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PATENT LICENSING AGREEMENTS AND ANTI-TRUST IN THE EEC: RECENT DECISIONS OF THE EEC COMMISSION

I. Introduction

In a series of recent cases, the Commission of the European Community has redefined the limitations on the terms of patent licensing agreements in the European Economic Community (the Common Market), in relation to the Community goals of encouraging the maximum development of free competition within the Community while also encouraging technical and economic progress. These decisions interpret the application of Art. 85 of the Treaty of Rome to patent licensing agreements. Art. 85(1) prohibits all agreements between enterprises that are likely to affect trade between member states of the Common Market and whose object or effect is to prevent, restrict, or distort competition within the Common Market. Even where an agreement is held to restrict competition under Art. 85(1), Art. 85(3) provides that the provisions of Art. 85(1) may be declared inapplicable to agreements that help to improve the production or distribution of products or to promote technical or economic progress, while meeting certain other criteria. In applying Art. 85 to patent licensing agreements, the Commission has paid special attention to market factors in determining whether a particular agreement is permissible. Patent licensing agreements can have the effect of splitting markets along national lines and of restricting competition, yet such effects may be commercially justifiable and necessary for proper exploitation of the patent. In the 1962 Notice on Patent Licensing Agreements, the Commission set out a policy statement with regard to patent license terms which did not fall under Art. 85. Commission decisions in recent cases, however, have modified and partially overruled this Notice, and the Commission in these cases has stressed the need to assess the propriety of particular license terms with regard to the market situation involved in the particular case. In these decisions, the Commission examined the particular economic circumstances of each agreement, and of particular clauses within each agreement, to balance the effects on competition with the economic benefits to be derived. The result is that the application of Art. 85 to patent licensing agreements is very flexible, and also very complicated for the foreign company wishing to enter into such arrangements with a European firm. This Note examines the general approach of the Common Market to patent licensing, and the application of this approach to particular license terms, in light of recent Commission cases.

1 Mar. 25, 1957, 298 U.N.T.S. 3. Articles of the EEC Treaty will be cited without further reference. The provisions of the Treaty and implementing regulations may be found in the CCH COMMON MARKET REPORTER.

2 CCH COMM. Mkt. Rep. ¶ 2698 (1962) [hereinafter cited as CCH]. The Notice on Patent Licensing Agreements is hereinafter referred to as the Notice.

3 Re Burroughs-Delplanque, CCH ¶ 9485 (1972); Re Burroughs-Geha-Werke, CCH ¶ 9486 (1972); Re Davidson Rubber, CCH ¶ 9512 (1972); Re Raymond-Nagoya, CCH ¶ 9513 (1972).
II. Article 85 of the Treaty of Rome

By the Treaty of Rome, signed in 1957, France, West Germany, Italy and the Benelux countries established the European Economic Community (EEC), also known as the Common Market. The goal of the Treaty was the eventual economic and political unification of the member countries. Economic unification is to be achieved by eliminating national barriers to the free movement of goods and services within the Community. The Treaty foresees a large, open, unified market, not restricted by national boundaries. Such a market relies largely on free competition of businesses operating throughout the Common Market. By Art. 3(f), one of the aims of the Community is “the establishment of a system ensuring that competition shall not be distorted in the Common Market.” The major provision establishing rules of competition in the Common Market is Art. 85 of the Treaty. Art. 85(1) prohibits agreements and concerted practices between undertakings “which are liable to affect trade between Member States and which are designed to prevent, restrict, or distort competition within the Common Market or which have this effect.” Under Art. 85(2) such agreements are void. The intention of Art. 85(1) is clearly

4 Among the methods toward this end are the elimination of customs duties between Member States (Arts. 12-17), the establishment of a common external tariff (Arts. 18-29), and articles providing for the free movement of persons, services and capital (Arts. 48-73). See C. Fulda & W. Schwartz, Regulation of International Trade and Investment 107 (1970). The fact that an agreement in violation of Art. 85(1) is void can be a strong deterrent to such violations. It means that the contract will not be enforced in a civil suit even if valid under national law. In Re Agfa-Optima, 2 C.M.L.R. 268 (1963), a German court held that an agreement for price maintenance and restriction of exports, though valid under German law, was not enforceable as it was within the scope of Art. 85(1) and had not been notified to the Commission of the European Communities. See A. Campbell, Restrictive Trading Agreements in the Common Market, 15(4) (1964). The European Court of Justice held in Consten-Grundig, CCH ff 8046 (1966), that the nullity imposed by Art. 85(2) affects only the offending elements in the agreement whenever such elements are severable.

5 The text of Article 85 reads:

1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings, and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:
   (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
   (b) limit or control production, markets, technical development, or investment;
   (c) share markets or sources of supply;
   (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
   (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:
   — any agreement or category of agreements between undertakings;
   — any decision or category of decisions by associations of undertakings;
   — any concerted practice or category of concerted practices;
   which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
   (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
   (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

6 Id.
to break down barriers to free competition within the Common Market and to prevent private agreements from maintaining the barriers which the member states have agreed to remove. Agreements which are void under Art. 85(1) include those limiting production, markets, and technical development, as well as market-sharing agreements. Such agreements, and in particular exclusive dealing agreements on national lines, would maintain the traditional European pattern based on national units in which distributors or licensees are given exclusive rights by foreign producers and licensors. It is this pattern which the Treaty is attempting to transform into a Community-wide market. An example of the conflicts involved can be seen in Grundig and Consten v. EEC Commission. In that case the German manufacturer, Grundig, had entered into an agreement with Consten, its French distributor of electrical appliances, by which Consten was given exclusive French rights to the trademark "GINT," while agreeing not to export from France. The intent of this agreement was to give Consten an exclusive distributorship, protected by French trademark law. This would permit the division of the European market along national boundaries, with each of the national distributors free from competition in the trademarked products. The European Court of Justice held that this agreement contravened Art. 85, despite the fact that it was valid under French law, because it restricted trade between EEC countries in the goods distributed. The facts of the case indicate the strength of the commercial interest in dividing markets on national grounds, and the decision indicates the intention of the Common Market to use Art. 85 to press toward more truly European markets, even to the extent of nullifying national laws.

