Aspects of Licensing in Canada

Some areas of Canadian patent laws differ greatly from American rules

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In Canada, inventions and any new useful improvements can be protected by the Letters Patent, granted pursuant to the Patent Act, a federal statute.

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The Act is administered by the Patent Office which is attached to the Department of Consumer and Corporate Affairs; the Patent Office is headed by a Commissioner of Patents who is appointed by the Governor in Council (i.e. the Cabinet) and who is charged, under the direction of the Minister of Consumer and Corporate Affairs, with the application of the Act.

The Patent Office is located in Hull, Quebec, where all specifications, drawings and models relating to an invention can be consulted, except for caveats and those filed in connection with applications that are still pending or that have been abandoned. However, anyone is entitled to know whether an application for a patent for an invention for which a foreign patent is said to have been granted, is pending or not in Canada; in such a case, the inquirer shall supply the Patent Office with as much information as possible concerning the foreign patent. Failure to supply the name of the inventor will reduce the likelihood of a successful search; whenever possible, the title of the invention, the number and date of the foreign patent should be communicated to the Patent Office.

A register of patent attorneys is kept in the Patent Office, listing the names of all persons (except those Canadians who may be appointed representatives of foreigners not carrying on business in Canada) entitled to represent applicants for patents, or to act in respect of other business, before the Patent Office. Because of the frequent complexity of inventions, filing of applications is practically always done through the intermediary of a registered patent attorney, although the inventor himself will sometimes pursue his application. The examiners may be interviewed by the inventors or their agents about pending applications.

The application for a patent must be done in the name of the original inventor, unless the applicant can show that he has acquired title to the invention or that the inventor had been hired for the purpose of discovering new inventions. As you are well aware, this area is often the source of disputes and litigation in the absence of employment arrangements not providing for the automatic assignment to the employer of all patentable inventions discovered by an employee in the course of his employment; this is especially true at the level of smaller firms where no well defined Research and Development Department exists.

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Applications for patents can be made in the case of an invention that was:

(a) Not known or used by any other person before the inventor discovered it.

(b) Not described in any Canadian or foreign publication more than two years before the application is made.

(c) Not in public use or on sale in Canada for more than two years prior to his application in Canada.

A patent application filed in Canada for an invention for which an application has previously been made in any other country can only succeed in Canada where no patent therefore has been issued to the inventor or his legal representative, in any other country or, if a patent was so issued, where the application in Canada is filed within twelve months after the earliest filing, in any other country. If the inventor or his legal representative is entitled to protection under the terms of a treaty relating to patents to which Canada is a party, or if such earlier filing has been made in a country which grants similar privileges to Canadian citizens, the Canadian application, if made within twelve months from the earliest filing date in any other such country, will have the same force and effect as if it would have been made on such earliest filing date.

Letters Patent

The granting of Letters Patent gives to the patentee the exclusive right, privilege and liberty of making, constructing, using and vending to others, to be used, the corresponding invention. The patent will be valid for 17 years from its date of issue. To the extent that the patent is not disclaimed, for instance, pursuant to an inadvertent misdescription of the invention, the patentee has, in the same manner as the inventor could before the issuance of the patent transfer the rights in his invention, the legal right to assign, in part or in whole, its patent; such assignment, when it relates to use in Canada, must be registered in the Patent Office, failing which it would be superseded by the valid registration of a subsequent assignment.

The Act provided for legal proceedings in the event of infringement; the action can be taken in a provincial court having jurisdiction or before the Federal Court and may

conclude for damages. Injunctive relief can also be granted. On the other hand, the Attorney General of Canada or any interested person, even in a defense, may seek the invalidation of a patent or of some specific claims contained in a patent.

In addition, the Attorney General or any interested person may, after a patent has been issued for three years, ask that an obligatory license be granted or even that the patent be revoked (under reserve, however, of any treaty to which Canada is a party) if there has been an abuse of the exclusive rights granted thereunder. This would be the case, for instance, if the patent is not being worked within Canada on a commercial scale without any valid reason, if the patented article is not available in Canada in sufficient quantity without reasonable justification, if, by the refusal to grant a license on reasonable terms, the patentee causes prejudice to the trade or industry of Canada or if the unreasonable application of a patent relating to a process involving the use of materials prejudices in Canada, the manufacture, use or sale of any such material. It is to be noted that the Patent Act expressly states that patents are granted not only to encourage inventions but also to ensure that inventions will be worked to the extent possible on a commercial scale in Canada without undue delay.

