

Impact of Canadian Law on Licensing

Need to understand law protecting trade secrets is becoming matter of general interest as technology transfers increase

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We live in a society which appears to thrive on the constantly increasing developments in science and technology. Each successive scientific advance essentially becomes more complex and subtle. The requirement to protect the increasing volume of new and sophisticated technology has placed a heavier onus upon legal and business professionals to determine the preferred means of protecting important developments which are not appropriate for patent protection.

Accordingly, the need fully to understand trade secrets, to protect them diligently under the law and, if possible, to license them, has become a matter of increasing general interest and concern.

The prominent role played by Canada in many major scientific developments throughout the world indicates that this rather limited and specialized area of the law may become increasingly important to the scientific and industrial communities.

THE GENERAL BASIS

Canadian law, as it relates to the preservation and protection of trade secrets and know-how, derives essentially from the common law and from equitable principles. There are few, if any, statutory enactments which positively and directly bear upon the issue of protecting industrial secrets other than in respect of the proscription of certain types of trade practices by the anti-combines or anti-monopoly statutes existing in Canada.

Unlike the United States, Canada is not unduly burdened with a large number of diverse acts, statutes and laws on this subject. Indeed, Canadian law, as it relates to the protection of trade secrets and know-how, is derived from, and continues to be influenced in notable measure by, British jurisprudence. Therefore, in any discussion of Canadian law as it relates to the protection of trade secrets and know-how, British case citations should properly predominate. In this respect, decisions of the British courts, although not binding upon the courts of Canada, enjoy persuasive authority and the leading British authorities are considered, by and large, to constitute the *locus classicus* of the present Canadian position.

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LICENSING TRADE SECRETS AND KNOW-HOW

The relative importance of trade secrets to industrial competitors and entrepreneurs appears clear. The well-settled state of the law as it relates to the protection of such information is also acknowledged. However, it is important for those who possess valuable trade secrets to ensure that those who are made privy to those secrets are regulated by the terms of carefully prepared, legally enforceable agreements. It will therefore be useful to consider some aspects of the licensing of such information.

Agreements regulating the use of confidential information are inherently regarded as agreements in restraint of trade insofar as they do not derive from a statutorily sanctioned source of monopoly. As agreements in restraint of trade, they may be enforced, and indeed are only enforceable, to the extent that the agreement goes no further than is reasonably necessary to protect the interests of the parties to the agreement and, perhaps more importantly, that they are not against the public interest. *Consolidated Textiles v. Central Dynamics*, (1974) 18 C.P.R. (2d) 1, 9. It is believed that even if the contractual obligation of such agreements were unenforceable there could still be a liability on a fiduciary basis. *Bee Chemical v. Plastic Paint*, (1978) 41 C.P.R. (2d) 175, 180; aff'd, 47 C.P.R. (2d) 133. What exactly constitutes an unreasonable restraint of trade would depend upon the circumstances of each particular case but, when drafting such agreements, careful regard should be had to the pertinent case law. An attempt by an employer to restrain a former employee from using the sum total of his working knowledge and experience for the benefit of his new employer has been considered to be an unreasonable restraint of trade.

WHAT MAY BE LICENSED

An agreement structured to license trade secrets and know-how may include virtually anything and any subject matter. Licenses of this type are regarded under Canadian law as a matter of contract whose content is dependent essentially only upon the desires of the parties and their respective bargaining positions. However, regard must be had to the regulatory provisions of the Combines Investigation Act which is discussed below. For the most part, however, these provisions do not directly relate to the actual license provisions regulating the transfer and use of technical information, being more relevant to ancillary matters such as tied-selling arrangements and resale price maintenance. Thus, the subject matter of license agreements may include bona fide trade secrets, know-how, information otherwise disclosed in a patent

application or even common knowledge if the licensee is willing to receive such information subject to terms of confidence and nondisclosure.

A case of particular concern to practitioners involved the settling of an extensive cross-license agreement. A main purpose of the agreement was to avoid litigation in about 20 countries between two large corporate entities. While both companies had filed numerous applications, patents had not yet issued. The applications of both were directed to essentially the same invention. The precise provable date of invention was in doubt. What was also in doubt was the ultimate workability of the different "know-how" held out dogmatically by each company's senior research staff as being critical to economic and successful workability.

A new and somewhat lengthy precedent was successfully created to meet the requirements of the license. In disposing of the conflicting know-how issue, a contingency clause was included, tailoring the amount of royalties payable to each party to the specific know-how that eventually proved to be successful and industrially workable.

The license agreement provided that the party holding the successful know-how would receive the larger royalty payments. Third-party licensing was also included in the agreement, and its wording was such that no party was without gain and profit.