The Treaty in Art. 85(3) recognized that there can be advantages to some restrictions on competition. It provides that an agreement which violates Art. 85(1) may nonetheless be permitted if it "helps to improve the production or distribution of goods or to promote technical or economic progress." In addition, such an agreement must allow consumers a fair share of the profit that results from the restrictions, must be indispensable to the achievement of the objectives under which the exception is granted, and must not enable the concerns to eliminate competition in respect to a substantial part of the goods concerned. The basic policy is that there are certain purposes which justify making exceptions to the general rule—improvements in production or distribution of goods and technical or economic progress—but this must not unduly impair other purposes of the Treaty, that is, benefit to the consumer and competition. In cases where the Commission or the European Court of Justice finds that an agreement falls under the provisions of Art. 85(3), an exemption is granted to the application of Art. 85(1).
III. Interpretation of Article 85

In interpreting Art. 85(1), the Court and the Commission have not adopted rules of per se illegality of contract terms. They have, in each case, looked to whether the contract clause had an effect on competition or might have such an effect. This is the doctrine of "effet sensible" or "appreciable effect"—in order to fall under Art. 85(1), the agreement must have an appreciable effect on competition in the Common Market. For example, in Volk v. Verwaeye, the Court upheld a contract term providing for exclusive right of sale within a national territory and for protection of the market because the parties had an insignificant share of the market. In the recent Notice Concerning Minor Agreements, the Commission set out quantitative guidelines for agreements considered not to have an "appreciable effect" upon market conditions. If the products to which the agreement relates do not exceed 5% of the market and if the annual turnover of the undertakings concerned does not exceed 15 million units of account (which are in terms of gold, and formerly about 1 U.S. dollar) or 20 million in the case of commercial undertakings, the agreement does not fall under Art. 85(1).

Where the Court or the Commission has found that the effect on market conditions is appreciable, Art. 85(1) applies to prevent restraints on competition. In the Grundig-Consten case, the European Court of Justice held that an attempt to reserve the French market through use of a French trademark license contravened Art. 85. The Court adopted a dubious distinction between the "exercise" and the "existence" of an industrial property right, but it clearly came down in support of the international principle inherent in Art. 85, as opposed to the national property right provided by French law. In other Court of Justice cases as well, it has been a general intention of the Court to foster the principle of internationalism. In Sirena, the Court held that the owner of an Italian trademark for cosmetics could not use the mark to prevent import of the products by a German user of the trademark. In these and other cases,

before the Court of Justice. A. ROBERTSON, EUROPEAN INSTITUTIONS 167-76 (2nd ed. 1966). Regulation 17 of 1962, CCH 2401-634 (1962), is the basic regulation under which the Commission acts as an enforcement agent of Art. 85. It requires, with certain exceptions, that all agreements which fall under Art. 85(1) must be notified to the Commission. The Commission may then issue a negative clearance, which states that the agreement is not in violation of Art. 85(1). The Commission may alternatively issue an exemption under Art. 85(3), or it may declare the agreement void in whole or in part. Failure to file can result in the agreement being void under Art. 85(2). Article 15 of Regulation 17 also provides for fines for violations, whether willful or negligent, of Art. 85 or of Art. 86, which deals with abuses of dominant market positions. The fines may be as much as one million dollars or 10% of the turnover of the last business year.

13 CCH 8046 (1966).
14 Jones, supra note 7, at 98 n.69.
15 CCH 8101 (1971); Jones, supra note 7, at 98-99.
16 Beguelin, CCH 8149 (1971) (French unfair-competition law held not to apply to an exclusive distribution contract solely to bar parallel importation); Deutsche Grammophon, CCH 8106 (1971) (German law providing exclusive rights of sale to sound-recording manufacturers held not applicable to prevent reimportation into Germany from French subsidiary).
the Court has made it clear that agreements which restrict distribution and sale of products to national markets in the EEC and which prevent competition by imports fall under the ban of Art. 85. One exception is Parke-Davis & Co.\textsuperscript{27} That case involved a suit brought by Parke-Davis, which held a Dutch patent on a drug, to prevent imports of the drug from Italy, which does not permit patenting of drugs. The Court upheld the Parke-Davis claim; to rule otherwise would have made almost worthless the Dutch patent. This ruling indicates that the Court will examine the nature of different industrial property rights, and that some will receive more protection than others.\textsuperscript{18} Patent rights, it appears, are those considered most entitled to special protection, even at some expense to the policy of fostering competition across national borders. Under the ruling in Parke-Davis, the exercise of patent rights does not fall under the prohibition of Art. 85 as distorting competition, though the concerted use of patents could in some cases amount to a violation.\textsuperscript{19}

When an agreement runs afoul of Art. 85, the Court and Commission have looked to the commercial realities surrounding an agreement to decide whether it meets the criteria for an exemption under Art. 85(3). In Re Transocean Marine Paint Association,\textsuperscript{20} an agreement among a worldwide association of marine paint manufacturers giving exclusive trademark rights within national territories and restricting competition within allotted areas, along with agreements concerning uniformity of standards and other terms, was held to appreciably restrict competition within the EEC. It was given an exemption, however, under Art. 85(3) because the agreement promoted improved distribution of marine paint, and because the agreement contained only restrictions which were indispensable to the improvement of distribution. The Commission also stressed that this was a new and small enterprise which had only a small part of the worldwide market for marine paints, and, in consequence, that the restrictive agreements were necessary for the initial organization of the company and did not enable it to eliminate competition. Decisions by the Commission concerning the granting of exemptions have emphasized such factors as lack of restrictions on exporting in exclusive dealing agreements,\textsuperscript{21} the benefits received by the consumer in terms of better services without a large increase in price,\textsuperscript{22} and the promotion of technical progress.\textsuperscript{23}

