

# European Licensing: 1978-1992

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*A legal practitioner's experience of licensing in Europe; a discussion of practical points*

I shall start with general points about the use of the block exemption lists, and then consider a handful of contractual provisions which regularly occupy the attention of businessmen and lawyers alike and need very careful drafting to reconcile the commercial aim with the dictates of competition law.

## THE BLOCK EXEMPTIONS

### General Problems

The European Commission has to perform a delicate balancing act in exempting categories of agreements. On the one hand, and despite the ever-present threat that a block exemption can be withdrawn,<sup>1</sup> the Commission wishes to ensure that no harmful agreements will slip through the net. On the other hand, to divide the category too narrowly — to give the net too fine a mesh — would, by making an application for individual exemption necessary even in unobjectionable agreements, lead to just the uncertainty about the agreement's status that it is the aim of the Regulation to avoid. Moreover, since preparations of the First A/S is very time-consuming for both management and lawyers, the result would be especially detrimental to the small and medium-sized enterprises (SMEs). The Commission therefore needs to encourage SMEs.

A second problem is a purely practical one. Until the Commission has seen a representative sample of one type of agreement, it cannot assess what provisions are important to businessmen. What are essential features of that type of agreement? Which ones do not in practice tend to have anticompeti-

tive consequences? Experience shows that the early block exemption Regulations were too narrowly drafted.

For instance, I have seen numerous research and development agreements that were innocuous enough, but they could not be fitted neatly into the R&D block exemption.<sup>2</sup> Those who have traced the history of the Know-How Licensing Regulation<sup>3</sup> from the days of the working paper to the 1987 draft will know what progress has been made on important practical points, as a result of both lobbying and the Commission's increasing experience in cases like *Rochem/Incyper* and *Int-Kal/Rob Products* came along.<sup>4</sup>

### ◆ Negotiations ◆

When in the negotiations do the block exemptions make their presence felt? A common proviso in this, either alone or with their lawyers, the businessmen, state not a tentative agreement. An eye might be kept on the competition law points, but they will certainly not be allowed to dominate at this early stage. The state it does, does a body of technology already exist? Or are we talking about a planned program of research, development and commercialisation? How should the relationship be structured? A formal joint venture? A simple licence? The list of questions is endless; but the first step should be to ascertain the net of draft that is really wanted, and only the second to analyse the proposals from the competition law point of view.

These difficult decisions have to be made. In my experience, most proposals for a transaction of substance fail to qualify clearly for the relevant block exemption. The first decision is whether to modify the commercial proposals to fit the

straightjacket. If the decision is not to tamper with the proposals, a string of questions will follow: whether to notify in a case that is arguably, but not plainly, within the Regulation, whether to apply for negative clearance or (more likely) both negative clearance and, alternatively, an individual exemption, whether to make use of the opposition procedure (if it is available) or submit a "comfort letter" from the Commission might be satisfactory.

The opposition procedure<sup>5</sup> is more rarely used than is often supposed. Probably, the chief reason is that a desired form of the agreement is not an "innovation" as the opposition procedure requires; it is already "blacklisted." And sometimes parties may be so early and over-cautious in notification, preferring to hope that an arbitrary notification will gather dust in a corner for the effective life of the agreement. However, note the particular reference in Article 4 of the Know-How Regulation to limitations to do with several seasons of supply.

Although many cases before the Commission are notified without a formal decision, parties can be reluctant to resort to the "comfort letter"<sup>6</sup> procedure, principally because it leaves the agreement with uncertain status in proceedings before a national court.<sup>7</sup> In fact, there are two comfort letter procedures, an informal one and a much less common formal one (where a summary is published in the Official Journal, inviting comments of interested parties). What is the effect of a formal comfort letter? There has been no decision

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on the point, but while the notice in the DT is unlikely to act as a strict copyright, nonetheless it is likely to weigh against a complainant who does not respond to the notice but later objects to the validity of the agreement before a national court.

What happens in an agreement that falls short of Article 85(1) and has not been exempted? Article 85(2) is plain: "Any agreements ... prohibited pursuant to this Article shall be automatically void."<sup>17</sup> In fact, the rigors of Article 85(2) have been relaxed by the ECJ's interpretation<sup>18</sup> that no more than the objectionable restriction is void, if it is severable.<sup>19</sup>

Unfortunately for the businessmen and his advisers, the "severability" test is troublesome to apply. One difficulty is that the test in English law is not as clearly defined as, for example Article 156 of the German Civil Code. And even if one can accurately formulate the test, it is extremely hard to determine whether a particular provision meets that test.

Third, it is uncertain what effect might be given by the court to one of those "horizontal" provisions that are seen in various forms, but which often amount to pulling oneself up by one's own bootstraps.