RIGHTS GRANTED BY LICENSE

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It is important to clearly define the use that may be made of the trade secrets, know-how or technical information conveyed by an agreement including rights of manufacture, use or sale, territory and time. The degree of exclusivity which the licensee is to enjoy should also be stipulated.

A nonexclusive license implies that the owner of the information may grant licenses to other parties and may also make use of the information himself. An exclusive license prohibits the licensor from licensing the information to third parties and precludes the licensor himself from using the information. Under a sole license, the licensor may not grant licenses to third parties but may use the information himself.

The grant of exclusive licenses in the home territory of the licensor is something of a rarity in that the very subject matter of the license is information which the licensor has obtained through its experience or research and development and which it has successfully exploited. Accordingly, the licensor is attempting to recoup some of its research expenditure by allowing others to make use of the benefit of its experience without limiting its own right to exploit further.

If some of the information contained in an agreement structured to transfer trade secrets and know-how is properly the subject matter of a patent, provision should be embodied in the document defining the rights of the licensor or licensee to procure patent protection in the licensed territory.

SUBJECT MATTER

Unlike patent license agreements, trade secrets, know-how or technical information do not lend them-

selves to ready and accurate definition in a license agreement. There will be instances where the subject matter of the agreement is in fact somewhat readily discernible insofar as it relates to well-defined production techniques, principles or products of the type with which the licensee has not previously been involved. In such cases, the license may be drafted to include all or virtually all of this new area of endeavor.

It has been suggested that one way of identifying subject matter is by reference to the licensor's products which may be identified as those sold under specific trademarks, constructed according to certain patterns or illustrated in the licensor's catalogues or advertising or in attached schedules to the license agreement itself.

Further difficulties arise when attempting to include within the license agreement improvements, modifications or new inventions relating to the licensed products or processes or which are competitive therewith. Appropriate wording must be chosen depending upon the circumstances occupied by the licensor and licensee and of course upon the nature of the technical information being transferred. In some cases it may be satisfactory to simply describe the licensed products "including improvements and modifications thereto."

CONSIDERATIONS ON CONFIDENTIALITY

As we have previously observed, the courts will go to great lengths to protect against the unauthorized disclosure of confidential information, and in some cases issue wholesale injunctions causing possibly disastrous consequences for the user of the information. We have also noted that such injunctive relief has been granted in situations where the disclosee alone in the world is under a disability with respect to the use of information and knowledge acquired from the discloser.

One must therefore be extremely prudent before undertaking obligations of confidence particularly in respect of a package of information much of which may be common knowledge at the time it is conveyed or may become common knowledge during the term of the agreement. The commitment to maintain such information in confidence may result in the imposition of an onerous burden which may be difficult if not impossible to honor.

From the licensor's point of view, caution should be exercised in not characterizing the whole of the information to be transferred to the licensee as being "new and useful" secret and confidential information. This is seldom the case, with the result that the agreement may fail for want of consideration or perhaps on grounds of misrepresentation.

Additionally, if a licensor undertakes to license a licensee in a particular territory and further covenants not to disclose the secret information to others, he may have precluded himself from arriving at similar agreements with licensees in other territories. Gareth E. Maybee, Q.C., stated in an article entitled "Technical Information Licensing Agreements," 44 C.P.R. 99, that:

"In most cases, all the licensor can say is that it has certain information in its possession or under its control that it is willing to disclose to licensee and permit

licensee to use for a consideration. The licensor must covenant not to disclose this information to others or use it itself in the licensed territory, and to disclose to others outside the license territory only on the same conditions with regard to confidentiality as have been imposed on licensee."

It is of course to the mutual advantage of both parties to the agreement that the duty of confidence be mutual and this should be carefully spelled out in the agreement to the extent that this is possible. However, on the assumption that all humans are not perfect and assuming the existence of human ingenuity, total reliance upon such a clause may be somewhat imprudent.

If one or both parties undertake to maintain certain information confidential, and the parties do not have the necessary facilities to maintain such a commitment, procedures should be adopted to establish conditions of confidentiality. These may include employee confidentiality agreements, the establishment and maintenance of restricted zones or areas and the adoption of precautions to prevent unauthorized observation of secret processes or machinery.

It is felt that a licensee should not covenant broadly not to disclose to others information received under a license agreement. It is practically impossible to maintain full and complete compliance with such a covenant.