Another requirement of Art. 85(3) is that the agreement allow to the user "a fair share of the resulting benefit." In Re D.R.U.-Blondel,\textsuperscript{24} the Commission granted an exemption to an agreement by a Dutch firm to give exclusive distribution rights in France to Blondel for enamelled household articles, on the grounds that the agreement permitted a simpler distribution system. Further, the Commission found that Blondel had lowered prices, thus giving benefit to

\begin{itemize}
  \item 17 CCH \textsuperscript{\textregistered} 8054 (1968).
  \item 18 Jones, \textit{supra} note 7, at 101-02.
  \item 19 G. ZAPHRIOU, \textit{EUROPEAN BUSINESS LAW} 254 (1970); Parke, Davis & Co., CCH \textsuperscript{\textregistered} 8054 (1968).
  \item 20 CCH \textsuperscript{\textregistered} 9188 (1967).
  \item 21 Re D.R.U.-Blondel, CCH \textsuperscript{\textregistered} 9049 (1965).
  \item 22 Re Hummel-Isbecque, CCH \textsuperscript{\textregistered} 9063 (1965).
  \item 23 Re Eurogypsum, CCH \textsuperscript{\textregistered} 9220 (1968); Re ACEC-Berliet, CCH \textsuperscript{\textregistered} 9251 (1968).
  \item 24 CCH \textsuperscript{\textregistered} 9049 (1965).
\end{itemize}
the consumer. In \textit{Grundig-Consten},\textsuperscript{25} on the other hand, the Court found that prices for the products of the German manufacturer were unreasonably higher in France than in Germany, so that no exemption could be granted. Such price differentials will be strong evidence against any application of Art. 85(3). Benefit to the consumer has also been found where the agreement results in improvements in the quality of products and in service.\textsuperscript{26}

These cases emphasize that economic considerations play a major part in decisions of the Commission with regard to exemptions. With the exception of prohibitions on exports, which are virtually always banned,\textsuperscript{27} Commission decisions have emphasized the examination of the effect of any particular agreement on market conditions, rather than the establishment of standards of per se invalidity.\textsuperscript{28}

IV. Application of Art. 85 to Patent Licensing Agreements

Patent licensing agreements are the most important forms of industrial property rights transactions in relation to anti-trust law because they provide the best means by which limitations in competition can be effectively imposed.\textsuperscript{29} The \textit{Parke-Davis} case\textsuperscript{30} is an indication of the degree to which the Court gives greater protection to patent rights than to, for example, trademark rights.\textsuperscript{31} No case has yet reached the European Court of Justice on exclusive licensing agreements of patent rights.

The Commission issued the Notice on Patent License Agreements on December 24, 1962,\textsuperscript{32} that indicated certain clauses not falling under the prohibition of Art. 85(1). This Notice was intended to indicate the considerations by which the Commission would be guided in interpreting Art. 85(1), and was subject to rules to be developed by judicial practice. Among other terms, it stated that the licensor could agree: 1) not to authorize any other person to utilize the invention and not to utilize the invention himself; 2) to grant regional licenses; 3) to set and enforce standards of quantity and quality; and 4) to

\textsuperscript{25} CCH \S 8046 (1966). In Parke, Davis & Co., CCH \S 8054 (1968), the Court ruled that it was not illegal per se for a patented product to be of higher price than the imported product, though where an objective ground for the price differential is lacking, this may be an abuse. In Deutsche Grammophon, CCH \S 8106 (1971), however, the Court seems to have toughened its stand, by stating that a price differential, if not explainable on objective grounds, can be conclusive evidence of an abuse of Art. 86, which concerns abuse of dominant position. This may be in part explained by the greater weight given to patent rights, as in \textit{Parke, Davis}, compared with trademark rights, as a \textit{Deutsche Grammophon}. See Jones, \textit{supra} note 7, at 101.

\textsuperscript{26} Re SOPELEM-Langren, CCH \S 9488 (1972); Re Davidson Rubber, CCH \S 9512 (1972).

\textsuperscript{27} But see Re Raymond-Nagoya, CCH \S 9513 (1972).

\textsuperscript{28} Jones, \textit{supra} note 7, at 111-12.

\textsuperscript{29} G. ZAPFIRIOU, \textit{supra} note 19, at 255.

\textsuperscript{30} CCH \S 8034 (1968).

\textsuperscript{31} The Court argued that trademarks were entitled to less protection than patent rights in Sirena, CCH \S 8101 (1971), arguing that "The purpose of trademark law is (in contrast to patent law) not to create a monopoly in favor of the trademark owner and thus to restrict competition, but to prevent the public from being deceived by misleading names." Id. at \S 7107. By this logic, the setting up of a monopoly might be justified under a patent right, but to attempt to do so under a trademark would be a misuse. See Schumacher, \textit{A Common Market Overview of the Competition Problem in the Seventies}, in \textit{CURRENT LEGAL ASPECTS OF DOING BUSINESS IN EUROPE} 58, 60 (L. Theberge ed. 1971), Jones, \textit{supra} note 7, at 101-02.

\textsuperscript{32} CCH \S 2698 (1962).
require the licensee to mark the product with an indication of the patent. These provisions have been elaborated and, in some cases, modified by the recent decisions of the Commission.

