

Exclusive Licenses in the EEC

Two recent decisions by EEC Commission are examined and their extensive ramifications are discussed

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Two recent decisions of the Commission of the European Economic Community, relating to the permissibility of exclusive or like manufacturing licenses, were considered of sufficient importance that a one-day conference was organized in London on December 11, 1975 (by European Study Conferences Ltd. of Uppingham, England). This was attended by over 180 people, many of them LES members. A large proportion came from mainland Europe.

The brief facts of the two cases are as follows:



J. Barrett "Kabelmetal"¹

In 1958, Kabelmetal (W. Germany) entered into a license agreement with Luchaire (France) in respect to its secret and patented manufacturing techniques relating to the machining of steel parts (e.g. pistons, gear wheels) by a process using cold extrusion. Luchaire was granted (a) the exclusive right to manufacture in France and to sell in Spain and Portugal and (b) the nonexclusive right to sell in specified member States of the EEC (namely, France and Belgium). Luchaire undertook not to sell elsewhere. The license agreement included other familiar provisions, such as technical assistance, "most-favored nation" clause, secrecy of know-how, and grant-back of a non-exclusive license to Luchaire in respect of improvements made by Luchaire and passed to Kabelmetal.

The agreement was notified to the EEC Commission on February 2, 1963. At the request of the Commission, the agreement was amended in March 1974 so that, *inter alia*, Luchaire was free to sell throughout the EEC.

The commission, in its Decision of July 18, 1975, held the exclusive manufacturing license to be within the scope of Article 85(1) of the Rome Treaty, but granted exemption under Article 85(3).

"Bronbemaling"²

In 1971, a Dutch patentee (Heidemaatschappij) granted a license to each of four Dutch companies under its Dutch patent relating to a process for installing a well-point drainage system, and such a system when so installed. The

patentee undertook not to grant further licenses without the consent of a majority of the parties concerned. Subsequently, Bronbemaling (a further Dutch company) having requested a license and been refused, commenced proceedings in a Dutch court for a declaration that the refusal of a license and the restrictive arrangement between the patentee and its licensees amounted to a breach of Article 85 of the Rome Treaty.

Bronbemaling alleged that the existing licenses had been granted in consideration of the withdrawal of opposition to grant of the patent, in which the four licensees had been directly or indirectly associated, but this was denied.

After the initial court hearing, the patentee notified the license agreements to the commission in August 1974. In a preliminary decision in July 1975 the commission held that the agreements are in breach of Article 85(1) and cannot be exempted under Article 85(3). Furthermore, the commission has left itself free to impose fines and has reserved to the final decision comment on the allegation concerning the circumstances in which the opposition was withdrawn.

I shall consider these decisions from the point of view of the licensor or licensee — the point of view of inventors or industrial concerns, large and small, who rely upon the protection of their industrial (or intellectual) property as a valuable and essential part of economic activity. The mere existence and ownership of an industrial property right has no practical significance. It is the use of that right — the exploitation of that right — that matters.

What then do *Kabelmetal* and *Bronbemaling* tell us? What signposts do they contain to indicate the path we should tread — or at least the path the commission would have us tread?

Positive Indications

Looking first for positive indications, *Bronbemaling* unhappily represents barren ground. *Kabelmetal*, on the other hand, indicates that the commission considers that certain quite common provisions in the License Agreement do not infringe Article 85(1) of the Rome Treaty.

First, the commission approves a so-called "most favored nation" clause, whereby Kabelmetal undertakes to extend to Luchaire any more favorable terms subsequently granted to other licensees. It is interesting to note that Kabelmetal gave this undertaking in respect of a subsequent licensee anywhere in the world.

The commission qualifies its approval by the comment "in specific cases however, particularly where the market situation was such that the only way to find other licensees was to grant them more favorable terms than those granted to the first licensee, this obligation could be an

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obstacle to the granting of further licenses and therefore constitute an appreciable restriction of competition." Whether or not the commission is right in alleging that this could be an appreciable restriction on competition is (or should be) irrelevant as the decision to grant any licenses at all is the prerogative of the proprietor of the industrial property, *Kabelmetal*.

