

## EEC COMMISSION ON EXCLUSIVE PATENT LICENSES

by  
*Dr. Herman Kindeldey, Munich*

In two recent decisions the EEC Commission has expressed remarkable views on exclusive patent licenses.

One decision (Davidson Rubber Co.) dealt with an agreement under which a U.S. company had extended exclusive patent and know-how licenses to a number of European companies, each of the licenses being essentially limited to one or more EEC countries.

The technology involved is the most important process for making armrests for automobiles. The number of competing processes and of the manufacturers using the latter is limited. The Licensees have a substantial share of the EEC market in the particular goods involved.

In its decision the EEC Commission states that an exclusive patent license can fall under §85, paragraph 1 of the EEC Treaty and thus be prohibited because it puts an obligation on the Licensor not to extend licenses to competitors of the exclusive Licensee. The exclusion of the possibility of granting other licenses in itself, the Commission believes, can be a restraint of trade.

In the "Davidson Rubber" case the Commission ruled that the exclusive license agreement does fall under §85, paragraph 1 and thus is an anti-trust violation. The reason for this is that the involved technology is the most important technology in the field concerned with the number of competitors being limited and the Licensees having a substantial share of the market. This situation negatively affects the position of other producers of armrests and related automobile components because they cannot use the patented process. The license agreement therefore substantially limits the competition within the EEC.

In the particular case decided, the Commission granted permission under §85, paragraph 3 of the EEC Treaty by virtue of the fact that the agreements brought about economic progress which could not have been obtained without the limitations included in the agreements and because the consumers share in the profit generated by such economic progress.

The other decision (Raymond/Nagoya) concerns an agreement between a German-based company and a Japanese company. It provides for an exclusive patent and know-how license limited to Japan and other Far East countries. The Japanese Licensee is not permitted to export the licensed products into the EEC.

In this decision the Commission reiterates its position that an exclusive license can constitute an anti-trust violation solely because the Licensor assumes the obligation not to grant licenses to others. The Commission ruled, however, that in the case to be decided the exclusivity of the license did not affect trade in the EEC because it was highly improbable that European companies would buy the products involved — fasteners to be used in automobiles — in Japan.

The two decisions make it clear that exclusive patent and/or know-how licenses relating to a product or process with a strong position in the market and affecting trade in the EEC are liable to be regarded as an anti-trust violation by the EEC Commission. Because of the strict conditions provided for under §85, paragraph 3 of the EEC Treaty, granting of an exemption will be the exception rather than the rule.

The two recent decisions confirm the Commission's position first stated in the "Burroughs/Geha" case. In that case the Commission had already indicated that an exclusive patent license limited to one EEC country can violate §85; the agreement involved was not found to be an anti-trust violation, however, because the Licensee had only a minor share of the market and the Licensor had reserved the right for him and his Licensees in other EEC countries to export the licensed products into the exclusive Licensee's territory.

Another important aspect of the "Davidson Rubber" case is that the EEC Commission seems to consider those clauses in license agreements which compel the Licensee not to export to other EEC countries and which thus affect trade in the Common Market as illegal. Such clauses had been included in the license agreements involved, but were cancelled voluntarily after they were criticized by the Commission. If this should be verified in future decisions, it would be an important development of the law initiated in the "Deutsche Grammophon" decision by the European High Court. In the latter decision the Court had decided that it is an anti-trust violation to prevent the buyer of goods sold by the owner of a copyright related right in one European country to export these goods to another European country where a parallel copyright related right exists. It was generally felt that this also applied to patents so that a Licensee could not prevent his customers from exporting the licensed products to other European countries in which parallel patents exist, but it was still hoped that it would be possible to put an obligation on the Licensee himself not to export the licensed products directly to another country covered by a patent corresponding to the one under which he is licensed. The EEC Commission may, however, strongly object to this.

Clauses of the following type were found to be acceptable by the Commission:

- A. An obligation on the part of the Licensee not to grant sublicenses without the consent of the Licensor.
- B. An obligation on the part of the Licensee to grant back to the Licensor licenses under improvements or further developments of the licensed product or process as long as such grant-back licenses are non-exclusive.
- C. Quality control by the Licensor.
- D. An obligation on both parties to a license agreement to exchange information on all improvements or developments of the licensed product or process.
- E. Arbitration clause.