The suggestion is that a licensee should at most undertake to take all reasonable precautions to prevent the information from coming into the possession of others. A possible clause suggested by Mr. Maybee in the implementation of this advice is as follows:

"The parties mutually covenant that they will take reasonable precautions to keep confidential the information now or hereafter given to the licensee by the licensor pursuant to this agreement to the extent that it is new to the licensee, and so long as the information is not available to the public; except so far as it may be necessary or desirable to disclose it to others in connection with the manufacture and the sale of 'licensed products'. It is understood that the licensor may disclose this information outside the 'territory' subject to this same covenant to keep it confidential."

THE CONSIDERATION PASSING

The consideration to be paid in terms of both the amount and the basis of calculation will be determined by the will and mood of the parties to the agreement. In this respect, the rate of royalty may depend upon the length of the agreement, the sale price of the product or the patented or unpatented features of the product. The consideration may include a lump sum, a lump sum plus royalties, or other monetary arrangements to be settled between the parties. The imagination of the parties is perhaps the only limiting factor, although common sense and the exigencies of modern business typically predicate that the royalties be calculated upon a fixed percentage of the selling price of the article whose production is facilitated by the transfer of the trade secret or technical information.

ROYALTY RECOVERY

It should be carefully noted that an action to recover royalties is based on the promise to pay unless the promise is made contingent upon the presumed novelty of the technical information or upon the validity of

any subsequently granted patent based thereon. Otherwise, and particularly in the case of a patent, the validity of the patent is immaterial and by no means controlling.

Accordingly, if a patent is revoked and the license agreement is silent on the issue of the licensee's continuing obligation to pay royalties, the licensee is obligated to continue with his payments if his license is for a term certain. The revocation of patent is an irrelevant circumstance for it is not an implied term of a license that the patentee will maintain the patent in force, and this even if the licensee is the only person in the world who must pay to use such information.

There are of course many other aspects which must be considered in formulating a license agreement, including provisions dealing with term and termination, patenting, ownership of patents on improvements, quality control, taxes, trademarks, currency exchange and others. For the most part, however, terms dealing with these matters in Canada need not be conditional to meet any peculiar requirements of Canadian law. Resort may be had to terms and conditions commonly incorporated into U.S. agreements.

Choice of Law

When choosing the law by which a license will be interpreted, it is advisable to choose the law of the jurisdiction in which the license is most likely to be enforced. If the exigible assets of the licensee are located in the country of the licensee, it would usually dictate that the choice of law be that of the licensee's country. If one chooses the law of the licensor's country, one is faced with the expensive problem of introducing expert evidence before the courts of the licensee's country to prove the law chosen to be that of the licensor.

If suit is brought in the licensor's country, one is faced with the equally cumbersome problem of seeking a reciprocable enforcement of a judgment rendered elsewhere. In the absence of a treaty establishing reciprocal enforcement of judgments, one may be put to the trouble of practically conducting a trial *de novo* in the courts of the licensee's country in an effort to gain that court's assistance in the enforcement of the judgment obtained in the licensor's country.

RESTRICTIONS ON TERMS OF LICENSE AGREEMENT

On the political policy level, there has been some discussion in Canada concerning the need for legislation prohibiting the inclusion of certain licensing terms in agreements consummated between parties dealing at arm's length. Such prohibitions would include a ban or limitation on export restrictions, tie-ins and grant-backs. At present, however, there appears to be no serious legislative impetus toward these objectives such that parties to arm's-length agreements need only be concerned with the provisions of the Combines Investigation Act. S.C. 1974-75, c. 76, s. 12 and the Statute of Monopolies, R.S.O. 1970, Vol. 9, App. A, p. 3.

Section 31 of Part 4 of the Combines Investigation Act defines a number of trade practices which are deemed reviewable, although not punishable, by the Restrictive Trade Practices Commission (RTPC) which may, follow-

ing inquiry, issue an order to rectify the practice. Any person who contravenes such an order is guilty of an offense and is liable to a fine or imprisonment or both under indictment or summary conviction.

As will be observed, on application of the Director of Investigation and Research, the RTPC has power to review particular situations which could have a detrimental effect on competition and may make such orders as are expressly authorized by the section. Reviewable trade practices include: refusal to deal; consignment selling; exclusive dealing; market restrictions and tied selling arrangements; implementation in Canada of foreign judgments; applications in Canada of foreign laws or directives and refusal by foreign suppliers to supply a person in Canada.

It will be of interest to note that Sections 31.5 and 31.6 of the Combines Investigation Act, dealing with the implementation in Canada of foreign judgments and the application in Canada of foreign laws or directives, respectively, were enacted primarily to deal with particular situations in which the provisions of the American antitrust and "trading-with-the-enemy" statutes were being given extraterritorial effect by American companies having Canadian subsidiaries.

