ECC: Quest for Legitimacy

Exclusive License Agreements not altogether bad and may even be desirable, Commission seems to agree.

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On March 3, 1979, the long-awaited draft regulation of the Commission of the European Economic Community concerning a group exemption under Article 85 (3) of the Common Market Treaty for categories of patent license agreements was officially unveiled.[1] After some six years of preparation, the draft publication initiated a four-month period during which interested parties may submit comments. After such period, and assuming the Commission does not decide to withdraw or modify it, the proposed regulation will become final and provide a group exemption for exclusive patent license agreements which comply with its terms. Effective date is January 1, 1980.

This period for comments from the public and private sectors is required by the enabling act adopted by the EEC Council under which the Commission was granted authority to issue regulations for "group exemptions" from the EEC antitrust regulations to certain types of restrictive agreements.[2] In this case, however, the exercise seems somewhat akin to "guilding the lily" since the Commission has been bombarded with comments (mostly critical) from all sectors ever since its first unofficial draft of the proposed group exemption regulation for certain types of patent license agreements was leaked out in late 1973. One result of the intensive lobbying activities and spontaneously volunteered comments was that the original draft underwent some drastic revisions. A second draft became widely circulated in late 1977, and yet a third one in the second half of 1978. Thus, the officially published draft is at least a fourth version, and it would seem almost preposterous to speculate that the Commission staff might consider going to a fifth one. Thus, it would seem likely that this is it, and that the business community finally has new guidelines for patent license agreements that replace the long discredited and limited ones of the famous "Christmas Message" which the Commission issued on Christmas Eve, 1962.[3]

Whether this excrutiatingly long gestation period was worth it, remains to be seen. At least the Commission is now on record as being of the opinion that exclusive licensing practices are not altogether bad, and under some circumstances may even be desirable.

KEY FEATURES OF THE DRAFT REGULATION

The principal substantive provisions of the draft are contained in its first five articles.

ARTICLE 1

This article contains the most important part of the regulation. It provides for the temporary dispensation from prior notification to the Commission (as a condition for obtaining an exemption from a Treaty Article 85 (1) prohibition on restraints of competition) of patent license agreements containing exclusivity grants and corresponding export restrictions if they meet certain conditions specified in that and subsequent article of the regulation.

Paragraph 1, specifies that the dispensation consists of the Commission declaring by this regulation that Article 85 (1) of the Treaty shall not apply to patent license agreements qualifying under the regulation of Article 85 (3) of the Treaty for the granting of an exemption to any agreement which might otherwise be determined to be invalid under Article 85 (1).

Hence, the reason for referring to a "group exemption" since the regulation automatically applies to all agreements meeting its terms without the need for individual clearance from the Commission. The exemption period is tentatively set to run until December 31, 1989, after which it may be extended for further periods if still considered useful. The exemption limited to agreements between only two parties ("enterprises") the provisions of which apply only to those contracting parties or to enterprises "economically tied" to them.[4]

Paragraph 1 also contains six subparagraphs, each

1. Commission communication in Official Journal No. C 58, pages 11-18 (CCH *Common Market Reports*, Par. 10-118)
2. Regulation No. 19/65/EEC, Article 5.
3. In its March 3, 1979 communication the Commission officially announced it would withdraw those former guidelines which were published in the Official Journal, No. 139 of 24 December 1962 at page 2922/62.
4. The concept of being "economically tied" is defined in Article 11 of the proposed regulation by reference to the ability of one enterprise to "exercise a decisive influence on the other, directly or indirectly, with regard to the exploitation of a patent", including where both enterprises are so "influenced" by a third enterprise. although this concept includes the notion of corporate control by means of ownership of a controlling share of another company's voting stock, the definition appears to be much broader in scope, and therefore much more difficult to interpret for American lawyers. Indeed, it would seem that the concept is broad enough to cover also the exercise of a decisive influence by means of a contract, such as other license agreements in the case of a group of independent licensees of a common licensor who are all covered by similar licensing agreements.

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of which deals with a specific type of restrictive clause which, absent an Article 85 (3) exemption, would be considered incompatible with the rule of free competition stated in Article 85 (1) of the Treaty. In order they cover clauses providing for:

1. Noncompetition by a licensor in the *manufacture or use* of the patented product, or in the use (either directly or through others) of a patented process within the Common Market or any defined portion thereof (the licensed territory).

2. Noncompetition by a licensee in the *manufacture or use* of the patented product or in the use of the patented process outside the licensed territory.[5]

3. Noncompetition by licensor and by any other of this licensees in the *sale* of the patented product or the sale of a product made by a patented process within the licensed territory.

4. Noncompetition by a licensee directly in the *sale* of the patented product or of a product made by a patented process "within the defined portion of the Common Market which a licensor reserves for himself or in territories granted to other licensees".[6]

5. Tying arrangements obliging a licensee to obtain certain products or services from the licensor or a source designated by the licensor, for so long as such obligation is necessary to insure a technically perfect exploitation of the invention.[7]

6. Minimum royalties or minimum production volumes or minimum performance levels imposed on a licensee.[8]

Paragraph 2 sets forth pre-conditions for the applicability of the exemptions granted under paragraph 1, sub-paragraphs (3) and (4), exclusivity and corresponding export restriction clauses.

These pre-conditions are set forth in four subparagraphs, which, in order, provide:

a) That the party (whether licensor or licensee) whose "market" is to benefit from the protection of the export restriction imposed on the other party or on another licensee (in the case of a restriction accepted by a licensor) does not have annual sales (on a fully consolidated basis) exceeding 100 million units of account.[9] If this condition is met, the exemptions shall continue to apply for so long as that amount shall not be exceeded by more than 10% on a fully consolidated basis, in any two consecutive fiscal years.[10]