The first two cases to reach the Commission, *Re Burroughs-Delplanque* and *Re Burroughs-Geha-Werke,* concerned exclusive licensing of patents and know-how for the manufacture of plasticized carbon paper, by the American corporation Burroughs to the French firm Delplanque and the German firm Geha-Werke. Burroughs had granted licenses for the use of two patents to these manufacturers, agreeing that each was to have the exclusive right to the use of the patent in their respective countries, and had also given licenses for trademarks and know-how. The Commission stated that Art. 85 could be applicable to exclusive licensing of patents because such agreements restrict the freedom of the licensor to permit the competitive use of the patent within the exclusive area. In the *Burroughs* cases, however, the Commission noted that the share of the market for carbon paper held by the parties to the agreements was small, about 10%; that the product was relatively new; and that licensors were free to sell the patented products everywhere in the Common Market. Furthermore, the Commission felt that other terms of the agreements (e.g., the requirement that the licensees keep secret any technical knowledge imparted to them by Burroughs) were essential to the licensor. The Commission decided that the agreements did not violate Art. 85 because they did not perceptibly affect competition. There was a competitive market for the goods, and the licensees could compete with one another (particularly as the goods were easily transportable) as well as with other producers.

In *Re Davidson Rubber,* the Commission was presented with a set of agreements similar to those in the *Burroughs* case. The Davidson patents were for an improved process for making automobile armrests and seat cushions. Davidson gave licenses for the use of two patents to a German, a French, and an Italian manufacturer, and agreed not to authorize anyone other than these manufacturers to utilize its patents or know-how within the specified areas each was given. The contracts also contained provisions governing use and transmission of know-how and provisions restricting sub-licensing. Although the contracts had originally contained export bans, these had been removed by the time of the Commission case. The licensees’ production of armrests represented about a third of the production in the EEC; other independent manufacturers

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33 CCH ¶ 9485 (1972).
34 CCH ¶ 9486 (1972).
35 Id. at 9044.
36 Jones, *supra* note 7, at ¶ 103-04.
37 CCH ¶ 9512 (1972).
38 The German company, Happich, was assigned exclusive use in Germany, Belgium, Luxembourg, the Netherlands, and Sweden; the Italian company Gallino had exclusive use in Italy; and the French company Maglum had exclusive use in France. In another contract, use of the patents to produce auto seat cushions was given to STAR, an Italian company, with the consent of Gallino.
39 A sub-license required the consent of Davidson. The French company Maglum, with Davidson’s consent, entered into a sub-licensing agreement with C.I.M. in 1965. The Commission held that this restriction was not covered by Art. 85(1), because it was “covered by the licensor’s exclusive right and also was justified by the licensor’s interest in not having its know-how conveyed without its consent to enterprises other than those authorized to utilize it.” CCH ¶ 9512, at 9141 (1972).
produced about a third, while auto manufacturers themselves produced the remaining one third. In Davidson the Commission held that the agreements had the object and effect of appreciably restricting competition within the Common Market and fell under Art. 85(1) because Davidson was restricted from licensing other producers and because the licensees had a substantial share of the market.\(^4^9\)

The basis for different decisions in the two Burroughs cases and the Davidson case lies in the different market situations involved. In all three cases the Commission stated that the holder of a patent may give licenses for a specified territory. It went on to qualify this privilege in Davidson:

> If, however, the owner agrees to limit the utilization of his exclusive right to a single enterprise in a particular territory and grants that one enterprise the right to utilize the invention to the exclusion of other enterprises, he loses the possibility of concluding contracts with other applicants for a license. In some cases, therefore, an exclusive license covering industrial property rights can restrain competition and be prohibited under Article 85, paragraph 1.\(^4^1\)

The Commission noted that the Davidson process is the most important one of its type, that the number of competing processes and manufacturers is limited, and that the Davidson licensees had a substantial part of the market.\(^4^2\) The result, the Commission felt, was that the agreement substantially disadvantaged third parties, particularly other manufacturers of automobile fittings, because they were prevented from using the process. The Commission held that the agreements, consequently, fell under Art. 85(1).\(^4^3\)

The Commission looked primarily to the market situation involved in its holdings in the Burroughs and Davidson cases. In the Burroughs cases there were competing processes and manufacturers, and the Burroughs process accounted for only a small part of the market for carbon papers that could be used several times. The market was also, presumably, a wide one, and the product was a standard item for business use. The Davidson licensees accounted for up to 40% of the total production of automobile armrests in their respective countries. The armrests were designed and manufactured according to the specifications of the automobile manufacturers and used almost exclusively by them, as there was virtually no substitute market.\(^4^4\) The Davidson process, it appears, allowed the three licensees to achieve, vis-à-vis the other twelve major manufacturers of automobile armrests, a very dominant position with about a

\(^4^0\) The Commission also made several other specific holdings:
1. An agreement by a licensee not to contest the validity of a patent was held to be invalid because it "represented a restriction of the actual and potential competitive position without giving any indication of why it was indispensable for the achievement of the beneficial objectives of the agreements." OCH \(\parallel 9512\), at 9142 (1972).
2. The Commission upheld a provision granting a non-exclusive license to Davidson and to the other licensees, for any improvements in the process by any licensees. \textit{Id.} at 9141.
3. The Commission upheld an agreement to settle any disputes arising under the agreement by arbitration because, by the terms of the contract, no arbitral settlement could be expected to arise that could alter the Commission decision in the case. \textit{Id.}
4. \textit{Id.} at 9140.
5. \textit{Id.}
6. \textit{Id.}
7. By "consumer" in the Davidson case, the Commission meant not the ultimate consumer, but the buyer—the automobile manufacturers.
third of the total market. Where in the Burroughs cases the market was a competitive one and the product a standard one, in Davidson the market was oligopolistic and the product specialized. Restriction of the patent right to the three exclusive licensees was, in this market situation, held to fall under Art. 85(1).