A prohibition on exports by the parties to countries outside the EEC also receives commission approval. You will recall that the licensee Luchaire has an exclusive sales license in respect of Spain and Portugal and is not otherwise permitted to sell outside the Common Market. The commission explains that this is not objectionable "because the products in question are not suitable for marketing through intermediaries and are therefore unlikely to be re-imported into the EEC and subsequently sold from one member state to another". I question how often in practice such a chain of events could be profitable, even if intermediaries are usually involved, save for situations where the home price is artificially depressed, as in the *Centrafarm* case.³

A grant-back provision under which the licensor is entitled to a nonexclusive license, with right to sub-license other licensees, in respect to all improvements made by the licensee, has been confirmed in previous commission decisions. Whether or not such an entirely reasonable provision would always receive the commission's blessing is put in doubt by observations in *Kabelmetal* about the effect on the licensee's freedom to grant licenses direct to third parties relating to such improvements; the loss of competitive advantage in relating to *Kabelmetal*'s other licensees (if any) who would receive sub-licenses to use Luchaire's improvements; and also a reliance on the short remaining life of the subject agreement due to expire on December 31, 1977.

Also deemed unobjectionable is an undertaking by Luchaire to pay royalties after the agreement has terminated for know-how received after a date specified in the agreement.

These then are the positive signposts in *Kabelmetal* for which, I suppose, we should be grateful, although some of them seem to be statements of the blindingly obvious.

Now for negative aspects of *Kabelmetal*, in particular relating to the grant of exclusive licenses, within the EEC. Following the two *Burroughs* decisions⁴ in December 1971, the view gained currency that where an exclusive license was limited to the right to manufacture a product, then this did not constitute a per se infringement of Article 85 (1) of the Rome Treaty and would be unobjectionable (that is to say not notifiable to the commission) if the restrictive effect on competition within the Common Market was not noticeable or to use the commission's expression in the *Burroughs* decisions, the effect was of "minor significance". The *Burroughs* licenses related to a new plasticized carbon paper and it was established that the sales of the licensed product represented some 10% of the total carbon paper consumed in the territory of each licensee (France and Germany, respectively).

Of course the question was how large a share of a market can one have and still come within the classification of "minor significance". Some guidance was given by the *Davidson Rubber* decision⁵ a year later. This related to a parallel-licensing scheme under which Davidson, an American company, granted separate exclusive manufac-

turing licenses in Germany, Italy, and France in relation to a process and machinery for forming padded objects, for example elbow rests for cars. During the commission's investigation it was established that the German licensee's share of the German market for such products was 20%, the French licensee's share was 40% of the French market, and the Italian licensee's share was 8% of the Italian market. However, on reaching its decision in that case, the commission seems to have relied on its assessment that the Davidson licensees together had something in the order of one third share of the total business in the Common Market in such products. It was therefore held that the exclusive licenses had the effect of noticeably restricting competition within the Common Market. Article 85(1) was found to be infringed.

In the *Kabelmetal*, we have another commission guideline. The agreement in question gives Luchaire the exclusive manufacturing rights in France relating to the production of cold-extruded components produced in accordance with *Kabelmetal*'s patents and secret technology. The commission concluded that Luchaire must account for about 20% of the production of such components in France (this was in respect of the year 1974); and this was held to support the conclusion that the exclusive license to Luchaire appreciably restricts competition within the Common Market.

Exclusive Right

Bearing in mind that Luchaire also had the exclusive right under the agreement to export its products to Spain and Portugal, it follows that its sales in France must be substantially less than its 20% of total French production.

On the facts available in the various cases, it is just not possible, in my opinion, to make any close comparison between the *Burroughs* and *Kabelmetal* situations. Whether or not *Kabelmetal* represents a deterioration from the position thought to have been established by *Burroughs*, it is certainly disappointing that the Commission has once again demonstrated its complete inability to get exclusive licensing into realistic perspective.