The above-outlined position of the EEC Commission on exclusive licenses has not yet been endorsed

by the European High Court. The tendency felt in prior High Court decisions makes it probable, however, that the Court will share the Commission's views.

It may very well be that in the future the decision in many cases will be between an unlimited number of non-exclusive licenses or no license at all. Whether this enhances licensing remains to be seen.

### PATENTS AND LICENSES SERVICING THE EXISTING LICENSE

by  
Willard Marcy\*

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*After license has been executed, both the licensor and licensee have a number of obligations that must be met for the benefit of all parties involved.*

If there are two sides to every question, there are also two points of view when it comes to licensing patent rights and then maintaining the licenses. One perspective is that of the licensee. The other, obviously, is that of the licensor. Perhaps the licensee who undertakes to develop a new invention has the more dramatic story to tell. Exploitation of the licensed technology may make or break a multi-million-dollar corporation. After a license covering patent rights has been obtained much research and development is usually still necessary. Plants must be engineered and built and markets must be developed before profitable commercial results can be seen. These formidable tasks will require entrepreneurial and managerial talents, capital and production and marketing capabilities. If the licensee has all these resources and exercises sound judgement, he may succeed.

One might think that the licensor who made all of this possible can simply sit back in anticipation of royalties from initial sales. Nothing could be further from the truth. In a well-drawn license designed to protect both parties, the licensor retains a number of important responsibilities. These responsibilities require diligent attention both before and after commercial sales begin.

I will group the licensor's more important problems into four categories pertaining to the protection of patent rights. I will suggest some factors of which the licensor should be aware and what actions, if any, should be taken to protect the rights of the parties to a licensing agreement, and what should be done to correct misunderstandings, misinterpretations, or rare cases of neglect or criminal intent.

The protection of patent rights involves not only the licensee and the licensor, but other parties at interest - the inventor, the federal government or a university, for example. To further complicate the picture, the rights of one party are seldom independent from those of the other parties. Divergent points of view must be considered in resolving difficulties, and past, present and future must be taken into account.

With all viewpoints balanced, judgements can be made based on integrity, honesty and a desire to treat all parties fairly. It follows that we cannot make a sharp distinction between patent rights which are primarily of interest to one party as contrasted to those rights which are solely of interest to other parties.

#### Rights of the Licensor

The first category deals with the protection of rights accruing primarily to the licensor. Number one is the observance of diligence by the licensee. A license should provide a step-by-step recitation of the duties required to present a comprehensive picture of how diligence is to be shown in commercializing the invention. Diligence usually includes undertaking technical research, obtaining government clearances, doing market development, advertising and providing adequate production to satisfy demand. There may, of course, be other requirements. The licensor usually requires a periodic written report from the licensee to reveal whether diligence is being shown. Observance of the diligence requirements is particularly important during the early stages of commercialization before the product is on the market.

The filling of market demands is an extension of diligence requirements. There may be many more marketing possibilities than are apparent at the time a license is signed. Additionally, new markets may develop periodically during the time a license is in effect. The licensor should be alert to these possibilities and call them to the attention of the licensee. The licensor should also be aware of the total demand for the licensed product and alert the licensee to a possible need to expand production facilities. If he demurs, the licensor should seek additional licensees insofar as the terms of the license permit.

Perhaps the most important right accruing to the licensor is royalties. Payment of these may be on an initial lump-sum basis or periodically over the term of the license. Frequently, the licensee has the right to sublicense, collect royalty payments from the sublicensees and retain a portion for his own use. Sometimes the licensor collects royalties directly from the sublicensees. In any case, the licensor must set up procedures to record the receipt of all royalties and to request payment of those that are overdue. Follow-up correspondence may be necessary and stronger measures are sometimes required before final collection is achieved.

The calculation of royalties usually involves the quantity of licensed product sold and its selling price. The simple arithmetical extension of the quantity times the price per unit should invariably be checked by the licensor. Figures on quantities and prices are usually checked by independent audit paid for by the licensor.

A license will occasionally call for payment of royalties in stock or the establishment of other equity in the licensee's corporation. This is especially true with fledgling companies organized to exploit new technical developments. Such a company frequently has been organized by an entrepreneur long on dedication and enthusiasm, but short on managerial talent. The licensor may help provide such talent.