Give Up Rights

In addition to cases of abuse of rights, a person may have to give up the exclusive rights to which he is entitled under the patent if the Government of Canada decides to use, after paying a reasonable compensation, the patented invention, unless the patent is assigned voluntarily by the patentee upon beng compensated. If such person is a Crown employee or civil servant, he must assign his invention or patent, as the case may be, to the Government who will compensate the inventor. Furthermore, applications relating to atomic energy will be sent for examination by the Commissioner of the Atomic Energy Board before the patentability of the invention can be ruled upon.

SPECIAL FEATURES OF THE CANADIAN PATENT LEGISLATION

In Canada, patentees are better protected than in the United States (except, perhaps, in the field of pharmaceutical products where, since the introduction in 1969 of section 41 (4), compulsory licences are practically granted for the asking). Many Americans have reasons to be pessimistic about the future of patents in the U.S. The courts have decided in the past 10 years against the validity of the patents in about 75 percent of the cases where patents were attacked. Essentially, there are three areas of differences in the field of licensing between Canada and the United States.

1. Misuse of Patents

We have seen above various circumstances under which the exclusive rights granted under a patent may be abused and the sanctions which may be applied under the Patent Act.

In addition to such remedies as set forth in the Patent Act, Article 29 of the Combines Investigation Act (Revised Statutes of Canada, 1970, C. 23) provides that in any case where use has been made of one or more patents so as to, *inter alia*, unduly limit the facilities for producing or manufacturing any article or commodity (but not services), unduly restrain or injure trade or commerce or unduly lessen competition, the Federal Court, (previously known as the Exchequer Court of Canada) on an application made by the Attorney General of Canada, may, for instance, declare void any licence relating to such use, direct the grant of licenses or even revoke such patents (consideration being given, however, to any treaty which Canada may have).

In Canada, it can be said therefore that abuses of patents are governed by the Patent Act whereas offenses involving patents but actually relating to practices aimed at restraining trade are dealt with under the Combines Investigation Act. The courts in Canada, unlike their American counterparts, have not been obliged to develop a doctrine of misuse of patents. More than 30 years ago, the Supreme Court of Canada, in the case of *Philco Products Ltd. et al vs Thermionics Ltd. et al.*(1940 S.C.R. 501) rendered a judgment on an action for infringement. The Plaintiffs were three radio companies which had formed a fourth one, Thermionics, to hold their patents. The defendant alleged that Thermionics' rights resulted from a combine (that is, a combination which is to the detriment of the public and restrains or injures trade or commerce) and could not, therefore, be relied on. It was held that such allegations could not be opposed to an action for infringement. A similar decision was rendered in January 1973 by the Federal Court of Canada in the case of *R.B.M. Equipment Limited vs Philips Electronics Industries Limited* (1973) F.C. 103.

However, it is conceded that, under certain circumstances, a plaintiff could face some difficulties should he have to reveal that the rights on which his claim is based, does in fact result from an illegal combine, as a crime can never be the source of any rights.

2. The Licensee cannot attack the patent while the license lasts

It is a well established principle of law in Canada that the licensee cannot attack the validity of the patent while the license remains in effect. This principle has been recognized by the Supreme Court of Canada (See *Campbell vs Hopkins & Sons (Clerkenwell) Ltd.* (1933) 50 R.P.C. 213). Since the Law in Canada becomes modified pursuant to the intervention of Parliament rather than by the Supreme Court overruling its own prior decisions (which is exceptional because of its strong adherence to the "stare decisis" rule), we can say that Canada will not likely follow the American jurisprudential precedent of *Lear vs Atkins*, 395 U.S. 653 (1969).

A 1971 decision of the Superior Court of Quebec has confirmed this principle by deciding that the clause by which the licensee bound himself not to contest the patent of the licensor, was not against public order and should, therefore, be upheld *(Deering Milliken Research Corp. vs Louiseville Spinners Ltd.* 4 C.P.R. 2d 18).

3. Triple Damages

We do not have in Canada the notion of triple damages in the field of patents. The Patent Act and the Combines Investigation Act, in their present form, contain

specific remedies in the case of abuses of rights, such as the mandatory issuance of a license, the annulment of any agreement unduly interfering with trade and commerce and even the revocation of the patent, but these remedies do not include any provisions for damages. In October 1974, an Act to amend the Combines Investigation Act was presented for the second time before Parliament as Bill C-2. Bill C-2 introduced the notion of damages by amending Article 31 of the Patent Act to provide for the eventual recovery of damages by any person who has suffered a prejudice as a result of a conduct amounting to a breach of the Combines Investigation Act. The proposed amendment also stipulates that an additional amount may be allowed by the Court to compensate the plaintiff for the costs to him of any investigation made in connection with the matter and of the proceedings.