There are significant questions, because the contractual provisions at stake are typically the sort of great commercial value, e.g. territorial protection or a continuing obligation to pay royalties. You might think that a court should have little sympathy for a complainant who seeks to avoid his contractual obligations by arguing that they are illegal so that he should never have entered into them. The opposite argument can be put rhetorically: if provisions of an offending agreement are not void and unenforceable between the parties to the agreement, against whom are they void?

Obvious difficulties arise from the fact that European competition law requires legal agreements to be judged according to their economic effects.<sup>20</sup> For instance, an agreement, which on paper appears highly restrictive will not fall foul of Article 85(1) if it does not have an appreciable effect on trade between

member states. The practitioner is often presented with a borderline case: how can he be expected to advise with certainty,<sup>21</sup> especially without a full study of the market conditions?<sup>22</sup> Equally, a provision that has the form of an anti-competitive restriction to take an obvious example: a non-competes clause may have a pro-competitive effect by encouraging the licensee to concentrate his resources on the licensed product to compete with well-established rival products. It all depends on the particular circumstances of the case. That is why the practitioners find themselves here and again justifying an *a priori* A & B potentially anti-competitive, but demonstrably beneficial arrangement rather than the other way round.

#### The Patent and Know-How Regulations

There are some general problems that the practitioner faces. I turn now to some particular questions raised by the Know-How Licensing Regulation. It has only just come into force, but many of the questions it poses have already been answered for clients in other contexts.

It is instructive to compare the Patent and Know-How Regulations. First, I should tackle a fundamental question: "When can one use the Patent Regulation and when the Know-How Regulation?"

**Mixed Agreements** — If only patents — or patents, with ancillary provisions about trademarks<sup>23</sup> — were involved, the answer was (and is) obvious. If, on the contrary, the licensed technology consisted of a combination of patents and know-how, practitioners faced difficult questions over the availability of the Patent Regulation (and sometimes made Provisional attempts to make complex agreements fit the Regulation).<sup>24</sup> With the coming of the Know-How Regulation, the problems of delimitation fall away in many "mixed" cases, so too, the problem that the Patent Regulation could not assist where there were restrictions in territories where there were not patented patents.<sup>25</sup>

The policy behind the new Know-How Regulation is that it

should be available in all mixed patent and (technical) know-how license agreements, which are not actually exempt by the Patent Regulation — so long as the licensed know-how is sufficiently "know-ty."<sup>26</sup> In particular, the Know-How Regulation may be useful where there is not complete patent coverage throughout the Community or where the intellectual is more general than that in the Patent Regulation.

What if the agreement covers other types of intellectual property rights too? The Patent block exemption was available for agreements which contained an incidental trade mark license (but not licenses of other intellectual property rights, such as copyright).<sup>27</sup> The Know-How Regulation is more extensive still.<sup>28</sup> If there are ancillary provisions concerning other intellectual property rights, the block exemption is still available, provided there are no obligations which go further in relation to the other intellectual property rights than those attaching to the know-how and the know-how obligations fall within the block exemption.

**Secret, Substantial and Identified** — The Regulation requires the know-how to be secret, substantial and identified.<sup>29</sup> It is hoped that the Commission will be able to interfere with the parties' own appreciation of what is useful, using the definitions to define only an obvious result. It is a legitimate hope. The Commission has in recent years been taking a pragmatic approach, looking for instance to know that the know-how was:

"... in the sense that, although individual members of the staff are not bound by confidentiality obligations, particularly in smaller systems in the industry, the know-how package in a whole is not readily available, and can therefore be said to be not in the public domain."<sup>30</sup>

Those engineers are, after all, the relevant public. And in June 1989, Commissioner Peter Gualtieri explained:<sup>31</sup>

"With regard to information in the industrial domain of technology, it is not the private possession of the Commission, but an intangible know-how which is of greater importance to the relevant staff of

the regulation we will seek to exclude only minimal information and to include relevant free objective facts in the license. The requirement of notification means that the licensee must be capable at the time of conclusion of the agreement of giving the licensor a competitive advantage over other competitors.<sup>12</sup>

In *Jas-Bal/Balk Products*, the Commission pointed to the technical difficulties to be overcome and the amount of research work underlying the know-how, concluding that it was "of particular value to Balk Products and . . . of great importance for the production of license goods, though by *Jas-Bal*," and had to be "considered as substantial and capable of improving the performance of the licensee who is thus willing to pay royalties for it."<sup>13</sup>

The Commission also emphasized in *Jas-Bal* that the initial body of know-how was supplied in written form and that where oral discussions took place for conveying technical information, there was provision for notes of the discussions to be taken. The requirement that the know-how be recorded in some suitable form is seen by the Commission as a useful discipline, to ensure that there is substance to the licensed know-how. The Regulation as published in more accessible form to the protection of business life, allowing the know-how to be recorded "at the latest when the know-how is transferred or shortly thereafter."<sup>14</sup> Where more convenient (e.g. because of bulk or particular circumstances), the know-how can be recorded not in the agreement itself, but rather in a separate document.