The Commission went on in Davidson to consider whether the agreements might be granted an exemption under Art. 85(3) on grounds that the agreement promoted technical or economic progress. To qualify for exemption under Art. 85(3), an agreement must also 1) reserve for users a fair share of the resulting profit, 2) not impose restrictions that are not indispensable to the realization of the goals of improving production or distribution or promoting technical or economic progress, and 3) not make it possible to eliminate competition for a substantial part of the products concerned. The Commission decided that the agreements did promote technical and economic progress, primarily because they permitted use of the process in the EEC and provided for development and improvement of the process.\footnote{Id. at 9141 (1972).} In discussing the grounds for exemption, the Commission stressed the commercial necessity for such an agreement in order that the process might be introduced and developed. It recognized that the process might not have been introduced at all if the restrictions on territories had not been set up for the licensees.\footnote{Id. at 9142.} The Commission saw advantages to the automobile manufacturers not in terms of a fair share of the profits, but in terms of the availability of the process and of a ready source of supply. The Commission also argued that the effective introduction of the process into the EEC required limitation of the number of licensees for the benefit of the licensees, who would have to set up production facilities for the process. The Commission further decided that the restraint on competition was not excessive.\footnote{Id.} Considering the same market situation in which it had decided that the effect was appreciable under Art. 85(1), the Commission decided that the effect was not excessive under Art. 85(3). The licensees were not considered to be in a position to eliminate competition because they held a one-third share of the market. The Commission, therefore, held that the agreements fulfilled the conditions for applying the exemption under Art. 85(3).\footnote{CCH ¶ 9513 (1972).}

In Re Raymond-Nagoya,\footnote{In Re Kodak, CCH ¶ 9378 (1970), the Commission granted negative clearance to a distribution agreement between Kodak and its European subsidiaries on condition that certain market-splitting terms be modified. This included the removal of a ban on exports to other EEC countries. However, as in Raymond-Nagoya, the Commission permitted a ban on exports to countries outside the EEC, arguing that these were unlikely to affect competition within the EEC.} decided the same day as Davidson, a German subsidiary of a French limited partnership granted licenses for exclusive use in Japan and other Far Eastern countries to a Japanese company for a patented process for producing plastic automobile fasteners. This license contained a provision that the Japanese company would not export fasteners to any European countries—a type of provision which was specifically disapproved in Davidson. Nevertheless, the Commission held that the license agreement did not fall under Art. 85; the specialized nature of the fasteners and the resulting market for the
fasteners were such that the Japanese company was not likely to wish or be able
to compete effectively in the EEC. The agreement in consequence did not have
an appreciable effect on competition within the Common Market. The Com-
mission particularly noted that the plastic fasteners were designed in close con-
sultation with auto manufacturers and that it was very unlikely that any Eu-
ropean manufacturer would wish to contract with the Japanese firm on this
basis.

V. Application of Art. 85 to Particular Types of Patent License Clauses

The cases of the Commission and the Court strike a balance between en-
couraging competition and permitting restrictions which provide other beneficial
effects. In practice, the EEC is somewhat less restrictive than are the United
States courts in applying anti-trust principles to patent licensing agreements.
The recent cases provide fairly clear guidelines for the approach of the Com-
mision to particular patent license clauses though the flexibility of this approach
leaves the application of these guidelines highly dependent on the facts of any
individual case.

A. Exclusive Right to Use

The 1962 Notice on Patent Licensing Agreements provides that agreements
giving exclusive use of the patent do not fall under Art. 85(1). This has been
modified by the decisions in Burroughs, and especially in Davidson, where the
Commission argued that an exclusive license could, in certain circumstances, be
restrictive of competition. If the effect on competition is “appreciable,” it will
fall under Art. 85(1); but an exemption may be granted under Art. 85(3)
provided the exclusivity is necessary to interest potential licensees and provided
the other requirements of Art. 85(3) are met. Art. 85(1) is especially applicable
in narrow, oligopolistic markets such as that in Davidson.

B. Exclusive Sales Licenses and Export Bans

In Davidson, license terms providing for exclusive right of sale within
national territories were modified at the request of the Commission to become
non-exclusive. Such terms cannot be used to restrict trade between member

50 CCH ¶ 9513, at 9147 (1972).
51 Id.
52 Jones, supra note 7, at 93-96.
53 For consideration of the application of Commission decisions to particular clauses, see also J. CUNNINGHAM, supra note 12, at 154-61; Jones, supra note 7, at 102-10.
54 CCH ¶ 9512 (1972).
55 Jones, supra note 7, at 103.
56 In the U.S., a territorial restriction cannot be enforced against a purchaser of a
patented article who resells outside the authorized territory of the seller. As in the EEC, the
patent monopoly only extends to the first sale of the product. Keeler v. Standard Folding Bed
Co., 157 U.S. 659 (1895); Hobbie v. Jennison, 149 U.S. 355 (1893); Adams v. Burke, 84
U.S. (17 Wall.) 453 (1873). A territorial license to manufacture is valid under section 261
F.2d 121 (9th Cir. 1954).
states. Export bans also cannot be used to restrict competition. Export bans forbid licensees from exporting into the territories of other licensees; such bans provide protection against competition for each of the territorial licensees within the particular territory of the license. In *Raymond*, however, the Commission upheld an export ban on the Japanese licensee, because it would have no appreciable effect on competition in the EEC.57

C. Restrictions on Methods of Exploitation58

Under the Notice a license may be limited to manufacture, use, or sale; such a limitation on the use of the patent does not fall under Art. 85(1). In *Davidson* the Commission had no difficulty in approving one license limiting the use of the process to manufacture of automobile seat cushions and forbidding use of the process for the manufacture of automobile armrests.