Kabelmetal mentions that Luchaire is the only licensee in the Common Market. (Thus, it follows that Luchaire is effectively the sole licensee). Furthermore, although the license agreement has been amended to leave Luchaire free to sell its products throughout the Common Market, some sixteen months previously, it had not in fact done so. I suspect that the commission was as much influenced by such factors than any calculation of production percentages.

What then is the future for exclusive manufacturing licenses relating to patent and know-how rights in the Common Market? I sincerely hope that one day we shall succeed in educating the commission to realize that their attitude toward exclusive licenses is not only unreasonable but also wrong. In the meantime, we must proceed with caution. It would be unwise to enter into an exclusive manufacturing license which, taking all factors into account, involves a greater activity in the relevant market than that indicated in the *Burroughs* decision. It must be acknowledged that the commission has not yet held any exclusive license arrangement to be prohibited. In *Davidson Rubber* and *Kabelmetal*, although the arrangements were held to fall within the scope of Article 85(1), the

commission granted exemption within the terms of Article 85(3). However, to gain any comfort from that, one must be prepared to notify one's agreement to the commission to obtain exemption. It is important to keep very firmly in mind that only the commission can grant exemption under 85(3), and therefore exemption can only be obtained by the notification procedure.

Time-Consuming

This, of course, will involve all the time-consuming procedure of completing and lodging Form A/B (in ten copies!) and, in due course, the inevitable and more time-consuming correspondence and negotiations with Brussels.

Busy people — already overburdened by the seemingly insatiable demands for more and more paper to be fed into the maw of the bureaucratic machine, and struggling to pursue their real business activities (in order to pay their taxes) — may well decide to eschew exclusive licenses in future and grant only nonexclusive licenses. After all, not even the commission can force proprietors to grant further licenses, or indeed any licenses at all.

If, in any given case, the parties decide that an exclusive license is essential and, furthermore that the effect of the arrangement on the market will be such that the commission is likely to consider the arrangement within the scope of Article 85(1), the exclusive license agreement should be carefully prepared with the notification procedure in mind. I understand that the commission has suggested (informally) that the preamble to such an agreement (or indeed any agreement which is to be subjected to the notification procedure) should set out a detailed statement of the underlying facts as they relate to the various matters mentioned in Article 85(3). This is obviously a most helpful suggestion and, although the parties (if not the drafter of the agreement) will possibly consider this exercise somewhat artificial in relation to the real purpose of the agreement, nevertheless adoption of this suggestion would be a wise course.

This will result in many more recitals in the preamble than we are used to in most agreements under English law, but that apparently is the way the game should be played.

It is recommended by some, in an attempt to make an exclusive license more acceptable to the commission, to provide that the exclusive licensee has the right to grant sub-licenses. Apparently there is no objection to such a right being subject to the approval of the licensor, as such clauses have already received commission approval in the *Burroughs* and *Davidson* decisions. Whether or not this carries any weight with the commission is doubtful, bearing in mind the *Davidson* case, in which two such licenses were in fact granted. The French licensee (Maglum) granted a sub-license to another French manufacturer and, in Italy, an additional license was granted to Stampaggio directly by Davidson, but with the approval of the existing exclusive licensee Galino. In spite of this, the commission held that the exclusive head-licenses fell within Article 85(1), apparently because the patent holder (Davidson) had given up the right to grant further licenses of its own volition.

Another suggestion to mitigate the commission's wrath is to limit the exclusivity to a relatively short period, for example five years. This in many cases will give time for

the licensee to develop a new market before he has to accept possible competition from other nonexclusive licensees. As far as I am aware, the commission has not issued any statement in relation to such an arrangement, but no doubt a case will arise in due course. One possible advantage of such an exclusivity limited in time is that, assuming the agreement is notified to the commission immediately, it is most unlikely on present performance that the commission will draw that agreement out of its hat (or is it a mountain?) before the period of exclusivity has expired.