From my experience, I would expect these criteria to pose few problems in practice.<sup>15</sup>

#### SOME CONTRACTUAL PROVISIONS

##### *Exploitation*

The Commission has never determined that it is in most cases safe to leave it to the parties to bargain freely about payments:

"... the parties are invited to be protected against the licensee's financial circumstances or an agreement for a contract not yet concluded not to be entered in

connection with the appropriate means of financing the technology transfer."<sup>16</sup>

**Royalty Periods** — Well known is the Commission's hostility toward an arrangement by which a licensee might find himself obliged to pay royalties on products which his competitors have become free to make (and, obviously, sell at a lower price).<sup>17</sup> The idea has surfaced again recently in the ECJ's judgment in *Hepp* (2-10000/87),<sup>18</sup> in the rather unhelpful illustrations given by the Court. Naturally, the licensee too will given sufficient bargaining power) resist the burden of such a provision.

The Patent Regulation Modified, Article 9(2) and 9(4), was relatively strict and these were indications<sup>19</sup> that where payments had to be made after the know-how had fallen into the public domain the Commission was more sympathetic to the spreading of a fixed sum (as opposed to running royalties). The much revised paragraph (7) of Article 2(8) now allows the continued payment of royalties "in the amounts, for the periods and according to the methods freely determined by the parties" — which suggests that evaluating turnover-related royalties may be acceptable, although Article 2 does not advertise the point. Two practical points first, the warning in Article 2 about the possibility that the fixed sum exception might be withdrawn<sup>20</sup> suggests that, around the date of the agreement, the parties might to accord their conclusions about the lead-time afforded by the body of know-how and the normal life-cycle of such know-how,<sup>21</sup> but the Commission at some future date be tempted to be less wise after the event.<sup>22</sup> Second, paragraph (5) of the know-how related article prolonged payments where it is the licensee who has caused the know-how to become publicly known.

At the time of writing, the ECJ's judgment in *E. Oltweg v. Ite de Wolke* is on the verge of being published, but the signs are that the Court has failed to seize the opportunity to give clear guidance on the subject of post-expiry royalty payments. This Article 27 reference to the ECJ arose out of litigation be-

tween  *licensee and licensor*, after the licensee had ceased paying royalties on the ground (among others) that all the licensed patents had expired; it had not, however, terminated the agreement according to the express provision.<sup>23</sup>

When drafting provisions for the payment of royalties continuing after expiry of patents, domestic competition law, in the shape of section 45 of the Patents Act 1977, must also be borne in mind. Subsection 4(1) allows termination by either party "to the extent (and only to the extent) that the contract or license relates to the product or invention." Where there is a licensed patent and know-how agreement, the defendant should think about separating out the several elements, to avoid the risk that the other party might terminate the whole agreement where (on the contrary) elements of it "ought" to survive. Don't let the baby be thrown out with the bath water.

**Royalty Rates** — Warnings in Article 15 about inappropriate royalty bases largely reflect the corresponding provisions in the Patent Regulation. The *Widening case*, however, allows that it is legitimate to employ a broader royalty base where, in instances, it would be impracticable to discover the value of the patented product alone. On the other hand, royalty provisions were held to be bad if they discouraged the licensee from meeting separate demand for the unprotected product.<sup>24</sup>

**Minimum Royalties** — Minimum royalty provisions are white-labeled<sup>25</sup> — even though such a provision, if the licensee succeeds in making it at a high level, especially if coupled with a "best endeavours" clause, may be tantamount to a non-competition covenant.<sup>26</sup> Note that, if anticompetitive effects do result, the Commission may withdraw the benefit of the exemption under paragraph (2) or (3) of Article 7.

**Improvements** — Like the royalty provisions, the improvements clause merits close attention, even in the absence of competition law questions. It is, hardly, an area where it is easy to fail to reflect the

the intentions of the parties.<sup>12</sup>

Article 2(1)(4) of the Know-How Regulation (for the corresponding paragraph<sup>13</sup> of the Patent Regulation) carefully distinguishes between disclosure of the know-how and the right of the licensee actually to use what it has learned. Moreover, it highlights the possibility that the improvements may relate to technical fields of application outside the original contractual field. Two other in practice very common areas contained language where one or other of these points has been overlooked so that it is hard to discover the parties' original intention.