D. Tie-in Agreements59

Tie-in agreements provide that the patent licensee must purchase supplies for production from the licensor. Such an agreement may provide greater profits for the licensor by restricting competition in the market for the supplies, and can also be used as an aspect of quality control of the patented process. Under the Notice, requirements for purchase of supplies from the licensor can be upheld only where this is necessary for the technically perfect exploitation of the patent. Where such tied sources of supply are not for purposes of quality control, as, for example, where quality control can be assured by objective standards, such a provision would fall under Art. 85(1). In many cases these arrangements are also prohibited by national law.60

E. Quantitative Restrictions61

Quantitative restriction terms place limits on the output of the articles produced under license, either by quotas or by royalty rates dependent on output. The Notice provides that the limitation of the quantity of products to be manu-

57 GCH ¶ 9513 (1972).
58 U.S. courts have upheld restrictions on the use of patents with respect to the type of article manufactured, see e.g., Atlas Imperial Diesel Engine Co. v. Lanova Corp., 79 F. Supp. 1002 (D. Del. 1948), and with respect to the use of the article made under the license, General Talking Pictures Corp. v. Western Elec. Co., 305 U.S. 124, aff'g 304 U.S. 175 (1938). Such terms have been criticized because they allow the patent owner to carve out fields in which he is not manufacturing with licensees who would otherwise be competitors. Marquis, *Limitations on Patent License Restrictions: Some Observations*, 58 Iowa L. Rev. 41, 65-71 (1972).
59 In general, it is patent misuse in the U.S. to grant a license for a patent on the condition that the licensee purchase unpatented supplies or components from the licensor. Leitch Mfg. Co. v. Barber Co., 302 U.S. 458 (1938); Carbice Corp. v. American Patents Dev. Corp., 283 U.S. 27 (1931). Such a contract will be illegal per se under the Sherman Act if it forecloses a substantial amount of commerce in the tied product. Int'l Salt Co. v. United States, 322 U.S. 392 (1947).
60 Jones, *supra* note 7, at 108.
61 Although of questionable authority today, several U.S. cases have upheld the right of a licensor to limit the maximum number of items a licensee can manufacture under a license, either by imposing exorbitant royalties after a certain production level is attained,
factured or of the number of acts constituting exploitation does not fall under Art. 85(1). In Burroughs, a term that the licensee was to produce in quantity sufficient to meet the demand was regarded as not restrictive. One author has suggested that the Commission might now consider that limits on maximum production are restrictive.

F. Grant-back Clauses

Grant-back clauses require the licensee to supply the licensor with information about improvements in the licensed product or process, and to grant the licensor a license or assignment of any patented improvements the licensee makes. The Notice held not to fall under Art. 85(1) undertakings concerning the disclosure of experience gained in exploiting the invention or the grant of licenses for inventions in the field of perfection or application; this, however, applies to undertakings entered into by the licensee only if these undertakings are not exclusive and if the licensor has entered into similar undertakings. This requires that grant-back clauses be reciprocal and non-exclusive. In Burroughs and Davidson clauses, providing for the initial granting of technical information caused no problem; in Davidson, clauses providing that the parties inform one another of improvements and grant non-exclusive licenses for any patents on improvements of the process were upheld. In Raymond the Commission required amendment of a grant-back clause. In the original clause, Nagoya was required to transfer ownership and to grant exclusive licenses to inventions outside the Raymond method. After amendment, Raymond was only entitled to non-exclusive licenses.

G. Qualitative Standards

Standards of quality may be set by the licensor for proper use of the patent. A license may further provide for inspection or other controls to assure that standards of quality are met. The Notice approved the setting of quality standards or obligations to procure supplies of certain products imposed on the
Licensees—insofar as they are indispensable for the technically perfect exploitation of the patent. *Burroughs* and *Raymond* both contained terms on quality which were not considered restrictive. In *Burroughs* the agreement was to conform to Burroughs's technical instructions, and this was considered non-restrictive because the sole purpose was to permit technically adequate exploitation of the patent. In *Raymond* Nagoya agreed to permit certain quality controls of the products and manufacturing processes. The Commission held that "these quality controls [were] necessary for the proper exploitation of the invention and the know-how and [were] to this extent permissible."

**H. Limitations on Sub-licensing**

Licensing of a patent may be exclusive to the licensee, or it may provide for sub-licensing. Restrictions on sub-licensing may be used to set limits to competition in the article or for other purposes, *e.g.*, to protect secret know-how. The Notice, I(A) (4)c, upheld limitations on the licensee's granting of sub-licenses. In *Davidson* a requirement that sub-licenses had to be with Davidson's consent was upheld (one such sub-license was in fact granted), and the Commission held this to be part of the monopoly acquired by the patent owner. In *Burroughs* the Commission upheld a term forbidding sub-licenses, on the grounds that such a term was necessary to keep know-how secret.

**I. Royalty Terms**

Patent license agreements generally provide for the payment of percentage royalties based on production of the article. In *Davidson* royalties were based on net selling price or the cost price of the raw materials used, and this was upheld without comment. In *Burroughs* a minimum royalty with a fixed rate was approved, also without comment. In *Raymond* a clause providing that if minimum license fees are not reached the license would become non-exclusive was also upheld without comment. None of these terms would appear to have any restrictive effect on competition. Differential royalty rates which tend to hinder penetration of one licensee's market by another and those which are clearly discriminatory would probably fall under Art. 85(1). In *Re Henkel-Colgate* the Commission indicated that differing royalties for licensees can raise problems of market sharing under Art. 85.

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68 CCH ¶ 9486 (1972).
69 CCH ¶ 9513 (1972).
70 CCH ¶ 9512 (1972).
71 CCH ¶ 9513 (1972).
72 Discriminatory royalty rates for ulterior purposes have been found illegal in the U.S. LaPeyre v. F.T.C., 366 F.2d 117 (5th Cir. 1966). *But see* Note, 65 Mich. L. Rev. 1631 (1967).
73 CCH ¶ 9512 (1972).
74 CCH ¶ 9486 (1972).
75 CCH ¶ 9513 (1972).
76 CCH ¶ 9491 (1972).
Under the Notice, I(B), "obligations whereby the licensee has to mark the products with an indication of the patent" do not fall under Art. 85(1). In Burroughs the licensee was required to use Burroughs's trademark and to affix patent information to the patented products, and this was upheld by the Commission because the sole purpose of the obligation of the licensee was to facilitate control of the quality and quantity of the products covered by the agreement. The licensees had the right to use other marks as well, the Commission pointed out.