This bill has not, however, been adopted and the Combines Investigation Act, therefore, remains in its present outdated form.

COMPLIANCE WITH CANADIAN LAWS

Whenever the licensee and the licensor are in two different countries, it is necessary to ascertain that the agreement complies with the laws of the adoptive country for the purposes of the "Applicable Law" clause.

Exchange Controls

In many international licensing agreements, consideration is given to foreign exchange controls. In Canada, no such controls exist: the Canadian licensee can pay the royalties in any currency. If they are to be paid in a foreign currency, he will have no authorization to seek, nor formalities to comply with, before converting his Canadian dollars.

The question of the rate of exchange is, however, a different problem; normally, the agreement would state that the royalties earned in Canada, as a percentage of gross sales for example, will be converted in the licensor's currency at the current rate of exchange at the time of payment.

Foreign Investment Review Act

The Gray Report of 1972 which led to the formulation of the Foreign Investment Act, commonly known as FIRA, identified six possible categories of foreign investment which could be subjected to the screening process provided in FIRA. One such category which was not covered by FIRA, as adopted by the Canadian Parliament at the end of 1973, related to new licensing and franchising arrangements. However, Mr. A. Gillespie, the federal Minister of Industry, Trade and Commerce, has said publicly that the Agency charged with the application of FIRA, would collect information on licensing arrangements between Canadians and foreigners when relating to the use of technology. It is, therefore, possible that, in the future such licensing arrangements will come within the purview of FIRA.

However, judging by the difficulties which are still delaying the proclamation into force of the second part of FIRA, dealing with the creation of new businesses, as opposed to the part relating to take- overs (which became law on April 9, 1974), we can assume that the agency, being overwhelmed by more urgent problems than collecting information on licensing arrangements, will not make any intrusion in the field of licensing for some time to come, if ever.

FIRA cannot, nonetheless, be completely ignored by foreign licensors coming to Canada. Indeed, a close examination of this new act must be made each time a foreigner intends to take an interest in the licensee. In addition, a right entitling the foreign licensor, for instance, to receive shares of the licensee corporation in the event of a default by the latter may constitute a take-over of a Canadian business enterprise, and as such be reviewable by the Agency. If the licensor contemplates creating a corporation in Canada either to receive royalties or to work his patent through a joint venture with a Canadian, he may become subject to the review process set up under FIRA, once the second part is proclaimed into law.

Concept of Trade Restrictions

It is not unfrequent that the licensor will impose certain restrictions on the ability of the licensee or of the purchaser of a patented product to freely deal with such product. For instance, the licensee may be prevented from selling outside a certain geographical area or the purchaser of a patented product may be obliged to sell at a predetermined price.

Whereas these restrictions may be illegal per se in the United States, this is not so in Canada. More than 60 years ago, the then highest court in Canada, the Privy Council, decided in the case of *National Phonograph Company of Australia vs Menck* (1911 A.C. 336), on appeal from the High Court of Australia, that the patentee can, in virtue of the exclusive rights granted to him, sell a product conditional on certain restrictions which would be invalid in the case of the sale of an ordinary product. The price restrictions were, therefore, upheld. In 1964, the then Exchequer Court (now the Federal Court) reaffirmed this principle in the case of *Rhône-Poulenc vs Micro Chemicals* (1964 Ex. C.R. 819); an appeal of this decision was dismissed by the Supreme Court of Canada.

Two Systems

When foreigners intend to deal with Canadians, they must remember that the provisions of their contract, in Canada, may be governed under a civil law system or under a common law system; whereas the province of Quebec has adopted the former, the rest of Canada lives under the latter. In other words, it does not suffice to stipulate that Canadian law will apply to a particular licensing agreement but it must be stated under the legislation of which province, it is to be construed.

The civil law and the common law doctrines of restraint of trade are much more extensive than the definitions of the Combines Investigation Act, which provides minimum standards below which the courts cannot go. The Combines Investigation Act is essentially a criminal statute, subject to strict interpretation. The principles of public order, both in the civil law and the common law, need not be so narrowly construed. Hence, the courts could strike down agreements which do not violate the federal statutory law. The strict judicial interpretation of the charging

sections of the Combines Investigation Act with respect to trade restraint has more or less rendered the Act ineffective in this area. Bill C-2 seeks to reinforce the government powers to control "exclusive dealings" by facilitating the intervention of the Restrictive Trade Practices Commission.