5. Perhaps noteworthy is the fact that unlike the case of such a restriction assumed by a licensor, the clause does not cover a situation in which the licensee would engage in such competitive actions "through others". Presumably this omission of indirect competition can be a little importance when the license agreement includes a clause prohibiting sublicensing or assignment, or partial transfers of the licensed rights (covered in Article 2 of the regulation) by the licensee. However, it would have been safer and less confusing if the regulation had applied identical language to both a licensor and a licensee situation.
6. It is important to note that with respect to sales of the products under license, the restriction can only apply on the licensee itself, and not on purchasers of the licensee. In the case of a sales restriction on a licensor the same distinction would seem to apply, except that the restriction can in such case also be applied on its other licensees (but not on purchasers of such licensees). Regarding the segment between quotation marks, one might wonder why the Commission chose such complex language when it would have been simpler and clearer to provide that the prohibition could apply to sales "outside the licensed territory." Does this raise the possibility that unless the licensor specifically spells out the areas of the Common Market it reserves to itself, such a flat export prohibition could be questionably outside the group exemption? What if the prohibition also covers areas outside the Common Market? Note that with respect to "territories granted to other licensees" no reference is made as to whether this is within or outside the Common Market. It would be helpful obviously if the Commission changed its formulation so as to avoid such uncertainty. However, the preamble to paragraph 2 of Article 1 of the regulation uses the terms "export restrictions outside the licensed territory" when referring to the language earlier quoted from paragraph 4 of Article 1, and therefore provides the intended meaning of that language.
7. In its first two unofficial drafts of 1976 and 1977 such tying clauses were considered allowable only if they involved "intermediate products" considered necessary to meet a quality-control requirement relating to the use by a licensee of a trademark or other form of identifying the licensed products with the licensor. The third unofficial draft of 1978 dropped the requirement of a quality control justification tied to the use of a trademark or other form of identification with the licensor in favor of justifying on the basis of "indispensability" for assuring a "technically satisfactory exploitation of the invention." The French official text of the published final draft uses the terms "exploitation techniquement irreprochable" (technically irreprochable exploitation), which would suggest a fairly narrow interpretation of this concession, since the need for purchasing supplies from the licensor or from suppliers designated by the licensor, would appear to rest on assuring "perfection" rather than just "satisfaction" in the quality of the licensed end product. To be noted also, is that such quality is now strictly based on technical performance and specifications, and not on outward appearances or other subjective forms of quality appreciation which could have been considered as appropriate for trademark-usage purposes. In the officially published draft the clause includes also the tying of services as well as of products. These would obviously be of a technical assistance nature. The concession for tying clauses appears to be further limited by Article 9 (4) of the official draft which provides that the Commission may withdraw in individual cases the benefit of the group exemption if a tying clause (though perhaps technically justified) results in foreclosing the licensee from obtaining products or services within the entire Common Market which are needed for the exploitation of the invention. Although stated that this is without prejudice to Article 1 (15) which allows a tying of supplies or services considered technically necessary, one might wonder how this can be reconciled in the event the technical justification results in an exclusive requirements contract arrangement, particularly when there are EEC sources for competitive products or services which arguably could be considered as technically "satisfactory".

   One might also speculate on the usefulness of this concession in the situations when licensors are required by the agreement to guarantee the adequate performance of the licensed products or processes, when such performances may depend essentially on the maintenance of consistency in the quality of certain supplies or components which requires a degree of technological sophistication which such licensors can only provide if they themselves supply those elements, or can control the suppliers thereof. Will the guarantee in such situations more readily justify the tying arrangement as being "indispensable," under this standard? One would expect it to be so, at least if the risk assumed by the licensors is sufficiently important and if the guarantee was a key factor in getting the license agreements concluded or approved.
8. In its first two unofficial drafts the Commission allowed such minimum royalty or performance requirements only in agreements giving the licensee the right to terminate such obligation, subject to giving up exclusivity, after five years, and annually thereafter. In the third and final versions this condition was dropped, but the right of a licensee to escape such obligation after five years, subject to giving up exclusivity, was included under Article 9 (3). Thus, if an agreement does not give such right of cancellation of minimum royalties in exchange for cancellation of exclusivity, the minimum royalty provision would not automatically preclude the agreement from qualifying for the group exemption, but in certain circumstances it could lead to the Commission later withdrawing such benefit.
9. On March 2, 1979, the E.U.A. was valued at U.S. dollars 1.35120. Thus, the critical level is reached if the benefiting party reaches annual sales on a consolidated, worldwide basis exceeding $135,000,000.
10. Since companies already approaching this volume of annual sales can expect to exceed this 10% margin over a relatively short period of time if their growth rate is reasonably healthy, it is obvious that they would have to keep in mind that their license agreements containing such sales exclusivity or corresponding export restriction clauses may not continue to benefit from the group exemption for the full duration of such contracts. Thus, the exemption could inadvertently bring such companies into legal jeopardy down the road if they lose track of their sales growth and continue to benefit from such restrictive clauses. The group exemption therefore could be of very temporary value and constitute a form of penalty on company growth, which appears to be a dubious goal from an economic policy

b) That the duration of the sales exclusivity and corresponding export restriction does not exceed the duration of the most recent patent existing at the date of execution of the agreement which duration may not be extended by subsequent agreements covering patent licenses for new applications or improvements of the patented subject matter covered in the original agreement.[11]

c) That the product covered by the patent license be allowed to be sold in the entire area of the Common Market by "commercial enterprises" which are *not* "economically tied" to the licensor or licensee.[12]

d) That the licensee or an enterprise "economically tied" to the licensee be the one actually producing the licensed products.[13]

It is to be noted here that such conditions no longer include the limitation on the size of the territory within the Common Market covered by such exclusivity and export restriction clauses, nor include a limitation with respect to exclusivity of manufacturing. Both types of limitations were contained in earlier drafts.[14]

standpoint. It certainly undermines the ideal of legal certainty which the Commission professes to be seeking by means of this regulation. The size-of-sales limitation is admittedly arbitrary, and expressive of the desire on the part of the Commission to assist small- and medium-sized enterprises over the large national or multinational ones, as it is clearly stated in the new portion of the preamble to the regulation which it added in the final published version for the first time. The Commission seems to have overlooked the fact that when small- or medium-sized enterprises are favored, it is with the expectation that they will some day become large enterprises. Thus, it seems inconsistent to grant the exemption when such an enterprise is still small enough, only to take it back when it becomes larger beyond an arbitrarily set limit. In view of the 10-year limit of the group exemption and the cancellation power retained under Article 9 of the regulation under individually analyzed circumstances, one might question the need for the Commission to set such an arbitrary and seemingly counter-productive size limitation.

