

Late Developments in EEC

Important new decisions affecting technology transfer and franchising agreements are analyzed

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In this paper we will deal with the most recent developments regarding the transfer of technology into EEC. The Commission within the last two years has shown a more accurate position as regards this matter.

After adoption of block exemptions for patent licensing agreements, the Commission has dealt with regulating know-how and franchising agreements. We will divide this study in the proposed draft regulation of know-how agreements and the ones concerning franchising, as well as the latest decisions that have been taken in these matters.

THE DRAFT COMMISSION REGULATION ON THE APPLICATION OF ARTICLE 85(3) OF THE TREATY TO CERTAIN CATEGORIES OF KNOW-HOW LICENSING AGREEMENTS

Background of the Regulation

The Commission in drafting this Regulation, recognized the importance of non-patented technical information, the large number of agreements currently being concluded by industry solely for the exploitation of such information, and the need of greater legal certainty with regard to the status of such agreements under the competition rules.

Features of the Regulation

In general terms, we can say that the draft Regulation is quite liberal. As Mr. Sutherland stated in a meeting that took place in June 1986, competition rules should not discourage the creation and dissemination of advanced technology in the Common Market.

It is clear that as technology opens up new markets and creates new competitors and products, competition is strengthened.

The Regulation follows these ideas by treating some restrictions on conduct as not infringing Article 85.1 and others as meriting an exemption along the lines of the group exemptions for patent licensing agreements.

Definition of Know-How

The draft Regulation considers as know-how non-patented technical information (e.g. descriptions of manufacturing processes, recipes, formulae, designs

or drawings) that are secret and substantial.

The term "secret" is meant in the sense that the know-how package as a whole or in the precise configuration and assembly of its components is not generally known or easily accessible.

The term "substantial" is intended to include information of decisive importance for the whole or a major part of:

- A manufacturing process or
- A product or
- For the development of the abovementioned.

Scope of the Regulation

The draft Regulation is applied to pure know-how agreements and mixed agreements.

Pure know-how licensing agreements — The information that is conferred may include related software and design features of products.

Mixed agreements — In these agreements, a patent or trademark license is granted along with the transfer of know-how. Included are:

— Mixed know-how and patent licensing agreements in which the know-how component is essential for the exploitation of the licensed technology and in which the licensed patents are not necessary for that purpose, since they are not covered by the Patent Licensing Regulations.

— Mixed patent and know-how licensing agreements in which the patents are necessary for the exploitation of the licensed technology and which restrict that exploitation in Member States without patent protection, since such agreements are not covered by the Patent Regulation.

— Know-how agreements containing ancillary provisions relating to trademarks, except those in which the licensing of the trademark is the main purpose of the agreement.

The Regulation excludes from its scope of application agreements solely for the purpose of sale, except where the licensor undertakes for a preliminary period before the licensee himself starts the production using the licensed technology to supply the contract products for sale by the licensee (Rec. 8).

In its Article 5 it excludes the same agreements as those considered in Article 5 of the Patent Regulation with the peculiarity of mentioning the case of agreements including the licensing of copyrights and design rights.

The Duration of the Exemption

The Commission has considered it appropriate to limit to a fixed number of years the period of territorial protection that are admitted by the Regulation.

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The duration is of seven years except for agreements that include the obligation of not putting the licensed product on the market in the territories licensed to other licensees within the Common Market, or obligation to use only the licensor's trademark, which will be only five years.

This period of time has been taken considering the interests of both the licensor and the licensee.

The licensor is assured against the danger that the licensees would quickly terminate the agreement and continue using the know-how made available to him. This is important because of the difficulty of exercising a post-term use ban.

The licensee may have access to a continuous flow of know-how and a chance of recouping his investment without running the risk that the licensor may terminate the agreement prematurely.

Analysis of the Clauses

The classification of the clauses contained in the Draft Regulation of know-how is similar to the one of the Patent Regulation. We will only make a comment on those which suppose a difference.

White-listed clauses:

— Territorial restrictions. It should be pointed out that as a condition for the exemption, the Regulation requires a detailed description of the know-how.

- Obligation not to sublicense.
- Fields of use.
- Quality standards and specifications.
- Secrecy.

Blacklisted clauses:

— Noncompetition.

— Improvements — The Regulation specifies the prohibition of the obligation on the licensee to grant the licensor an exclusive license for improvements that would prevent him from using or licensing them, where such licensing would not disclose the original and still secret know-how.

- Tie-in clauses.
- No challenge.
- Customers' restrictions.
- Price restrictions.

Other clauses include:

— Post-term use ban. It is white-listed as long as the know-how is secret and does not consist only of practical experience.

It becomes a blacklisted clause when the know-how is public.

The inclusion of this clause produces the prohibition of imposing the licensee a grant-back obligation upon the licensor for improvements in the conditions of Article 3(c).