K. Agreements Not to Contest Patent Validity

For the benefit of the licensor, terms may be included which forbid the licensee from challenging the validity of the patent, and thereby perhaps obtaining use of the process or article without the need to pay patent royalties. In Davidson the Commission reaffirmed language in Burroughs and required the removal of a clause prohibiting the contest of patent validity by the licensee. The Commission held that the condition "represented a restriction of the actual and potential competitive position without giving any indication of why it was indispensable for the beneficial objectives of the agreements." In Raymond, however, the Commission applied the "appreciable effect" rule to permit such a term, because it was highly unlikely that it would have any effect on trade in the EEC. Some continental legal systems retain the rule that one is estopped both to claim a benefit and to challenge the right under which that is granted—one cannot both "approbate and reprobate." It appears that these restrictions will still apply, but that the Commission will oppose a term which is wider in scope than the national law.

L. Arbitration Agreements

Arbitration agreements provide that if a dispute arises between the parties, the dispute will be settled by arbitration rather than by suit. These were upheld in Burroughs and Davidson. In Davidson the Commission held that, in the circumstances, the terms did not "give rise to an expectation of arbitral settlements that could alter the decision in [the] case."
M. "Most Favored Licensee" Clauses

To protect the licensee against competition by a possible subsequent licensee with more favorable license terms, a "most favored licensee" clause can be used. Under such a clause the original licensee is assured terms as favorable as those given to any other licensee. Such a clause was allowed in Raymond. The clause provided that no other license would have "more favorable terms of exploitation."

N. Know-how Secrecy

Where the licensor also provides non-patented know-how to the licensee, terms may be included to provide that this know-how be kept secret by the licensee. In Burroughs requirements that secrecy be maintained for ten years after the license period and that models, designs, etc., embodying know-how be returned within 90 days of the termination of the license, were upheld by the Commission. Such terms would seem to receive liberal treatment in the EEC under the language in Burroughs:

Secrecy is essential for technical know-how which is a collection of industrial processes that are not protected by legal provisions on industrial property. Secrecy is a necessary condition if the owner of the technical knowledge is to assign it to other enterprises in order to have it fully exploited and it is a prerequisite for any commercial exploitation of the technical know-how, so long as such knowledge is not in the public domain.

O. Life of License

The duration of a license might exceed the life of the patent itself, especially if the license is for use of know-how and trademarks as well as for the patent. The Notice was expressly limited to clauses of a duration not exceeding the period of validity of the patent. Where a license is for a longer duration, it is likely that terms acceptable only in a patent license would not be acceptable as far as they are outside Art. 85(1). The Notice, I(A)(4)a, does provide that

85 Such terms have also been upheld in the U.S. See Cold Metal Process Co. v. McLouth, 170 F.2d 369 (6th Cir. 1948).
86 CCH ¶ 9513 (1972).
87 In the U.S., trade secret licensing was upheld by the Supreme Court in Dr. Miles Medical Co. v. Park & Sons Co., 220 U.S. 373 (1911). This has been called into question by Lear Inc. v. Adkins, 395 U.S. 653 (1969). See, Kittler, Current State of Patent and Know-How Licensing, 27 Bus. Law. 691 (1972), and Adelman & Faust, Inventions and the Law of Trade Secrets, after Lear v. Adkins, 16 Wayne L. Rev. 77 (1969), which suggests that more radical changes in this area of the law may be undertaken in further decisions.
89 In the U.S., payment of royalties after the expiration period has been held to be void and the entire license tainted. E.g., Brulotte v. Thys Co., 379 U.S. 29 (1964); see Lear Inc. v. Adkins, 395 U.S. 653 (1969). In a case with close analogies to patent licenses, the Supreme Court upheld short term gasoline station leases, while pointing out that suppliers might attempt to use such leases to set up price maintenance programs through fear of non-renewal, and that such coercion would be illegal. Simpson v. Union Oil Co., 377 U.S. 13 (1967); Marquis, supra note 56, at 49.
90 J. Cunningham, supra note 12, at 157-58.
licenses may be limited in time. In *Davidson* the Commission approved licenses for the life of the patent, and a sub-license which ran from year to year.\(^91\) In *Burroughs-Delplanque* a license for a fixed term, which then ran from year to year, was upheld without comment.\(^92\) In *Burroughs-Geha* the licenses were for trademarks and know-how as well as for patent rights, and presumably for this reason, the Commission upheld without comment a term which provided that royalties would be reduced by 50% in the event that Burroughs no longer had patents or no longer had protection under patent applications.\(^93\)

**P. Restrictions on Selling Price**\(^94\)

The Commission has not considered license terms with restrictions on minimum prices, but it is reasonable to assume that these would be held to restrict competition with regard to price.\(^95\)

**VI. Conclusion**

The recent Commission cases indicate the degree to which the Commission looks to market and other economic factors in its application of the rules on competition of the Rome Treaty to licensing agreements. Virtually no contract provision is illegal per se as a restraint on competition. Most objectionable are provisions for banning exports and forbidding litigation of the validity of patents by a licensee; even these provisions were upheld by the Commission in *Raymond-Nagoya*, where the licensee was a Japanese company and the provisions were not likely to affect competition in the EEC.\(^96\) In any case involving exports to an EEC country, these provisions would fall under Art. 85(1). An export ban particularly conflicts directly with the goal of a single, unified European market. Other contract provisions are judged in light of the market situation. The emphasis is on the actual effect of the agreement on trade and competition. In *Burroughs*, where the licensees had only 10% of the market, where the licensor could compete with the licensees, and where the nature of the product was such as to make competition among producers easy throughout the EEC, the Commission held that the granting of exclusive manufacturing rights did not fall under Art. 85.\(^97\) In *Davidson* the licensees held dominant positions in an oligopolistic market, the process was the most important of its type, and the products were highly specialized. Nonetheless, the Commission, while not granting negative clearance, did grant an exemption to the agreement largely on grounds of the commercial reasonableness of the agreements.\(^98\) Not to grant such

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\(^{91}\) CCH ¶ 9512 (1972).