Another, and popular, suggestion is to grant a non-exclusive license with a "gentleman's agreement" not to grant any further licenses. This is a potentially dangerous course because, if the Commission happens to collect enough circumstantial evidence (for example, from an unsuccessful and disgruntled applicant for a further license), it could establish by implication that the effect of the purported nonexclusive license is, nevertheless, that of an exclusive license. It goes on to find Article 85(1) infringed. In this connection never use a so-called "side letter" — do not enter into a nonexclusive agreement and then write to the licensee assuring him that you will never grant any further licenses. Such a letter, taken with the formal agreement, constitutes of course an exclusive license.

An immediate, and perhaps more serious, dilemma is what to do about existing exclusive licenses. First, all such licenses should be thoroughly reviewed to ensure that the exclusivity is still essential, if it ever was. If exclusivity is no longer necessary, the agreement should be cancelled and replaced by a nonexclusive agreement.

If exclusivity is essential, then the relevant market should be carefully evaluated in order to establish what share of the market is met by the licensee. If this share, considered in relation to all the surrounding circumstances, fits the *Burroughs* situation, then the parties are entitled to assume that the agreement does not fall within Article 85(1) and no further action should be necessary.

If, after every consideration, an existing exclusive license agreement is found to be both essential and also of sufficient significance to fall within Article 85(1), then of course that agreement should have been notified already. If it has not, and this is because the need to do so has been overlooked, then you have the agonizing choice between belated notification (in the hope that the commission will overlook the lapse), or you do nothing and take the risk of being "found out". Of course, in the case of an exclusive license, this risk is quite real. Any third party refused a license could bring the situation to the notice of the commission, which was exactly what happened in *Bronbe-maling*.

As to the effect of *Kabelmetal* on future licensing activity, this will probably reduce to some extent the incidence of exclusive licenses (particularly long-term licenses), but I cannot believe that industrial property licensing in general will be much affected. I believe that industry and the entrepreneur will always find a way of doing successful business, and they are far too resilient to be dissuaded by the bureaucrats.

Furthermore, it is surely not a vain hope that the commission's present attitude toward exclusive license agreements will change in the future. Up to present, no exclusive license has in fact been prohibited and, should that situation arise and the license is sufficiently important, the case will presumably go to the European Court of Justice

on Appeal. That tribunal has not yet pronounced on the subject of exclusive licenses, but it is to be hoped that the judges would take a broader and more reasonable view of the subject, and reason would prevail.

The commission clearly is failing to realize that its concern about the effect of exclusive licenses does not in reality arise from consideration of free competition. What it in fact is concerning itself with is the abuse of patent monopoly, against which there already exist provisions for compulsory licenses in all the national laws and also in the Community Patent Convention. In the United Kingdom, at least, if a market is not being adequately served with a product the subject of a patent, and the patentee or exclusive licensee refuses to grant a third party a license on reasonable terms, that party can apply to the appropriate authorities for a compulsory license under the patent. Furthermore, the existing exclusive license could be terminated and, in the final analysis, the patent could be revoked if the patentee or exclusive licensee refuses to cooperate. Thus, any abuse of an exclusive license situation is dealt with *if* it occurs and not, as the commission is attempting to do, before the event.

Vexed Question

In a recent opinion prepared by the commission in relation to the Community Patent Convention, the commission says, "There is no obvious justification for treating someone who acquired a national patent as a result of an assignment differently from the holder of an exclusive license, which from a commercial point of view is very close to an assignment". This was in the context of the vexed question of "exhaustion of rights", but I have been asked whether a simple patent assignment is within Article 85(1).

Since a patent is property I assume that an assignment is protected from the Rome Treaty by virtue of Article 222.⁶ In any event, an assignment does not restrict the rights of the owner but merely establishes a new owner, and consequently it cannot be an infringement of Article 85(1). Furthermore, the Community Patent Convention itself specifically provides for the assignment of patents.