— Royalties. The following obligations upon the licensee are white-listed —

- To pay a minimum royalty.
- To continue paying turnover-related royalties for up to three years after the know-how has become publicly known through the action of third parties.

On the contrary, payment of royalties on goods or services not entirely or partially produced by means of the licensed technology or for the use of know-how, which has become public by action of the licensor or an undertaking connected with him, is blacklisted.

Other Features of the Draft Regulation

The know-how Regulation follows the patent Regulation as regards the inclusion of the opposition procedure and the retroactive effects of its application.

RECENT DECISIONS OF THE COMMISSION RELATING TO KNOW-HOW LICENSING AGREEMENTS

The latest decisions of the Commission follow the lines of the Draft Regulation. The most significant ones are *Boussois / Interpane*, 15 December 1986, and *Mitchell Cotts / Sofiltra*, decided two days later.

Boussois / Interpane

The agreement concerns the transfer by the German firm Interpane to the French firm Boussois of a body of technical information, some patented and some not, in connection with the sale to Boussois of a production plan for applying fine thermal insulation coatings to flat glass to produce insulating "low-emissivity" glass for double-glazing units.

The unpatented know-how license to Boussois is substantial in that it comprises a body of detailed information.

Three provisions of the agreement were considered restrictive of competition:

— The exclusivity of manufacture and sale in France granted to Boussois because it prevents other licensees for the same territory for five years and Interpane for two years from manufacturing or selling in France the products covered by the agreement. It also prevents future licensees for other territories in the Community from directly selling in France for five years.

— The prohibition on Boussois manufacturing outside France.

— The prohibition on Boussois selling the products in another territory within the Community outside France.

The Commission exempted these clauses under Article 85.3 because each produces benefits comparable to those arising from the patent licensing agreements exempted by Regulation 2349/84. It stressed that the parties in view of the average life cycle of the technology of only about five years have limited their secrecy obligation and the licensees' exclusivity to this period, it is appropriate to grant exemption until the end of the five years period.

Mitchell Cotts / Sofiltra

The decision concerns agreements between an English Company, MC and a French Company, Sofiltra, for the creation of a joint-venture company in the United Kingdom with the grant of a know-how license by Sofiltra to the joint venture for the manufacture and marketing of high-efficiency air filters using microfine glass fiber for the nuclear, biological, chemical and computer markets.

The Commission considered the following provisions as not restrictive of competition, according to 85.1:

- The obligation of the joint venture:
 - To maintain confidentiality in respect of the know-how, information or technology disclosed to it.
 - Not to grant sublicenses.
 - To disclose to Sofiltra any improvements developed or acquired by the joint venture, and to grant roy-

alty-free nonexclusive licenses to Sofiltra for the use of such improvements.

— The obligation of Sofiltra to disclose, on a nonexclusive basis, to the joint venture any improvements or inventions relating to the licensed equipment that it had lawfully acquired or with respect to which it had the right to grant licenses.

The Commission considered in the specific circumstances of the case that the obligation imposed on the joint venture not to manufacture or deal in products competing with the licensed product was necessary and is not an appreciable restriction of competition.

On the other hand, a mutual ban on active sales was considered to fall within Article 85.1 since such a restriction results in the sharing of markets between Sofiltra and the joint venture, which are competitors.

Nevertheless, the Commission considered that the restrictions were indispensable to attain the benefits to which the joint venture gives rise and exempted them under 85.3.

THE PROPOSED BLOCK EXEMPTION REGULATION FOR FRANCHISING AGREEMENTS

At the end of June, the Commission forwarded a draft of its proposed block exemption Regulation for franchising agreements to the Member States for consultation.

This has been the last step after the two famous decisions taken on this subject: the *Pronuptia* decision of January 28, 1986, and *Yves Roches* of December 17, 1986.

The Commission considers that the block exemption Regulation is one of the great innovations of Community law and provides a clear criteria for determining an agreement's legal status. We will make an analysis of the Draft Regulation pointing out the provisions that have more interest.

Scope of the Regulation

The Regulation concerns four kinds of franchising, which are defined in Article 1. These are:

- Producer's franchising agreements.
- Distributor's franchising agreements.
- Service franchising agreements.
- Master franchise agreements.

Definition of Franchise

According to the Regulation a franchise means a package of intangible property rights relating to trademarks, trade names, shop signs, utility models, designs, copyrights, know-how or patents, to be exploited for the resale of goods or the provision of services of end users and which includes:

- The use of a common name or sign and a uniform presentation of contract premises.
- The communication of a substantial know-how.
- The continuous provision of commercial or technical assistance by the franchisor to the franchisee.

Structure of the Regulation

The Draft Regulation on franchising is similar to the patent licensing agreements Regulation. As the latter, it contains a list of permitted restrictions, i.e. a white list, a blacklist, and an opposition procedure.

It also deals with the conditions to apply the block

exemption (Article 3). These conditions reflect the interest of the Commission that competition is not limited and that there is the possibility of parallel imports.