The RTPC can, however, only issue an order in respect to exclusive dealing, market restrictions and tie-ins if it finds that the use of these reviewable practices are likely to impede the entry of a firm into the market, impede the introduction of a product into the market, or have any other exclusionary effect with the result that competition will be substantially lessened in the market. The RTPC must also find that these consequences will follow either because the practice is engaged in by a major supplier or because the product is widespread in a market. Further, the RTPC is unable to make orders prohibiting exclusive dealing if this practice is engaged in only to facilitate entry into the market.

Limited Ability

As will be appreciated, the ability of the RTPC to make orders is somewhat limited. If the licensor is not a major supplier of the type of products under review and the sale of such products has not yet commenced in Canada, the RTPC is not likely to be in a position to make an order overriding exclusive dealing, market restriction or tied selling provisions. As the parties grow in size, however, a reviewable trade practice could come into being provided the criteria set forth in paragraph 31.4(2) of the act are met.

Section 38 of the Combines Investigation Act sets forth a number of matters which are considered to be indictable offenses under the act. These offenses include conspiracy to restrain or injure competition unduly, mergers and monopolies which unduly limit competition, price discrimination and resale price maintenance. Convictions under the Conspiracy and Merger and Monopoly Provisions of Section 34 are now extremely rare due to the onerous evidentiary burden placed on the Crown of providing that competition has been unduly limited in the market. However, great care and caution must be exercised, particularly with respect to the prohibition of agreements which tend towards resale price maintenance. Essentially, an indictable offense arises in a situation where one person who supplies a product, by

agreement, threat, promise or any like means, attempts to influence upward or to discourage the reduction of the price at which another person supplies the product.

Accordingly, it is important that if a licensing agreement should speak to prices at all, it should be made perfectly clear that the licensee is under no obligation to accept any suggested resale prices of the licensor and that the licensee may sell at any price it chooses. It should further be made clear in the agreement that if the licensee chooses to sell at prices other than those suggested by the licensor, the licensee will not suffer in any way in its business relations with the licensor.

Finally, conduct contrary to the Combines Investigation Act does not, as such, invalidate a patent nor is it necessarily a defense to infringement unless elements of illegality and/or fraud are involved.

Statute of Monopolies

The other statutory enactment which should be borne in mind is the Statute of Monopolies. This Statute was enacted in 1624 during the reign of King James I. The act declared that, by common law, all monopolies and letters patent of any kind were and always had been null and void, but provided an exception in Section 6 of the Statute in case of:

"Letters Patent and Grant of Privilege for the Term of Fourteen years or under . . . to the true and first Inventor and Inventors of such Manufactures, which others at the Time of Making such Letters Patent and Grants shall not use, so long as also they be not contrary to the Law, nor mischievous to the State, by raising Prices of Commodities at home, or Hurt of Trade or generally inconvenient . . ."

It is generally felt that the Statute of Monopolies became part of the law of Canada pursuant to the Treaty of Paris of 1763. In any event, in Ontario, the Statute of Monopolies was specifically adopted by statutory enactment. There is considerable doubt whether the Statute of Monopolies as enacted by the province of Ontario is *intra vires* the proviso that is within the legislative jurisdiction of the province to enact, insofar as the statute purports to deal with matters in respect of patents of invention, a legislative authority assigned to the exclusive jurisdiction of the Parliament of Canada.

In other respects, and insofar as the Statute of Monopolies purports to be concerned with civil rights within the province or with the administration of justice within the province, it is at least arguable that the Statute of Monopolies is within the legislative competence of the province of Ontario and is therefore validly enacted.

No claimant has been successful in asserting a claim under the Statute of Monopolies, the court having sidestepped the issue by deciding the cases on other grounds. Courts have notably refrained, however, from expressing an opinion with respect to the validity, constitutional or otherwise, of the Statute of Monopolies and have in fact made a point of not specifically discouraging claimants, in the proper circumstances, from bringing a claim pursuant to the provisions of the Statute.

Insofar as the monopoly or near-monopoly exercised pursuant to a trade secret does not fall within the exception provided by Section 6 of the Statute of Monopolies, it would perhaps be wise for parties to licensing agreements affecting the transfer of con-

fidetial information to keep a watchful eye on the provisions of the Statute of Monopolies.

CONCLUSION

The continuous scientific and technological growth throughout the world would indicate an increased activity in the field of trade secrets, know-how and technical information and the licensing thereof. Those who practice in this area of law will doubtless seek to

maintain a sound working knowledge of the law. This should preferably include not only the requirements of the main enactments and conventional agreement structuring but also an awareness of the peripheral laws and statutes such as those previously mentioned. Such an awareness could ensure compliance with any federal or provincial laws, the contravention of which could prove financially and publicly disastrous for any normally law-abiding and well-intentioned company.