\(^{92}\) CCH ¶ 9485 (1972).

\(^{93}\) CCH ¶ 9486 (1972).

\(^{94}\) The Supreme Court has held that it is not illegal to have a price fixing clause for a manufacturing patent owner. United States v. General Electric Co., 272 U.S. 476 (1926). Recent cases, however, have limited this right, and suggest that legal price fixing in patent licenses may not long survive. United States v. Line Material Co., 333 U.S. 287 (1948); United States v. Huck Mfg. Co., 382 U.S. 197 (1965) (semble), aff'g mem. 227 F. Supp. 791 (E.D. Mich. 1964). See, Marquis, *supra* note 58, at 50-52.

\(^{95}\) J. Cunningham, *supra* note 12, at 161; Jones, *supra* note 7, at 109 n.89.

\(^{96}\) CCH ¶ 9513 (1972).

\(^{97}\) CCH ¶ 9486 (1972).

\(^{98}\) CCH ¶ 9512 (1972).
exemption, the Commission seemed to be saying, would tend to prevent the introduction of technical advances into the EEC.\(^9\) To Davidson and the licensees, an exemption is almost as useful as a negative clearance. The only effective difference is that the exemption does not necessarily bind the courts of member states. In the Davidson contracts an arbitration agreement upheld by the Commission prevents litigation on the contracts between the parties in the member states in any case so that the exemption should have the same effect, as between the parties to the agreement, as a negative clearance.\(^10\)

The decisions in these cases give greater importance to patent rights than to other property rights such as copyrights and trademarks. The Court pointed out in Sirena that the purpose of a trademark right is to prevent the public from being deceived by misleading names, but that the purpose of a patent right is in fact to create a monopoly in favor of the owner of the right.\(^10\) In Davidson there is an effective splitting of the market along national boundaries through use of patent licenses. The licensees have plants located only in particular countries, dealing closely with national auto manufacturers; this situation and the specialized nature of the products produces an effective splitting of the market on national lines. This would not be permitted through use of copyright or trademark licenses. The Commission in Davidson tried to strike a balance between present commercial realities and the goal of a unified market, but the effect of the decision is to permit commercial considerations to dominate. It is not clear in what sort of market the Commission would cease to apply the logic of Davidson; at some point the market position of the licensees would be so dominant as to enable the licensees to eliminate competition for a substantial part of the products concerned, and an exemption under Art. 85(3) would not be granted.

Although patent rights are accorded greater protection than other industrial property rights, this protection is in some ways limited in the Burroughs and Davidson cases. These cases represent a shift in the emphasis of Commission cases from consideration of legal forms to greater consideration of the actual market effect of particular patent licensing agreements. Previously patent licensing agreements were considered to be outside Art. 85. In the 1962 Notice, the Commission stated that Art. 85(1) was inapplicable to terms in exclusive use agreements that provided for territorial division of markets by the licensor of patent rights. The opinion of the Commission at that time was that a patent licensor was free to use his patent monopoly as he chose. In recent cases, however, the Commission has argued that a patent license restricts the licensor as well as the licensee. The licensor who grants an exclusive territorial license limits his freedom to contract with other potential licensees, and this limitation may have the effect of restraining competition in the patented article or process. Following this argument, the Commission has overruled parts of the Notice in the decisions in Burroughs and Davidson. These decisions indicate that patent licensing arrangements which aim at dividing markets may fall under Art. 85(1) where the market is narrow and oligopolistic, as in Davidson. Rather than looking to

\(^9\) Id.
\(^10\) See note 4 supra.
the type of the agreement, the Commission has shifted to examination of the actual market effects of particular agreements.

The Commission follows this same policy in its Notice on Minor Agreements of May 27, 1970.102 This Notice limits the broad terms of Art. 85(1) to agreements which might have "appreciable" effect on competition within the Common Market, and means that small and newly formed companies may engage in non-competitive practices such as exclusive distributorships and export bans. In the case of patent licensing agreements, this examination of market factors has led, in Davidson, to a narrowing of the rights of a patent licensor in cases where competition might be impaired. Davidson indicates the need for a licensor to examine the market situation in the particular product in order to determine the contract terms which will be permitted by the Commission.

The application of the exemption under Art. 85(3) in Davidson shows the willingness of the Commission to permit agreements which promote technical progress of some sort. Nonetheless, the decision indicates that any patent licensing agreement must be drawn with careful consideration of the particular market situation involved in order to avoid running afoul of the Commission and Art. 85. The decision also points out the need to be aware that changes in the market situation may require changes in the terms of patent licensing agreements.

To a company wishing to enter into licensing agreements with EEC firms, the principles are clear though their limits are not: 1) Small and newly formed companies are given broad freedom to engage in practices which would be "anti-competitive" for larger firms under the 1970 Notice. This applies especially where a firm is introducing some new technical advance or process. 2) Licensing of patents receives kinder treatment than does licensing of other forms of industrial property rights and can provide the basis for division of production and, effectively in some cases, of markets along national lines. 3) Export bans and similar terms within the EEC where they may have an "appreciable effect," cannot be used to restrict territories of distribution, and the Commission is especially watchful for contract provisions which aim at market splitting. 4) The market situation in the product will control the degree to which other restrictions and contract terms can be used to set up exclusive areas for production and to restrict competition. The greater the degree of competition in the market, the more permissive will the Commission be in permitting restrictions which have the effect of setting up exclusive territories for production and distribution and which impose other restrictions on the parties. 5) Particularly in the case of patent licenses, the Commission is liberal in permitting modification of particular offending terms and in granting exemptions under Art. 85(3) (where the agreement has been properly notified), where contract terms, though potentially restrictive, are necessary for proper use of the patent, and where other abuses are unlikely.

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