As a consequence of this, it does not allow a ban on purchasing franchising goods from other franchisees, so that crossed supplies between franchisees are permitted.

When a system of franchising is combined with a selective distribution system, the franchisee must be free to obtain the goods from approved distributors (Article 3a).

In order to assure an equitable position to consumers, the Regulation provides for an EEC-wide guarantees system for franchised products (Article 3.b).

The last condition the agreement must fulfill is the freedom of the franchisee to acquire a financial interest in the capital of competitors of the franchisor where this investment does not involve him personally in carrying on competition activities.

Analysis of the Clauses

Among the clauses deemed to be restrictive of competition that qualify for automatic exemption under the draft regulation are:

— The grant of exclusivity by the franchisor in a specified territory to the franchisee.

— The obligation of the franchisee to exploit the franchise only from the contract premises.

The clauses that are restrictive of competition but are permitted are in Article 4. That is what we can call the white list.

These are the white-listed clauses:

- Purchasing obligations on the franchisee.
- Quality obligations.
- Resale of the products only to end users or to other franchisees.
- Noncompetition.
- Use of know-how only for the exploitation of the franchise.
- Secrecy obligation.
- Minimum turnover.
- Prohibition to sub-assign.

The benefits of the block exemption would not be available where in the agreement appears the clauses of Article 5, i.e. the blacklist. These clauses are the following:

- Obligation of the franchisee to obtain supplies of goods from the franchisor when the products that are the object of the franchise do not bear the franchisor's trademark.
- The franchisee is obliged to obtain supplies of goods from the franchisor or third parties nominated by the latter where he can obtain identical goods from third parties on more favorable terms.
- Resale price maintenance.
- No-challenge clause.

The Opposition Procedure

The same as in the Patent Regulation, and in the Draft Regulation on know-how, this procedure is included (Article 6). By this, the Commission permits to maintain a sufficient degree of flexibility.

It makes possible for certain borderline provisions, which are included neither in the white list nor in the blacklist to benefit from an exemption after notifying to the Commission if the Commission does not raise objections within six months.

Some Ideas About the Draft Regulation

This Regulation is mainly based in the European Court's judgment in the Pronuptia case. However, its provisions differ considerably depending on whether the franchised goods are sold under the franchisor's trademark or not, and there are some differences from the Court's approach.

The main departures from the judgments are the following:

- The obligation of no competition in the territory of the franchisee or one of the other franchisees is limited to the life of the agreement.

- The Draft Regulation, which protects the franchisee's possibility of obtaining the franchised products from other sources, does not include in the white list an obligation to purchase the contract products only from the franchisor, even where the products concerned are sold under the franchisor's trademark. Such an obligation is necessary to protect the reputation of the franchisee.

THE LAST CASE ON FRANCHISING

The last case which the Commission decided is the *Computerland* franchise system issued on April 29, 1987.

In this notice, the Commission announced its intention to grant an exemption to the standard franchise agreement employed by Computerland in connection with its network of franchise and retail stores.

Under the Computerland agreements, franchisees use the Computerland name, trademarks and system to sell, predominantly to business end-users, various brands of microcomputer products produced by the major computer manufacturers and to provide service and training facilities with respect thereto.

The main aspects of the Computerland system can be summarized as follows:

- Franchisees are given a nonexclusive right to use the Computerland name, marks and system in connection with the franchise.

- To obtain these rights, the franchisees must pay an initial entrance fee and monthly royalties.

- The use of the rights granted is limited to the franchise and upon termination of the agreement the franchisee must cease using this and return the operator's manual and any other copyrighted material to the franchisor.

- The franchisee may continue to use any improvements it has developed as long as these are separable from the operation of the Computerland system.

- Territorial exclusivity and territorial restrictions on sales are not an essential aspect of the Computerland system.

- Franchisees are permitted to sell to customers regardless of where they reside or do business and may also establish satellite showrooms and sales facilities outside their protected area.

- Franchisees are free to buy the products they sell from any supplier.

- Franchisees are required to sell only to end-users, except in the case of sales to other Computerland franchisees and subject to any exception resulting from rights franchisees may have because of arrangements with manufacturers.

The Computerland agreements that were initially notified imposed an obligation not to engage or have a controlling interest in any business whose activities include the sale or service of computer products offered by Computerland stores.

This obligation lasted for the time of the agreement and after three years of its termination at a given distance from the ex-franchisee's former outlet, two years at a given distance from any Computerland store and one year at any location.

Computerland modified this noncompetition clause and now it applies within a radius of 10 kilometers from the franchisee's former outlet, for only a one-year period following termination of the agreement.

This decision will be the first one in which the Commission treats a business-formed franchise in which none of the products sold by the franchisee are produced or trademarked by the franchisor. This is why territorial exclusivity plays a less significant role than would normally be the case.