manufacturing of CD-R products, were fighting against the current of much larger trends.

Facing a massive erosion of its royalty rates within a jurisdiction that remains a substantial maker of CD-R products, Philips took its case to the European Commission, apparently in hopes of getting resolution either through informal means or, if necessary, by taking action in the WTO dispute-resolution system. The European Commission conducted its investigation of Taiwan's compulsory licensing system over the summer of 2007, and the results are due to be released were a damning indictment of Taiwan's system, setting tough deadlines for action by Taiwan to start to right some of the wrongs or else the Commission would proceed with a full-blown complaint to the WTO against Taiwan, a step that could have negative repercussions for Taiwan's technology economy.

In late May 2007, Gigastorage and TIPO announced that the compulsory license would be cancelled, given that Gigastorage planned to move its production offshore to Thailand, where Philips does not have these patents registered. By July, TIPO announced the withdrawal by another CD-R company, Princo, of its application for a compulsory license.

On September 29, 2007, Philips and Gigastorage announced that they had reached a settlement as to royalty amounts, a move that was apparently motivated by the infringement suit Philips had brought in the United States. With the net closing around it in other jurisdictions, it probably made sense for Gigastorage to make a deal.

By the spring of 2008, with Taiwan's presidential elections coming at the same time as the Commission's deadline, Taiwan requested some extra time and indicating that amendments would be forthcoming. In fact, major amendments to all of Taiwan's intellectual property laws are underway. However, as of this writing, new draft amendments to the Patent Law continue to give little comfort to technology companies in that they are still very vague as to the conditions under which compulsory license grants may be made and to whom they can be granted.

Continuing concerns

Despite the settlement reached between Philips and Gigastorage from their U.S. litigation, Taiwan's handling of its compulsory licensing program gives little comfort to technology companies. Complaints about Taiwan's program include a lack of procedural fairness and transparency, as well as an apparently heavy-handed tilt in favor of local export-oriented industry that is inappropriate considering Taiwan's WTO obligations. In the Tamiflu and Philips matters, for example, the failure to appropriately consider clear export-orientation issues indicates that the compulsory licensing decisions were being made without an

adequate review of relevant facts and law; it was as if the decisions to grant compulsory licenses were made first, with the rest of the proceedings a mere show. Also, the government's apparent re-use of the same expert panels at different instances in the Philips compulsory licensing situation seemed to undercut the need to freshly evaluate the grant, while other aspects of the procedures appeared aimed at limiting Philips' ability to participate in its own defense.

The major concern for IP professionals looking at Taiwan's compulsory licensing program is that what was done to Philips could always be done to other companies whose technologies are coveted by local industry. Philips calculates the potential damages from the government interference as being in the hundreds of millions of U.S. dollars, which is no small change.

So how did Taiwan get onto this whole misadventure? Was it local politics gone wrong? In looking at the big picture for Taiwan's economic future, it makes no sense whatsoever to inject instability and fear into the international technology companies considering doing business here. With Taiwan consistently ranking in fourth place in numbers of U.S. patents applied for and received (behind the United States, Japan, and Germany), it also no longer makes sense for Taiwan to have a "pirate" mentality. Technology policy is a long-term matter, but many people, both in government and in business, still fail to understand that and instead focus on short-term gains for local companies without considering the long-run negative effects.

Economically and technologically, Taiwan's interests are far more aligned with those of the rights-holders than with the infringers. Given the rampant violations of intellectual property going on across the Strait in the PRC – including infringement of Taiwan companies' IP – Taiwan has an excellent opportunity to position itself as a trusted partner and intermediary for safeguarding new technological developments, and to revitalize its manufacturing sector as an ideal place for carrying out cutting-edge projects. Taiwan's semiconductor foundries realized this fact early and capitalized on it, making Taiwan a key player in that industry worldwide. With the PRC entering the semiconductor industry and new technologies always on the rise, however, it is essential for Taiwan's economic future that it stop trying to fight basic TRIPS compliance and move on to offering innovators, both foreign and domestic, a "TRIPS-plus" protective environment.