The Commission's philosophy is simple. A string of improvements should not lead to agreements or territorial restrictions of excessive duration. Instead, the contract should not place the parties in an unequal position. The vital concern is when, at the end of the agreement, the licensee can continue using the licensee's improvements, but the licensee is banned from using the basic licensed know-how. The Commission believes that, if the licensee is forced to negotiate for rights to the licensee's improvements, the licensee is likely to win a continued license of the basic know-how as a *quid pro quo*.

A reflection of this philosophy is the principle that a strong licensee should not be allowed to demand either an assignment or (worse) the same thing as an exclusive license of the licensee's improvements. To three treaties (even the Know-How Regulation) adds a refinement. It makes allowance for the licensee's legitimate interest in "non-reversible" know-how, that is, the situation where the licensee's dealing in his own improvements would compromise the licensee's rights in the basic know-how.<sup>14</sup> Real is that fact, the complicated language of Article 2(1)(4) and the extensive blacked paragraph<sup>15</sup> are easily understood. Since the basic principles are familiar, I will add only a few comments:

• Instead of the formula of reciprocal nonassignment licenses, note the phrase in Article 2(1)(4)(i): "the Licensee has accepted an obligation, whether exclusive or not . . ."

• Whereas the Patent Regulation<sup>16</sup> insisted on an actual right of invention, Article 2(1) of the Know-How Regulation is rather different.

• Note the further mention of improvements in Article 2(1) (i) (concern's right to refuse them) and Article 2(1) (ii) (licensee's right to come communicating improvements, if licensee engages in competing activities).

The improvements clause is one area where the opposition procedure can be useful for curing provisions which go a little way outside the whiteline, while not falling foul of the Maxline.

#### Topic: Quality Standards

Two have long been the concerns of competition authorities. They are treated in detail in section 44 of the Patents Act 1977 (and, before that, in section 32 of the 1949 Act). A reminder, if reminder was needed, that the authorities' law is set against them is provided by the *Witt case*, which Bruce Carver has already mentioned.

The European principles are well established, but there are still some open questions on the language of Article 2(1)(4) — "necessary for a technically satisfactory exploitation of the licensed technology."

This is an area in which it is particularly difficult to advise in a given case. Is "necessary" absolute, as it seems? One is always left with the nagging question: if the law is probably necessary, why does it need to be made a contractual obligation? It ought to be sufficient to ban the licensee from selling goods of inferior quality, and leave the rest to the diligent licensee to "police." It is comforting that the Commission has taken a pragmatic line, despite the possibility for abuse.

Second, does the phrase "technically satisfactory" allow a higher standard than "good-to-midling"? Earlier indications<sup>17</sup> suggested not. However, in *Jet-Rol*, the justification for *Jet-Rol's* obligation to purchase the "pre-mix" from *Rich Products* was that this was necessary "in order to ensure consistent quality in the licensed product."<sup>18</sup> Note that, apparently, it was not impossible to make good quality

licensed product without the pre-mix; merely that, with the pre-mix, the results were more even.

A rather different idea is a restriction that obliges the licensee to sell (instead of like 1) unlicensed and unlicensed articles, alongside the licensed products. For example, in *Winstaling*, the licensee was obliged to sell (patented) rings only in conjunction with approved boards.<sup>19</sup> The Commission and the Court both condemned this restriction.

#### Field of Use

Field of use (and similar) provisions are very important in practice. After a hesitant start — when the Commission suggested that a field-of-use restriction was acceptable only where the licensee was himself unable to operate in that technical field — a more liberal view is now taken. The test is simply stated. Nevertheless, it can be very hard to apply in practice. Moreover, there is always the fear that a genuine field-of-use restriction might be viewed by over-zealous officials as a disguised form of customer-sharing. Highlighted in Article 2(4). Unfortunately, in this important topic little guidance is available from the *Queen case law*.<sup>20</sup>

The whitelined provisions of the Patent Regulation — simply, a technical field of application — has now been broadened by the inclusion of individual product markets. This was an idea that was discussed in *Winstaling* and, more recently, in *Jet-Rol*.<sup>21</sup> Once again one sees the introduction of a criterion of an economic nature, about which it is hard to form a certain view.

There are some other significant restrictions now expressly dealt with. Whitelined is a limit on the use of know-how to the licensee's own proper purposes (i.e. not to build a manufacturing facility for a third party). Additional covenants may be changed in appropriate cases.<sup>22</sup> Exemplified is a limit on the licensee's production (qualitatively) to amounts required for his own products (e.g. for which the licensed product is a component, as long as the absolute quantities are not controlled by the licensee).<sup>23</sup> And, as already mentioned, customer restrictions may benefit from the