11. It is not clear if "duration" of the patent is its statutory period or the duration of its validity which could be shorter. Since the regulation stresses the importance of the validity of the patent for other purposes (see Article 3, paragraph (4) (d)) the duration of the patent's validity would probably be also determinative within the present context.
12. Presumably, this would allow for establishment of distribution agreements for either the whole or parts of the EEC so long as the products involved can be effectively sold throughout the Common Market area by enterprises which are not economically tied (controlled by) the licensor. However, in the case of an exclusive distribution agreement the parties may risk being in violation of Treaty Article 85 (1) unless their agreement complies with the provisions of regulation No. 67/67 EEC (Official Journal No. 57, March 25, 1967 at p. 849/67) in order to benefit from the group exemption of certain categories of exclusive dealing agreements covered by that regulation.
13. In prior drafts the application of the group exemption was limited to the two principal parties, i.e. the licensor and the licensee. Only in the official final draft has it been made clear that it would also extend to enterprises "economically tied" to the parties. However, from the first draft onward, the Commission also provided for application of the group exemption in the case where the original licensee was granted specify authority to grant sublicenses. This is now covered under Article 10, paragraph (2) of the Draft Regulation. A "sub-licensee" would seem to constitute an "economically-tied" enterprise under the definition in Article 11 of the Draft Regulation.
14. The first two unofficial drafts contained such limitations. With respect to exclusivity of manufacturing, Article 9 paragraph (2) of the Draft Regulation now provides that the Commission may withdraw the benefit of the group exemption in individual cases of the agreement does not provide for the right of a licensor to terminate such exclusivity after five years (and annually thereafter) "should the licensee have failed to exploit a patent or have done so inadequately."
15. It may have been the intention of the Commission in rewriting its various drafts to organize the Draft Regulation so as to include under Article 1 those clauses which it considered normally to constitute violations of Treaty Article 85 (1), i.e. clearly invalid but still subject to a "rule of reason" type of justification

ARTICLE 2

This article lists in nine subparagraphs the types of patent licensing clauses which the Commission does not consider sufficiently anticompetitive to even require an exemption under Article 85 (3), and which therefore would not affect the exemption granted under Article 1 of the Draft Regulation when added to the clauses covered by that article in any license agreement otherwise meeting the requirements of the Draft Regulation.[15]

In order, these clauses cover:

1. Field-of-Use-Limitation. This type of limitation is only allowed in terms of restricting the manufacture of a patented product or the utilization of a patented process to one or more of the different technical applications of the invention comprised within the claim coverage of the patent. For this purpose, technical applications are considered "different" if the products related to any applications excluded by such a clause from the license agreement are materially different from the products covered by the license grant.[16]

2. Post-Termination Prohibition against continued exploitation of the patent by the former licensee if such patent is still in effect.

3. Prohibition against Sublicensing and against transfer or assignment of the license.

4. Patent Marking Requirement which obliges the licensee to make a reference to the owner of the patent, the licensed patent or the license agreement on the licensed products.

5. Maintenance of Confidentiality Obligation to assure the protection of licensor's secret processes or secret know-how relative to industrial technology, which obligation may extend beyond the term of the license agreement.[17]

6. Patent Infringement Notification which a

for an exemption qualification. On the other hand, it appears to have grouped under Article 2 of the Draft Regulation those clauses which it considers as not involving Treaty Article 85 (1) violations, and which would therefore probably qualify for a "Negative Clearance" under the notification procedures covered by Council Regulation 17 (Official Journal No. 13, February 21, 1962). On this basis one could consider each of the clauses grouped under Article 3 of the Draft Regulation as constituting a sort of "per se" violation of Treaty Article 85 (1) in the eyes of the Commission, which therefore might not easily, if ever, qualify for an exemption by the Commission under Treaty Article 85 (3).

16. From the beginning the Commission appears to have been unwilling to allow fields-of-use limitations other than based on the narrowest possible technical grounds. In its first draft it considered tolerating only a limitation which the licensor could prove necessary due to his licensee not being "technically equipped to exploit the patent properly in the excluded fields of application." In subsequent drafts down to the present Draft Regulation the Commission has been willing to relax this stringent (and somewhat unrealistic) position only to the limited extent of distinct fields of application encompassed within the four corners of the patent claims involved. Furthermore, such distinctiveness, to be recognized as sufficient, must result in the manufacture of products under the license which are "materially different" from those not covered by the license grant, whatever that means. Mere cosmetic differences would not seem to be enough. Beyond that it may be difficult to predict what will be considered sufficient.
17. This clause is limited explicitly to technical secrets, and one might question why the Commission did not see fit to also in-

licensee may be required to give to the licensor wherever such infringement comes to the licensee's knowledge, and which may be accompanied by an obligation on the licensee to institute a patent infringement action, or to assist the licensor in such an action against the infringer. However, such a clause may not prejudice licensee's right to contest the validity of the licensed patent.

7. Compliance with Quality Standards established by the licensor, including licensor's right to inspect and verify such compliance.[18]

8. Grant-Back Obligations, which may require that the licensee share with his licensor all experiences acquired in exploiting the licensed invention, and to grant the licensor *nonexclusive* licenses on any inventions made by the licensee covering improvements or new applications of the licensed invention, provided that the licensor is subject to a similar obligation toward the licensee.[19]

9. Most-Favored Licensee Treatment, which impose on licensor the obligation to grant the licensee, after the conclusion of the license agreement, any more favorable licensing conditions subsequently extended by licensor to another enterprise.[20]

Paragraph 2 was added in the Draft Regulation to clarify that in case any of the clauses enumerated in paragraph 1 of this article were to be considered as falling under the prohibition of Article 85 (1) of the Treaty against restraints of trade, the benefit of the exemption granted under paragraph 1 of Article 1 of the Draft Regulation would apply even in the absence from the license agreement of any of the clauses mentioned in said Article 1. Thus, there is a very clear indication here that the Commission considers these Article 2 clauses as permissible provisions in any patent license agreement, whether or not any exclusivity clauses are involved.

ARTICLE 3

This article contains a listing of 14 clauses which the Commission considers to be sufficiently problematic in their anticompetitive tendencies to be classified as unacceptable for purposes of the agreement qualifying for the exemption. Any patent license agreement which would contain one or more of these black listed clauses would not only be excluded from coverage under the group-exemption regulation, but would be suspect enough to warrant at least a separate notification to the Commission if the parties believe they can come up with a sufficient justification to request an individual Article 85 (3) exemption declaration from the Commission. The likelihood of getting Commission approval would however be very small since the listing of the clauses under the Article 3 ban of the Draft Regulation constitutes a very strong expression of the Commission's consistently maintained dislike of such clauses.[21] Thus, the following clauses could be practically considered as constituting per se violations of the EEC antitrust rules, and should therefore be avoided in EEC licensing agreements if the parties want to play it safe and to enter into enforceable contracts. An alternative, of course, would be to notify the agreement to the Commission and seek an appropriate exemption or clearance before the agreement is put into effect.

In order, the prohibited clauses consist of:

1. Prohibition to Contest Validity imposed on the licensee with respect to any licensed patent or other exclusive rights of the licensor or of any enterprise economically tied to the licensor.[22] However, the licensor may reserve the right to cancel the agreement in the

clude trade secrets which are of a non-technical nature. Conceivably, this might be a reflection of the great disparity under the national laws of the various Member States, with respect to the legal recognition and protection given to such types of secrets. Since U.S. lawyers would have a tendency to draft their "confidentiality clauses" broadly so as to include technical as well as trade secrets, it would have been helpful to their clients if the Commission could somehow have confirmed that the addition of trade secrets would not constitute a problem as far as qualifying the agreement for the Article 1 exemptions.

18. In its first two drafts the Commission limited the right of inspection to cases in which the licensee was also using the trademarks of the licensor, or the licensed products were identifiable with the licensor in some other way. This was dropped in the subsequent drafts along with the requirement that quality control specifications had to also be predicated on such involvement of the licensor's "goodwill."

19. In its first draft the Commission also required that the licensor have the right to grant sublicenses to its other licensees with respect to such licensee-developed inventions. Since this was subsequently dropped, it would seem that the licensee might now be able to impose under the license agreement an obligation on the licensor not to grant sublicenses, without the consent of such licensee to other licensees. In view of the reciprocity concept included under this provision, this would be fully justifiable where the licensor applies a like restriction on the licensee against sublicensing to third parties. What is less clear is whether the clause would still be acceptable if the licensor withheld the right to sublicense from the license grant, but obtained such right to sublicense under the license grant-back. Since other licensees can be considered under the Draft Regulation definition in Article 11 as "economically tied" to the licensor it would seem plausible to argue that such a result is correct.

20. In the prior drafts the Commission included this type of clause under the list of "exempted clauses." Presumably the Commission concluded that such a clause would not have anticompetitive effects. It could be argued however that such a clause might prevent a licensor from signing up new licensees if he could not do so without giving up certain economic benefits under an earlier agreement (the one benefiting from the group exemption) which might have been negotiated under quite different economic circumstances. The clasue is also not limited to the Common Market, so that more favorable license terms extracted from the licensor under less than free bargaining conditions prevailing in many developing nations' regulations on foreign technology transfers, could be looked to for purposes of applying this clause. In such situations licensors might want to avoid the inclusion of such a clause in their EEC license agreements.

21. In its original draft the Commission listed some 20 clauses. Some of these were subsequently combined or dropped. The clauses which were dropped from subsequent drafts included provisions for territorial restrictions on licensee's manufacturing activities within the licensed territory, concerning arbitration outside the Common Market, and obliging a licensee to use the trademarks of the licensor.

22. The reference to "other exclusive rights of the licensor" would obviously seem to apply to secret know-how. In that context one might wonder what the Commission might do with respect to a clause in the agreement (fairly typically used in U.S. licensing practice) under which the licensee recognizes that the know-how conveyed by licensor was previously known to licensee, is considered by licensee to constitute valuable information which it does not believe to be in the public domain, and that in the absence of such know-how being conveyed by licensor, the licensee would not have been in a position to independently engage in the types of activities covered by the license agreement? Conceivably, this would make it difficult on the licensor later on to claim that the know-how was in fact not new or secret, if a subjective test were to be applied in any contest between the licensor and the licensee. On the other hand, the Commission, or the EEC courts could well apply an objective test, in which case such a clause would not appear to be of great effect, and therefore not objectionable as such, provided of course that the statement was included in the agreement in good faith.

event that licensee undertakes such contest, but may not impose any other measures or sanctions on the licensee that would tend to discourage the licensee from contesting the patent's validity since these will be considered as equivalent to an outright prohibition.

2. Excessive Duration of License Agreement, if the term is to go beyond the life of the most recent patent existing at the time of its execution, *unless* either party has the right to terminate such license agreement at least on an annual basis after the expiration of the patent.[23] If the licensor has conveyed also secret know-how and processes, which the licensee intends to use beyond the life of the licensed patents, it may be alright, however, for the agreement to continue in effect with respect to certain permissible obligations of licensee with respect to such secret and unpatented technology.[24]

3. Noncompetition Covenants, under which either of the parties agrees not to compete with the other party, or with any of the latter's economically tied enterprises, or with any other licensees, whether in research and development, or with respect to manufacturing, use or sales activities, *except* to the extent allowed under the types of clauses described under Article 1, Paragraph 1, points 1 to 4 (exempted exclusivity and export restrictions provisions).[25]

4. Overbearing Royalty Payment Obligations which require that licensee pay royalties:

a) for products which are not fully or partially covered by the licensed patent, or made by a patented process, or in accordance with any know-how conveyed by the licensor;

b) even in case of invalidity of the patent;

c) after the expiration of the last patent covered by the license;

(d) after the manufacturing processes or other know-how conveyed to the licensee have entered into the public domain, provided such entry is not attributable to the licensee or an enterprise economically tied to the licensee.[26]

The foregoing does not prevent that the licensor impose an obligation on the licensee to continue to pay proportionately reduced royalties, in the event the license agreement continues, with respect to:

— portions of the patent which have not been invalidated;

— other patents;[27]

— or other manufacturing processes, or know-how conveyed to the licensee which have not entered the public domain.

5. Non-Apportionment of a royalty payment obligation whereby a licensee who has obtained a patent license grant combined with a trademark license grant is forced to continue to pay at the full royalty rate after the expiration or invalidation [28] of the licensed patent.

6. Quantitative Restrictions, which limit licensee's production or sales [29] volumes, or the volume of his operations using the licensed technology.

7. Price Fixing Provisions limiting the freedom of either or both parties with respect to prices, price components, rebates, or comprising any recommendations with regard thereto from one party to the other.[30]

23. It would seem therefore acceptable for such contracts to go on indefinitely, so long as both parties have the right to end the contract on one year's notice or less. Presumably, this could also be the case when the patent is determined to be invalid (see also discussion in footnote 28 *infra*) provided the annual termination provision is made applicable from the date of invalidation. Continuation in such cases could be justified on the ongoing interest of the parties on continuing know-how contributions and on improvement patents and the like (see Article 3 (4) and footnote 27, *infra*). However, the exclusivity provisions exempted under Article 1 would presumably be valid only for the duration of the most recent patent existing at the date the agreement was entered into. To be consistent with that provision (Article 1 (2) (b)) any continuation of the agreement on the year-to-year basis contemplated in the present clause, would appear to be subject to either party no longer being tied to the exclusivity obligations. A further question would then arise, as to whether the parties would at that point have to actively engage in competitive manufacturing or sales activities against each other, or if it is merely suffi ient that they would have the right to do so, without actually engaging in such activities? Would any de facto continuation of the exclusivity status constitute a "concerted practice" in violation of Treaty Article 85 (1) and not covered by the group exemption under the Draft Regulation? In this connection it is interesting to note that the first two drafts made specific reference to concerted practices as well as to agreements, whereas such reference was dropped in the later drafts.
24. See Draft Regulation Article 2.1 (5) *supra*, and Article 3 (10) *infra*.
25. The Draft Regulation's stand against allowing no-compete clauses in general is quite understandable in the light of the Commission's oft-repeated view that every licensee should be considered as an eventual effective competitor of the licensor and should be encouraged in that direction.
26. In view of the recent decision handed down by the U.S. Supreme Court in *Aronson v. Quick Point Pencil Co.* (Feb. 28, 1979), U.S. lawyers may have difficulty accepting the Commission's seemingly unfavorable attitude toward unpatented know-how which enters the public domain after the licensee has concluded his bargain with the licensor. It is clear however from the preamble to the Draft Regulation that the Commission has in mind only ancillary know-how related to the basic patent grant. It will probably be still a very long time before the Commission can be expected to issue clear guidelines with respect to know-how licenses as such and it is to be hoped the U.S. Supreme Court's *Quick Point Pencil* decision will stimulate the Commission toward taking a more favorable attitude toward such types of licenses.
27. The inclusion of "other patents" was made only in the final published version of the Draft Regulation. It would appear that here again, subject to the limitation on the duration of the exclusivity rights under Article 1 (2) (b), and subject to the annual termination option after the expiration (or invalidation) of the last patent existing at the date the agreement was executed, such an agreement could be allowed to have an indefinite duration, particularly if this allowed the licensee to use patented improvements, albeit on a nonexclusive basis. Under a more restricted interpretation, however, it might be argued that "other patents" is limited to other patents in existence at the date of agreement which patents have not become invalidated.
28. Unlike the situation with respect to Article 3, paragraph (2) of the Draft Regulation (see also the discussion in footnote 23, *supra*) the Commission made it clear here that the invalidation of the patent would be considered the same as and therefore coextensive with the "expiration" of the patent. Since the Commission only added the words "or invalidation" only in its latest published draft, but did not add them in the other places where the Draft Regulation makes reference to patent "expiration" only, does this mean that in those other situations the invalidation of the patent has no application? This would seem surprising, and may therefore be considered as drafting oversights. Correction of such oversights, if indeed that is what they are, before the final draft becomes effective as a final regulation, would remove this area of speculation and be a desirable improvement.
29. The reference to "sales" was added only in the published Draft Regulation, and appears to close an unintended loophole that was probably inadvertantly overlooked in prior drafts.
30. The first and second drafts also included references to "other terms of sale". Their omission from the third and final drafts would appear to constitute a surprising concession. On the other hand the wording may be unduly broad in that it could also be construed to apply to price provisions with respect to supplies which the licensee might purchase from the licensor or firm

8. Field-of-Sale Limitations imposed on either or both of the parties concerning their use of the licensed products which go beyond the scope of the patent claims, such as with regard to how and to whom they are to be sold,[31] but without prejudice to the application of Article 1, point (1) to (4) of the Regulation (exempted exclusivity and export restrictions).

9. Trademark and Tradename Restrictions, which prohibit the use by the licensee of his own trademark, trade name or package dress, and the like. This does not prevent licensor from requiring the use of product markings in accordance with Article 2.1. (4) of the Regulation, nor from requiring that licensee make the required use for the maintenance of licensor's trademark.[32]

10. Post-Termination Prohibition on Continued Use of Secret Know-how by licensee, without prejudice, however on licensor's right to impose on licensee an obligation to continue to pay royalties for such continued use, subject to such know-how not having entered into the public domain (see Article 3, point 4 (d)), and only for a reasonable length of time.[33]

11. Field-of-use Restrictions for secret know-how communicated to licensee, including secret manufacturing processes, without prejudice, however, to licensor's right to claim a proportionately higher royalty rate to cover any uses by licensee of such secret information for purposes other than those intended by the license agreement and which are not covered by patents of the licensor.[34]

12. Assignment Obligation requiring licensee to

enterprises economically tied to licensor. Is this what the Commission intended?

31. In its first draft the Commission was aiming at "any restriction on other undertakings or consumers preventing them from obtaining the licensed products within the Common Market or from selling them". In its second and third drafts it changed the focus of this clause from resale restrictions to "restrictions on one or both parties concerning the use of the products manufactured under license for applications going beyond the patent claims". This appeared to shift the emphasis from sales or purchase limitations imposed on third parties, to field-of-use limitations imposed on the contracting parties themselves. In its final Draft Regulation the Commission retained the emphasis on use limitations on the parties going beyond the patent claims, but added, significantly, the explanatory language about how and to whom the licensed products were to be sold (the official French version refers to the "means for their commercialization"). This would seem to focus the prohibition on so-called field-of-sale limitations, rather than field-of-use limitations. Nevertheless, by using this somewhat confusing approach, the Commission may have wanted to avoid interpretation of this clause that would have limited its application strictly to marketing arrangements and restrictions (as was clearly the context of the original draft version) in order to retain flexibility for applying it also to technical field-of-use limitations which cover product applications not falling within the scope of the patent claims. This would therefore seem to further limit the scope of the allowed technical field-of-use limitations covered under Article 2 (1), which only cover limitations in the manufacture of the licensed product, or in the use of a patented process. Therefore, once the product under license has been manufactured, the proposed group exemption would not seem helpful regarding any contractual provisions on the further disposition of such products.

32. In its three prior drafts the Commission consistently sought to ban a provision in patented license agreements that would impose on the licensee the obligation to use a specific trademark, trade name or get-up for the licensed products. In its final Draft Regulation the Commission changed its position considerably (no doubt as a result of the strong criticism which industrial and professional groups have raised against such ban) by shifting to a ban on provisions that simply would prevent licensees from using their own trademarks, trade names or "getups". Article 2 (4) of the Draft Regulation allows obligations on the licensee to mark the products made under the patent license with an indication of the patentee's "name", the "patent", or the "licensing agreement". This does not include a "trademark", although it is quite conceivable that the patentee's "name" could consist of, or include a trademark. It certainly would cover a tradename (i.e. "business name"). The Commission's reluctance to support a licensor's trademark interests, which often represent a very important investment which licensees are eager to tap for their own benefit (witness the current "Franchising Boom" in Europe), is also reflected in the cautious statement at the end of this clause (9). Indeed the Commission only ventures to recognize obligations on the licensee "to make such use of the licensor's trademark as is necessary to preserve its validity". Since trademark registrations, unlike patents, are not subject to annual maintenance fee payments and minimum "working" requirements, it is difficult to understand what the Commission's concession amounts to. Also, the Commission appears to have missed the distinctive values of trademarks as marketing tools and as promoters of customer interest in the products involved. These values are not created by minimal use, but rather by maximum use and exposure of the trademarks in the marketplace. Where a licensee is given exclusivity for a market, it is difficult to see how the licensor's trademark and "customer goodwill" investments can be maintained, let alone improved, unless the licensee accepts to continue to use licensor's trademark. It would seen therefore that the Commission has been applying patent concepts to trademarks when it formulated this clause. In any event, an obligation in a patent license agreement for the licensee to use trademarks of the licensor would no longer appear to be prohibited under the Draft Regulation, so long as it does not prevent the licensee to also use its own trademarks.

33. The previous drafts provided for a maximum period of three years following the expiration of the agreement. The substitution in the final draft regulation of a standard of reasonableness for the fixed maximum period of time would appear to be conceding that under appropriate circumstances, the continued payment of royalties related to such know-how could extend beyond three years, provided the know-how continues to be secret. The reference to Article 3 (4) (d) might however suggest that in such cases the royalty rate may also have to be reduced if the patent to which such know-how relates is no longer in effect, or if part (but not all) of such know-how has become publicly available. In the preamble to the Draft Regulation the Commission expresses the view that it is unacceptable for a licensee to be obligated to continue to pay license fees for secret know-how after it has entered into the public domain "since the licensee is thereby placed at a disadvantage in relation to competitors". If that is the test for determining the reasonable duration of ongoing royalty payments, one could conceivably go as long as such know-how remains secret and is used by the licensee, even after the agreement has long ended. It would also appear plausible to argue that the right to unilaterally stop royalty payments for secret know-how after it becomes part of the "public domain" should be also predicated on the licensee being able to show that his competitors are actually using the same knowledge. Otherwise, how can it be contended that the licensee is "at a disadvantage in relation to competitiors"? Indeed, the information or knowledge involved may be available "publicly" only in a very diffused or abstract manner, or may not be readily assimilated without technical assistance, or important expenditures or investments of the kind which the licensor has had to perfect or absorb over considerable length of time. Presumably, the Commission might be willing to recognize these arguments in individual cases, submitted to it through the normal notification procedures under regulation 17. However, for purposes of the group exemption draft, the concept of what is in the public domain may be very broadly applied in favor of licensees having the earliest possible excuse to stop such ongoing obligations.

34. In prior drafts the concession to licensor for asking a higher royalty rate was limited to licensee's use of such know-how for other purposes than those intended under the patent license agreement, without however this further limitation that such other purposes must not be covered by patents of the licensor. There is no limit in the preamble of the Draft Regulation as to why this wording was added. This further limitation does not specify which patents are considered, so presumably it should be interpreted to apply to any other patents of the licensor besides those covered by the license agreement. If so, however one might question why licensor should be precluded from demanding a higher royalty for the know-how applied to such other patented areas, since this would obviously result in the license having an implied license (without further royalty payment) under such other patents consistent within the purposes for which know-how may be used.

transfer to licensor his rights to or under any patents covering improvements or new applications derived by the licensee from the licensed patent.

13. Extraterritorial Extension of Patent Monopoly, whereby licensor seeks to impose any hindrance on the manufacture, use or sale of the licensed products in areas of the Common Market wherein licensor, or any enterprise economically tied to licensor does not hold a corresponding patent.[35]

14. Patent Tying whereby the licensor subjects the licensing of one or more patents to licensee's acceptance of other licenses which he does not desire.

ARTICLE 4 — ARBITRATION CLAUSES

Whereas in previous drafts the subject of arbitration was dealt with either as an exempted or permissible li ensing provision subject to meeting certain strict and elaborate conditions which varied considerably from draft to draft,[36] the Commission wound up covering arbitration in a separate and rather succinct article.

In doing so it took also a much more resigned or lenient attitude toward such arbitration clauses, since it now no longer appears to care how, where or by whom arbitration decisions are rendered, and only requires that such decisions be communicated to the Commission by the parties without delay, together with a copy of their license agreement, but only if the arbitration tribunal involved itself with the interpretation or application of one of the provisions or measures covered by Article 1 (exempted clauses regarding exclusivity, export restrictions, tying of needed products or services, minimum royalties or performance levels, and the related conditions therefor) or by Article 3 (prohibited provisions or measures).[37]

OTHER PROVISIONS OF INTEREST

Although the first four articles of the Draft Regulation contain its most pertinent operative provisions, it may be of interest to briefly note also the following additional features:

— The group exemption will not apply to license agreements involving patent pools, joint ventures between competing enterprises, reciprocal agreements between parties wishing to cooperate in respect of patents, trademarks, secret manufacturing processes or other secret know-how; or where one of the parties is granted distribution rights over protected products (Article 5).

— The group exemption also applies to license agreements based on pending or registered utility models; or pending or issued "certificates of utility" or "certificates of addition" under French law; as well as to license agreeements in which the licensor is not the patentee but has been authorized by the patentee to grant such licenses (Article 10).

— The group exemption also applies to outright assignments of patents or rights to patents, if the consideration to be paid therefor is based on the volume of sales of the patented product by the assignee or on the volume of production or the number of operations involving the patented invention (Article 12).

Finally, it should be noted especially that the group exemption can be withdrawn on a case-by-case basis if the Commission finds pursuant to Article 7 of regulation No. 19/65/EEC,[38] that the beneficial conditions justifying an Article 85 (3) exemption are no longer prevailing in the case under consideration, and particularly in the following situations (Article 9):

— When there are grounds for suspecting that the products covered by the license agreement are not subject to competition within the licensed territory from products which the consumers consider to be similar in nature, intended use, and price.

— The license agreement fails to provide for licensor's right to cancel the exclusivity of manufacture or use for failure of licensee to exploit the licensed patent, or to do so adequately, after a maximum period of five years from the date of its execution, and at least yearly thereafter.[39]

— The license agreement fails to provide for licensee's right to terminate, by means of giving up his exclusivity, his obligation to pay minimum royalties, or produce minimum quantities or to perform a minimum number of operations, at the end of a maximum period of five years from the date of execution of the agreement, and at least yearly thereafter.[40]

35. This clause seems somewhat inconsistent with Article 1, paragraphs (1)-(4) of the Draft Regulation, and the Commission's omission to make a specific exception with reference to those Article 1 provisions, makes it difficult to interpret the scope of this prohibition. In the Preamble the Commission does appear to allow for such exception, however, when commenting generally about Article 3, points 3, 7 and 13. Nevertheless, a specific reference in the context of this clause would have been useful.
36. The first draft went as far as prohibiting any arbitration proceedings outside the Common Market. The second draft required that the arbitrators set forth the grounds for their award, and that such award be notified to the Commission, together with a copy of the license agreement, before the award was to take effect, or any surety was deposited toward the enforcement of such award. The third draft limited the notification obligation to a prompt communication of the award but only if it dealt with any of the exemptions or prohibitions of the regulation, together with a copy of the license agreement. This far more liberal approach was retained in the final Draft Regulation.
37. One might ask what would be the penalty for failure to communicate to the Commission such an award, or for doing so after too much delay. The answer appears to be provided by Article 9 (5) of the Draft Regulation which gives the Commission the right to withdraw the benefit of the group exemption in such cases, and when the award communicated to the Commission fails to set forth the reasons on which it is based. Just how heavy-handed the Commission will be in pulling this claim, remains to be seen, but it would seem likely that so long as the award does not offend the public interest (and the Commission's sensibilities) with respect to the application of the policies comprised by the group exemption, that the Commission would be quite lenient. In the opposite situation, where the award is disputed by the Commission, it is to be seen whether the Commission would go as withdrawing the exemption retroactively, or merely prospectively. Furthermore, the losing party is an arbitration situation would have a ready way to fight the ward by notifying it to the Commission if there were some arguable grounds for claiming that the arbitrators did not properly interpret or apply the provisions of the group exemption regulation. In some cases an advantageous result might even be obtained by such losing party if the award was not communicated promptly, and the winning party was not aware of this requirement, a situation that could conceivably occur readily when arbitration takes place outside the Common Market.
38. See footnote (2), supra.
39. This situation could be easily avoided by proper draftsmanship when the license agreement is prepared. This paragraph therefore provides a strong justification and incentive for a licensor insisting on the inclusion of such a provision in the agreement when negotiating exclusivity rights and obligations with the prospective licensees in the EEC.
40. The comment made in footnote 39, supra, would also apply here

—When either party to the license agreement is prevented from procuring from within the Common Market products or services for the exploitation of the invention, except to the extent allowed by Article 1 (1) (5) of the regulation (exempted tying provision).
—When there is a default with respect to the provisions of Article 4 (arbitration), or the arbitral decision involved does not set forth the reasons on which it is based.[41]

In view of the need of certainty in applying EEC antitrust regulations and policies to the complex business of technology transfers to, from and within the Common Market, the Draft Regulation appears to make a significant contribution. As shown in the footnoted comments, the Draft Regulation does raise some new questions and uncertainties in some areas, while providing answers and helpful guidelines in others.

in favor of the licensees insisting on the inclusion of such a provision in their agreement negotiations.
41. See discussion in footnote (37), supra.

The main problem with it is that its application may be too limited by excluding many agreements between parties whose size are considered too big by the Commission, and by excluding agreements which are predominantly based on unpatented know-how, or on an important trademark.

On balance, however, it is useful in the most commonly recurring areas of license agreement drafting. It is an improvement over the Christmas Message. Most of all, it recognizes the importance of patent licensing to economic progress, even where this involves exclusivity provisions and related export limitations. If the Draft Regulation should be withdrawn, it will have at least contributed this expression of legitimacy for certain types of restrictive provisions which under U.S. practice have since long been accepted under the "Rule of Reason."

COMMENTS OF THE LICENSING EXECUTIVES SOCIETY INTERNATIONAL

The Licensing Executives Society International is a body representative of a number of societies throughout the world. Our individual societies in the Common Market have been closely following the changes made in the first, second and third Preliminary Drafts. These societies have made representations to their Member Governments on the various Drafts and will no doubt make further representations on the Formal Draft before the further meeting of the Advisory Committee on Restrictive Trade Practices and Dominant Positions, which meeting is required by Regulation 19/65.

We cannot say that the viewpoint of all our member societies is identical and will not in this memorandum attempt an exhaustive analysis of the Formal Draft. We will only comment on certain points which we think are of major importance.

We are glad to see that the production of the various Drafts has indicated a progressive realization by the Commission that the very restrictive attitude expressed in the first Preliminary Draft is unsuitable if the Block Exemption Regulation is to serve its intended purpose. However, while we think that the Formal Draft is a considerable improvement, significant further changes appear to be desirable.

The intended purpose of the proposed Regulation is to exempt from notification a significant number of otherwise notifiable Agreements. Because of uncertainty as to the Commission's interpretation of Article 85, companies have been led to believe that certain practices dealt with in the Regulation did not raise any problems. Our opinion is that a Regulation along the lines of the present Draft will call for the notification of many Agreements which, at the present, the parties believe in good faith do not require notification. This will either mean that the parties will ignore the Regulation — a highly undesirable result — or the notification of more Agreements to the Commission than in the past.

Moreover we do not believe that the Commission is fulfilling its obligations as called for by Regulation 19/65. We quote from the preamble:

> WHEREAS in view of the large number of notifications lodged in pursuance of Regulation No. 17 it is advisable that the Commission is enabled, in order to facilitate its task, to declare by way of a Regulation that the provisions of Article 85(1) are inapplicable to certain categories of agreements and of concerted practices.

Since we conclude that a Regulation in terms of the present Draft will not exempt a large proportion of notifiable Agreements from notification under the provisions of Regulation 17 of 1962, we regard the Draft as unacceptable and as being unsupported by Regulation 19 of 1965.

KNOW-HOW

We make the above observations with particular reference to paragraphs 10 and 11 of Article 3. It is our experience that the great majority of Patent License Agreements are combined with license to use know-how. We agree with the statement in the preamble to the Draft Regulation:

> "in practice Patent Licence Agreements with such ancillary provisions are very frequent"

Article 3 paragraph 10 deals with the licensor's right to control the use of know-how after the expiry of the Agreement. Article 3 paragraph 11 deals with the licensor's right to impose a field-of-use restriction with respect to ancillary know-how.

We see no reason why the Regulation should impose any restriction on the Patentee's rights to prevent the licensee using the know-how after the expiry of the Agreement. We think this provision may be counterproductive in the sense that it may inhibit the licensor from communicating know-how to the licensee toward the end of a Patent License Agreement which runs for a number of years. Similarly, we see no reason why a licensor cannot impose a field-of-use restriction in respect of communicated know-how. The licensor may well have know-how which has uses in several fields. The effect of Article 3 paragraph 11 may well be to discourage him licensing such know-how if he cannot control the fields in which that know-how may be used. If a licensee wishes to use the know-how for purposes other than those connected with the patented invention, the parties should be free to negotiate a separate agreement in respect of other fields. As at presently worded Article 3 paragraph 11 provides that licensor must grant a license to the licensee for the use of that know-how in other fields. In other words, it is a form of compulsory licensing. This is probably undesirable when the licensor is a small company and the licensee is a large company. In our view it is undesirable that a Regulation dealing primarily with Patent Licenses should draw significant distinction with respect to know-how ancillary to that Patent License.

EXPORT BANS

The Commission's views on a Patentee's right to impose export bans on his licensee will impose radical departures from traditional licensing practices within the Common Market and may seriously inhibit licensing. It is therefore unfortunate that the Draft Regulation attempts to control export bans in Patent License Agreements, when the matter has not been considered in depth by the Court of Justice. Making the assumption, which we do not accept, that the Commission can control export bans in Patent License Agreements, we regret that the Draft grants exemption only in limited circumstances which will not benefit the very many companies which have only a small turnover in the relevant products and yet which form part of a large group having a total turnover in excess of the 100 million units of account referred to in Article 1.2(a).

A licensee's investment can often be better protected by sales exclusivity rather than by manufacturing exclusivity. Under the present proposed wording, a large company would hesitate to enter a new business by taking a license and consequently the transfer of technology would be hindered. Thus, the interests of individual inventors and small companies, needing a large company as a partner, are not helped. We think that any references to a restriction based on turnover should simply be retained in Article 9.

The Draft Regulation is also unclear with respect to export bans on licensees from selling from the EEC to outside the Common Market and the contrary situation with respect to licensees outside the EEC selling to within the Common Market. We believe that these are outside the scope of the Rome Treaty but this should be stated in the Regulation. There are references in the preamble to the undesirability of export bans in intracommunity trade but these need more emphasis to make the limited scope of the Regulation in this respect more clear.

QUANTITY RESTRICTIONS

In the preamble to the Regulation the Commission states:

> Since the Commission considers that control over the marketing of a licensed product within the Common Market is not a matter that relates to the existence of the Patent, and since such control can be exercised indirectly by setting a maximum to the quantity of products the licensee may manufacture or market or to the number of operations for which he may employ the Patent, the benefit of this Regulation is for this reason alone not available for such an obligation (Article 3(6)).

A common form of licensing in a process industry is for a licensor to license the construction and operation of a plant which is capable of a certain limited production capacity. The amount of the royalty is fixed in the Agreement. We do not believe that this is objectionable. It is permissible in both Japanese and German Law. We therefore disagree with the present wording of Article 3b) and the passage in the preamble quoted above.

TRADEMARKS

The inclusion in the proposed Regulation of controls on the use of trademarks is undesirable. It would be much better if trademarks were dealt with in a separate Regulation. The proposed wording of Article 3(9) will lead to a situation where a licensor with a famous and important trademark cannot prevent the licensee using his own trademark with respect to the same goods. The use of double brand names of this nature raises an important point of principle which should not be dealt with in a Regulation directed to Patent License Agreements.

TRANSITIONAL PROVISIONS

The treatment of existing Agreements notified or not, is complicated but at the very best the parties have a period of three months from the date that the Regulation comes into force for modifying them to conform with the proposed Regulation.

We are aware that the Commission's freedom of action is limited because of the wording of Regulation 19/65. We are also aware that, in practice, a longer period may be effectively permitted.

Because of the way in which the Commission's policy has developed in this field and, in particular, since the Christmas Message of 1962 has never been withdrawn, there are thousands of Agreements in existence which have never been notified to the Commission because when the parties signed these Agreements they believed, in good faith, that no possible violation of Community Antitrust Law might arise. A period of three months or even six months is inadequate for the parties to modify their Agreements to comply with the proposed new Regulation. Moreover, we are concerned that one party to such a License Agreement may attempt to use the Regulation as an "excuse" for asking for modifications of the Agreement not arising out of the necessity to make it comform to the conditions of the proposed new Regulation. This is highly undesirable. We are unclear as to the best procedure of handling this difficulty. Adequate transitional provisions are required in respect of existing Agreements. The exact extent and form of these transitional provisions is difficult to envisage. One acceptable transitional measure might be an exemption for a period of, say, three years of all existing Patent License Agreements containing no restrictions on competition other than those stated to be permissible under the 1962 Christmas Message or otherwise exempted under the new Regulation, subject to the usual opportunity to review and withdraw the exemption in individual cases. A three-year period compares favorably with the time taken to introduce this Regulation and cannot be regarded as excessive.

CONCLUSION

As indicated at the beginning of this memorandum we support the Commission in attempting to clarify the law in this field and we are glad to see that the Formal Draft recognises that the very restrictive attitude expressed in the First Preliminary Draft is unsuitable if the Regulation is to serve its intended purpose. We hope that we shall be afforded an opportunity to explain our views to the Commission officials dealing with the subject at a mutually convenient meeting so that a Regulation can be arrived at which will benefit both industry and consumers. — MICHAEL BURNSIDE, CHAIRMAN, European Communities Committee, June 25, 1979.