The doctrine of restraint of trade in common law is a method used by the courts, in the absence of statutory provision, to supervise trade practices. Contracts in restraint of trade are prima facie illegal unless at the time the contract is made, the restraint is reasonable to protect the interest of both parties and is in no way injurious to the public interest. Case law indicates that various considerations apply when deciding upon the validity of a covenant in restraint of trade: (a) the nature of the contract, (b) the status of the parties to the contract, (c) the purpose of the contract, (d) the corresponding obligations under the contract. After having considered the general economy of the contract, the courts will examine the restrictions themselves: the limitations will be weighed on the basis of their duration, the territory and the nature of the production involved.

In the province of Quebec, which is a civil law jurisdiction, the courts, while also applying the test of reasonableness, will rely however more heavily on the public order concept. Generally speaking, the courts in Quebec will refuse their assistance not only if the agreement is likely to create a monopoly, but even if it merely restrains trade more than is reasonably necessary for the protection of the legitimate interests of the stipulator.

TAXATION

Federal Income Tax Act

Section 212 (1) (d) states in part that every nonresident person shall pay an income tax of 25 percent on every amount that a person resident in Canada pays or credits to him as, on account or in lieu of payment of, or in satisfaction of royalty, including any payment for the use of or for the right to use in Canada any property, invention, patent model, secret formula, and process. This tax is payable on the gross amounts paid or credited to the nonresident without deducting any expenses attributable to the earning of these amounts.

Note that the rate of 25 percent will become effective January 1, 1976; until then, the rate of 15 percent applies. However, the Government has publicly stated that the withholding rate of 15 percent will likely continue to apply when the payments are made to a person who is resident in a country with which Canada has or will have a tax treaty.

A payment made under a bona fide cost- sharing arrangement relating to research and development expenses in exchange for an interest in any property or thing of value which may result from the arrangement may not come into the ambit of section (212) (1) (d) and will, therefore, be exempt from taxation.

On the other hand, if, under certain circumstances, the licensor receives a lump-sum payment for the cancellation of a licensing agreement, it may be in the nature of a capital payment and, therefore, only half of any capital gain which may be realized will be subject to tax. Such payment must be made pursuant to a relinquishment of capital rights and not as compensation for loss of future royalty earning.

The Canadian licensee taxpayer, who does not withhold and remit to the Minister of Revenue the taxes owing by the nonresident licensor, becomes personally liable for same. For the nonresident licensor, withholding taxes on royalties may be an important factor to take into consideration, especially if he cannot obtain in the country where he is subject to taxation, a tax credit equivalent to the nonresident taxes paid in Canada.

Activity and Taxation

If the nonresident licensor, through technical assistance programs or otherwise, becomes so active in Canada that he becomes deemed to be carrying on business in Canada, he will become taxable as such on all income earned in Canada, including royalties paid to him.

Provincial Taxes

Provinces do not impose withholding taxes; generally speaking, therefore, royalty payments made to nonresidents will not be taxed under existing provincial taxation statutes.

International Tax Treaty

Canada has entered into some 17 tax agreements with other countries, 16 of which are currently in force. An agreement with Belgium was entered into in 1958, but it has never been proclaimed in force in Canada.

Nine of Canada's existing Tax Treaties expressly refer to the payment of royalties; most provide for the limitation of the rate of withholding tax on payment of royalties. In the case of the France-Canada Tax Convention, royalty proceeds are taxable in the state of the debtor.

Canada is currently renegotiating all its tax treaties and, in addition, negotiations are underway with certain countries with which Canada does not have at present a tax convention. To date, only two such new treaties have been signed; France is the first country to have entered into a tax convention under Canada's new series of tax agreements and Belgium became the second one a few weeks later, when a Convention for the Avoidance of Double Taxation and the Settlement of Other Matters with respect to Taxes on Income was signed on May 29,1975. However, these conventions will not enter into force before the date of exchange of instruments of ratification (a delay of 15 days after such date has been provided in the case of Belgium).

Whereas most provisions of these two new treaties have been inspired by the O.E.C.D. 1963 Draft Double Taxation Convention on Income and Capital, as amended in 1974, the Articles of the new Canada-France and Canada-Belgium Tax Conventions dealing with royalties depart from the O.E.C.D. model by providing that royalties may be taxed in both states, namely that of the licensor and that of the licensee; the royalties cannot, however, be taxed at a rate exceeding 10 percent of the gross amount of the royalties in the country of the licensor recipient.