I now turn to the *Bronbemaling* case. In its decision, which is only a provisional one, the commission has stated quite clearly that its objection to the license agreements between the Dutch patentee and the four Dutch licensees is limited to one single point, the provision whereby the parties to the agreements have conspired to control the granting of any further licenses under the patent. However, in passing, the commission has referred, not in the formal decision but in the section setting out the facts, to the circumstances in which the license agreements were made. *Bronbemaling* had requested the Dutch patentee to grant it a license and had been refused. Consequently, *Bronbemaling* commenced an action in the Arnhem district court and it was as a result of this that the agreement came to the notice of the commission. During the court proceedings, evidence was given that the four licensees had originally opposed grant of the Dutch patent and had subsequently withdrawn their opposition in consideration of the patentee granting each of them a license. Whether this was the true or only consideration is in dispute but, in referring to this matter, the commission states, "However, this issue can be reserved for the administrative procedure in connection with the final decision".

The question arises whether agreements which do nothing more than compromise patent disputes, specifically patent opposition proceedings, might need to be notified to the commission under Article 85(1).

I confess that I cannot see how the reason why a patent is granted, or the circumstances surrounding that grant, can be any business of the commission.

Considering first the settlement agreement itself, this will inevitably be a simple nonexclusive license which, as I understand it, is never likely to infringe Article 85. Possibly some nominal lump-sum payment might be provided or some other consideration established (as alleged by the parties to the agreements in *Bronbemaling*).

The more important point, in my view, is that the grant (or possibly the revocation) of a patent is a matter for authorities which are quite independent of the commission; either the national Patent Offices or courts or, in due course, the European Patent Office or the European Court of Justice. Furthermore, have we not been taught that the existence and the exercise of a patent are quite separate matters (a teaching with which, incidentally, I profoundly disagree). As that is the current view of the commission, then it cannot (perhaps in this uncertain world I must say "should not") even attempt to concern itself with matters relating to the existence or creation of a patent right.

In addition, it should be remembered that when a patent opposition is withdrawn, the relevant tribunal will still consider all the available evidence before deciding whether to grant a patent. In *Bronbemaling*, the main ground of opposition was lack of inventive step. Bearing in mind that this was a Dutch patent and bearing in mind the reputation of the Dutch Patent Office, I cannot believe that the Dutch patent in question can be hopelessly invalid (on the evidence which was available).

Dealing with a final point. In *Bronbemaling*, the patentee had granted four licenses. The commission has taken the strongest exception to the patentee's undertaking not to grant further licenses without obtaining the consent of the existing licensees. It has been suggested that this situation is akin to a patent being owned by five joint-owners, so that the problems could arise from the provisions under British law relating to the co-ownership of patents.

Our Patents Act provides in Sect. 54(3) that a license shall not be granted under a jointly-owned patent without the consent of all the joint-owners. Thus, if there are five joint-owners and one wishes to grant a license, the consent of the other four owners must be obtained. Shades of *Bronbemaling*! Can the commission argue that Article 85(1) is infringed?

I think not, and again Article 222 of the Rome Treaty would seem to apply. The restriction on licensing is not a voluntary arrangement between the owners, but it is an essential condition inherent in the patent property they have been granted. Furthermore, and more directly to the point, an essential ingredient for infringement of Article 85(1) is missing — there is no agreement!

NOTES

1. *Re. Kabelmetal's Agreement* (1975) Common Market Law Reports (C.M.L.R.) D40.
2. *Bronbemaling v. Heidemaatschappij*. Official Journal (EEC) No. L.249 of 25th September 1975.
3. *Centrafarm BV v. Sterling Drug Inc.* (1974) C.M.L.B. 480.
4. *Burroughs Cooperation Agreements*. (1972) C.M.L.R. D67.
5. *Davidson Rubber Company*. (1972) C.M.L.R. D52.
6. Rome Treaty, Article 222. "This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership".