EEC Licensing of Intellectual Property

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I. INTRODUCTION TO ARTICLE 85 OF THE EEC TREATY

A. Article 85

Article 85(1) of the Treaty Establishing the European Economic Community\(^1\) ("EEC Treaty") prohibits, as incompatible with the Common Market, agreements that may affect trade between Member States and which have the object or effect of restricting competition within the Common Market. Article 85(3) provides for exemption from this prohibition. Exemption can be granted when collaboration leads to improvements in production or distribution of goods or promotes technical or economic progress. Only the


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.

Id.
Commission of the European Communities\(^2\) ("Commission") can grant individual exemptions.\(^3\) Under Article 85(2), agreements or provisions thereof that infringe the Article as a whole are void in respect of the provisions that restrict competition.\(^4\)

Multiple objectives are encompassed by this Article—not only efficiency (firms and industries that provide what consumers are willing to pay for should expand at the expense of others), but most importantly, that the Common Market should be integrated and that smaller firms should be able to enter a market. Foreclosure may harm competitors even when it does not harm consumers.

**B. Sunk costs and ancillary restrictions**

Most technology licenses involve investment by each party.\(^5\) Unless each party is assured that it can appropriate part of the benefits engendered by its investment, it is unlikely to invest. Thus, often the parties have to ensure: (i) that once the licensee has committed itself to tooling up and developing the market, the licensor will not license other parties for the same territory and that the licensor will prevent licensees from other territories from competing there; (ii) that when the licensor has granted an exclusive license for a territory, the licensee will not cease to use the licensor’s invention and turn to competing technology, paying no royalties to the first licensor; and (iii) that the licensee will not challenge the validity of the patent, and meanwhile exploit it without paying royalties. There may be other terms relating to improvements, reciprocal or otherwise, limitations in time or space, quotas, or customer restrictions.

\(^2\) The Commission of the European Communities, established in Brussels, is the administrative body responsible for enforcing the competition rules and ensuring that the EEC Treaty is not infringed.

\(^3\) Council Regulation No. 17/62, art. 9, 13 J.O. 204 (1962), O.J. ENG. SPEC. ED. 1959-62, 87, 89. The Council of Ministers in Council Regulation No. 19/65, 36 J.O. 533 (1965), O.J. ENG. SPEC. ED. 1965-66, 35, has also empowered the Commission to grant exemptions to specified categories of agreements, such as those for patent and know-how licenses. See infra note 18.

\(^4\) EEC Treaty, supra note 1, 298 U.N.T.S at 47-8.

\(^5\) Economists call such an investment a "sunk cost" when it cannot be turned to any other use. To prevent the other party or others appropriating the benefit of such costs, the investor must ensure his position by an enforceable contract.
These ancillary restrictions, which may be necessary to induce investment in developing the original invention and its exploitation, restrict conduct. The Commission usually treats them as restricting competition contrary to the prohibition of Article 85(1). Unless the restrictions are exempted under Article 85(3), it may be difficult to enforce them because of their invalidity under Article 85(2). A national court may have to adjourn to enable the Commission to grant an exemption.

Prompt contractual remedies for infringing ancillary restrictions on conduct are vital to induce the original investment. The licensor must invest in developing the technology. The licensee has to set up production, create a market, and also may have to improve the technology for industrial use. The Commission lacks the resources to grant more than a very few individual exemptions each year and is the only entity with authority to exempt. Therefore it is important that agreements not be treated as infringing Article 85 unless the risk of reducing competition in the market is realistic.

C. Importance and difficulty of analyzing ex ante

Perceived ex post, as has been the practice of many European lawyers and officials, these ancillary restrictions are clearly anti-competitive. After the investments have been made, it appears better if the licensor and all his licensees are free to sell throughout the Common Market and compete with each other.

Economists, however, are concerned that the right incentives to investment exist and believe that the situation should be appraised ex ante, at the time parties decide whether to commit themselves to investment. The ancillary restrictions needed to provide incentives are procompetitive if, without them, the parties would not have made the investment. One should compare the position that has resulted from the collaboration with that which would have occurred without it.  

6. In the three years from 1990-1992, the Commission granted only thirteen individual exemptions.

It is difficult to determine whether ancillary restrictions are pro- or anticompetitive. It may be hard to demonstrate that the parties would not have made their investment without ancillary restrictions on conduct; it is easy to argue that they might have made the same investments with less protection.

It is hardly surprising that officials, most of whom were jurists of some kind before joining the Commission and few of whom were familiar with micro-economics or had experience in industry or commerce, have tended to appraise agreements \textit{ex post}—at least when applying the prohibition of Article 85(1). They have been more flexible when granting exemptions under Article 85(3). Exclusive patent and know-how licenses have been exempted in several decisions. Only once, in \textit{Burroughs}, has the Commission held that an exclusive license did not restrict competition. In \textit{Burroughs} the licensor and both licensees, whose aggregate market share was under ten percent, were permitted to sell throughout the Common Market a product for which the cost of transport was negligible. Other exclusive licenses have been held to fall within the prohibition of Article 85(1) and exempted under Article 85(3), provided that each licensee was allowed to sell throughout the Common Market.\footnote{8}

Properly understood, therefore, Article 85(1) requires a comparison between two market situations: that which arises after the making of an agreement and that which would have arisen had there been no agreement. This concrete examination may show that it is not possible for a manufacturer to find an outlet in a particular part of the market unless he concentrates supply in the hands of a sole concessionaire. That would signify that in a given situation an exclusive distributorship agreement has effects which are likely only to \textit{promote} competition. Such a situation can in particular appear when what is at issue is gaining access to an \textit{[sic]} penetrating a market.\footnote{9}

\textit{Id.} (emphasis in original).


Compare the justification by Judge Taft of ancillary restrictions in United States v. Addyston Pipe & Steel Co., 85 F. 271 (6th Cir. 1898), \textit{aff'd}, 175 U.S. 211 (1899).


9. \textit{See} Zuid Nederlandsche Bronbemaling en Grondboringen BV v. Heidemaat-
D. Invalidity of agreements

The provisions in agreements that infringe Article 85 by restricting competition within the Common Market are void by virtue of Article 85(2). Only the Commission can grant an exemption. National court judges in Member States are required to apply European Community ("Community" or "EC") law. Therefore, if an action is brought on a contractual provision, the judge must first decide whether such provision infringes Article 85(1). If it does not, he or she can disregard the competition rules. The judge is likely to be influenced, however, by the wide interpretation given to the concept of restriction of competition by the Commission.

If the agreement does infringe Article 85(1), the judge must consider whether it is capable of exemption. If not, parts of the agreement will be void. If, however, the agreement has been notified to the Commission with a request for exemption, effective prior to the period at issue in the litigation, and is of the kind that the Commission may exempt, the judge is required to adjourn pending the exemption determination. If the national procedural rules so permit, the judge also may ask the Commission to provide it with legal and economic data. This is more controversial.


12. Id. arts. 4-5, O.J. ENG. SPEC. ED. 1959-62. Notification is the process by which parties to a contract request Commission review of an agreement’s terms for compliance with Community law.


In its Notice on cooperation between national courts and the Commission in applying Articles 85 and 86 of the EEC Treaty, O.J. C 39/6 (1992), the Commission said how it
E. Possible ways of dealing with the Commission’s case load

1. Formal decisions on individual notifications

Parties may notify agreements to the Commission requesting exemption from Article 85(1). Exemption may be granted retroactively to the date of notification. Such an exemption amounts to a formal decision and binds the parties to whom it is addressed. A national judge may not treat an agreement as void by virtue of Article 85(2) when it has been exempted formally, but the Commission may withdraw the benefit of the exemption for the future if the agreement no longer merits exemption. An exemption does not affect liability for abusive exploitation of a dominant position that violates Article 86, the EC’s not-very-close analogy to section 2 of the Sherman Antitrust Act, although the reason that gave rise to the exemption, especially of an individual agreement, may show that there is no abusive exploitation of any dominant position.

2. Informal comfort letters

The Commission usually responds to a notification with an informal comfort letter saying that the agreement merits exemption and that the file is being closed. Such a letter is not an exemption and, although a national judge may take it into account when ap-
plying Article 85(1), the judge has no power to grant an exemption. A letter stating that the agreement merits exemption, and therefore implying that it is caught by the prohibition of Article 85(1), places the national judge in a quandary. Even if he or she adjourns, the Commission may refuse to reopen the file. With my back to the wall, I would argue a national judge enforcing the agreement after a Commission letter has been sent stating that the agreement merits exemption does not amount to the judge granting an exemption. This is, however, dubious.

3. Conditions and obligations may be attached to an exemption or comfort letter

The main reason why specialized practitioners do not recommend that many agreements be notified to the Commission for an exemption, is that the Commission may intervene and require changes to be made to the agreement after the parties’ relative bargaining positions have changed.

In ARD, MGM and United Artists granted an almost exclusive copyright license for West Germany to certain German broadcasting organizations ("ARD") for $80 million. ARD was to scrutinize a large library of films, some four to five percent of the total stock of films available worldwide, and to dub those that it thought suitable for transmission in Germany. The term of the license was long—about twenty-five years for some of the films. The agreement was notified to the Commission. The Commission decided that the exclusive license foreclosed third parties and that the size of the library was far greater and the term of the license far longer than was usual in the trade. It, therefore, refused to grant an exemption until ARD waived part of its contractual exclusive rights.

In order to receive the exemption, ARD had to permit the licen-

sors to license others to transmit the films that it did not exploit. ARD also agreed that the "windows" during which third parties could license films be greatly expanded, that it would provide such third parties with dubbed copies of the films where available, and would pay half the cost of dubbing any others.

German viewers benefitted by having more films available on television and by seeing the more popular ones more often. The copyright holders obtained further lucrative opportunities to grant licenses. Perceived ex post, the market is more competitive. Seen ex ante, the result may be different. Will another film studio be able to find a firm like ARD who is prepared to invest substantial sums for the license and much effort to exploit English language films in countries where another language is spoken? More serious still, the Commission's dislike of innovation increases the risk of collaboration to exploit a market for the benefit of consumers.

4. Bifurcation of Article 85(1) and (3)

The Commission often treats vertical restraints strictly under the prohibition of Article 85(1). Vertical restraints are perceived as isolating the market in each Member State. Some vertical agreements, including exclusive technology licenses, are exempted en bloc, provided that the agreement fits within the rigid limitations of the applicable regulation.\(^\text{18}\)

The practice of exempting ancillary restraints, rather than finding them outside the prohibition of Article 85(1), had the advantage that the difficult decisions were centralized in the Commission, which had very wide discretion whether to grant exemptions. Had the difficult decisions as to whether the ancillary restraints were anticompetitive been left to courts in Member States, their judgments might well have been hard to reconcile.

Interpreting Article 85(1) widely has a grave disadvantage. It

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ensures that most ancillary restraints necessary to the exploitation of intellectual property will be found violative of Article 85(1), thereby requiring exemption if important terms of a license agreement are to be enforced. The Commission lacks the resources to grant many exemptions—it has never managed more than ten exemptions under Article 85(3) in a single year. Problems in enforcing the terms of a license must result in marginally fewer licenses being granted.

5. Group exemptions for patent and know-how licenses: Regulations 2349/84 and 556/89

Since the Commission nearly always states that any element of exclusivity forecloses third parties, most patent licenses and know-how licenses are brought within the terms of one of the group exemptions. The group exemption for patent licenses ("Patent Regulation") is very narrow and is rarely applicable, but the exemption for know-how licenses ("Know-how Regulation") is more liberal. Combined patent and know-how licenses usually are adapted to fall within the know-how group exemption’s terms. The Regulations are not always clear, therefore adaptation is not entirely risk-free. I am surprised by the extent to which commercial clients are prepared to enter into important agreements without being sure whether the agreement is enforceable. It is disgraceful that they should have to do so. Counsel should be able to give firm advice.

6. Narrower construction of Article 85(1)

The European Court of Justice has accepted partly a doctrine that ancillary restraints necessary to make investment viable do not infringe Article 85(1). In Nungesser,20 the European Court of Justice said that in order to encourage investment by a licensor and licensee in the development of an important new variety of maize seed protected by plant breeders rights, it is necessary to permit open exclusivity—a license where the licensor agrees neither to exploit in the territory nor to license anyone else to do so. Therefore,

19. Patent Regulation, supra note 18; Know-how Regulation, supra note 18.
such a license does not infringe Article 85(1).21 Nevertheless, without any analysis of the amount of protection needed, the Court added that absolute territorial protection manifestly goes too far ever to be exempted.22

If the Commission were less formalistic in analyzing agreements and followed the case law of the Court, industry would not have to distort agreements to come within the confines of a group exemption.

F. Conclusion

National courts may well follow the Commission's decisions. There are few judgments reported from national courts. A national court has no power to exempt, so it only can adjourn while the Commission decides. By then, the defendant is a complainant providing ammunition to the Commission. The Commission may refuse to exempt important provisions or require changes to be made by one or both parties. A defendant may be able to prevent an exemption being granted by refusing to make amendments desired by the Commission. ARD was able to waive its rights, but even that possibility is being challenged by the licensors on appeal. Courts must be able to enforce agreements that increase, rather than decrease, competition under Article 85(1), but it takes a strong minded national judge to decide contrary to the Commission's practice.

Competition presupposes markets, which presuppose exclusive rights and the normal performance of agreements. In a sinful world this requires that contracts be enforceable.

II. INTRODUCTION TO THE PRINCIPLE OF THE FREE MOVEMENT OF GOODS AND SERVICES

A. Intellectual property rights are national

Intellectual property rights still are governed by national law. Some harmonization has taken place, but the Community Patent

21. Id. at 2069, ¶ 58, [1983] 1 C.M.L.R. at 353.
Convention\textsuperscript{23} has not yet been ratified by sufficient States to come into force. Moreover, the law of each country grants rights only for that country. An inventor wanting protection in all Member States must apply for a patent in each State.

B. Attempted avoidance of competition rules

Since the 1960s, it has been widely accepted that Article 85 forbids the imposition of export bans on licensees. Nevertheless, it was thought that by relying on the separate national laws governing intellectual property rights, a holder in several Member States might achieve the same result. A licensor might grant a license, for instance, under the French patent or limited to France, and rely on national rights in Germany to restrain imports from France. In some Member States, the doctrine of exhaustion prevented the use of such rights to restrain the sale of goods put on the market legally, by or with the consent of the holder. This rule did not apply in all Member States. In those where it did apply to some kinds of intellectual property rights, it sometimes applied only to sales within the country. Hence, sales abroad rarely exhausted national patent rights.

C. Free movement of goods within the Common Market

Markets in different Member States often will bear very different prices. Often, this is due to government measures. For instance, there are price controls for pharmaceutical products in several Member States, and some Member States grant only process and not product patents. The basic principle of the Common Market, however, is that goods, services, workers, and capital should circulate freely without hinderance from tariffs, quotas, or measures of equivalent effect imposed by Member States. Consequently, traders buy in the low priced States and sell where prices are higher. Such parallel trade tends to reduce price differences.

The principle of the free movement of goods is implemented by Articles 30 to 36 of the EEC Treaty. Article 30 provides:

Quantitative restrictions on imports and all measures having

equivalent effect shall . . . be prohibited between Member States.24

Article 36 provides a derogation from the principle:

The provisions of Articles 30-34 shall not preclude prohibitions or restrictions on imports . . . justified on grounds of . . . the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States.25

Article 36 has been narrowly construed because it derogates from a fundamental principle of the Common Market.

D. Birth of the distinction between the existence and exercise of a right

Consten & Grundig v. Commission26 was an early case decided under the competition rules. To encourage its dealer, Consten, to incur sunk costs, Grundig included several ancillary rights in the license agreement. Consten was granted an exclusive territory supported by export bans and permission to register the “Gint” mark in France.27 The products also bore the mark “Grundig,” by which the public could recognize their origin.28 Consten sued traders, who imported Grundig apparatus from Germany where it was approximately twenty-five percent cheaper, for trademark infringement. The Commission condemned the absolute territorial protection conferred.29

In upholding the Commission’s decision, the European Court of Justice distinguished the existence of national property rights, which, according to Articles 36 and 222 of the EEC Treaty, is a matter for national law, from their exercise, which is subject to the

25. Id. art. 36, 298 U.N.T.S. at 29 (emphasis added).
27. Id. at 303, [1966] C.M.L.R. at 420.
28. Id.
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Treaty provisions. The agreement had the object of restricting parallel imports and was not justifiable as being necessary to prevent confusion. This decision has given the Court vast discretion. Rights are usually defined by the various ways in which they can be exercised. The distinction between existence and exercise cannot be drawn by logical analysis. The Court, acting as a supreme court, has been able to develop the law actively. The Court treats the "justifiable" enforcement of rights as part of the right itself, that is, the right's existence, and classifying enforcement of the right for a purpose that the Court considers improper as its exercise, which is subject to the EEC Treaty.

E. Exhaustion of intellectual property rights when the product has been sold by or with the consent of the holder

In Centrafarm BV v. Sterling Drug Inc., the European Court of Justice developed the concept of international exhaustion. In words repeated in many judgments to follow, the Court said that Article 30 is a "fundamental principle" of Community law. Article 36 derogates from the principle and, therefore, should be construed narrowly. The Court developed the concept of the "specific subject matter" of an intellectual property right.

In relation to patents, the specific subject matter of the industrial property is the guarantee that the patentee, to reward the creative effort of the inventor, has the exclusive right to use an invention with a view to manufacturing industrial products and putting them into circulation for the first time, either directly or by the grant of licences to third parties, as well as the right to oppose infringements.

31. In 1966, after the refusal by the French to attend the Council of Ministers, the legislative mechanism of the Common Market broke down. Little important legislation was adopted between 1966 and the adoption of the Single European Act in 1987. Judges of the European Court of Justice admitted being highly activist during this period.
33. Id. at 1162, ¶ 8, [1974] 2 C.M.L.R. at 503.
34. Id.
35. Id. at 1162, ¶ 9, [1974] 2 C.M.L.R. at 503 (emphasis added).
reward the inventor—and to the mechanism for doing that—the exclusive right. The Court objected to the limitation in national laws of the concept of exhaustion to sales within the country. The Court concluded that:

Whereas an obstacle to the free movement of goods of this kind may be justified on (1) the ground of protection of industrial property where such protection is invoked against a product coming from a Member State where it is not patentable and has been manufactured by third parties without the consent of the patentee and (2) in cases where there exist patents, the original proprietors of which are legally and economically independent, a derogation from the principle of the free movement of goods is not, however, justified where the product has been put onto the market in a legal manner, by the patentee himself or with his consent, in the Member State from which it has been imported, in particular in the case of a proprietor of parallel patents.36

The Court ruled that:

The exercise, by a patentee, of the right which he enjoys under the legislation of a Member State to prohibit the sale, in that State, of a product protected by the patent which has been marketed in another Member State by the patentee or with his consent is incompatible with the rules of the EEC Treaty concerning the free movement of goods within the Common Market.37

This judgment considerably reduced the value of intellectual property rights. Holders lost the ability to discriminate between Member States. The policy of some Member States to keep down the price of drugs at the expense of the pharmaceutical companies was extended to those Member States that were more concerned with encouraging innovation.

36. Id. at 1162-63, ¶ 11, [1974] 2 C.M.L.R. at 503-04 (emphasis and numbering added).
37. Id. at 1168, [1974] 2 C.M.L.R. at 507.
1. The Court retracts somewhat

The importance of consent by the holder of the intellectual property rights was reiterated in *Keurkoop BV v. Nancy Kean Gifts BV*. In this case, the holder was allowed to exercise its right to restrain imports when the holder had not consented to the sale in another Member State where it had no intellectual property right.

The Court stated that, in the present state of Community law, before intellectual property rights are harmonized, it is for national law to define the scope of intellectual property rights. The Court openly distinguished between the legitimate and improper exercise of national intellectual property rights and laid the ground for the exercise of its discretion in later cases on grounds more clearly based on policy.

After considering the possibilities of applying Article 85 to any agreement there might be, the Court ruled that the holder may prevent importation of infringing products from another Member State:

[P]rovided that the products in question have not been put into circulation in the other Member State by, or with the consent of, the proprietor of a right or a person legally or economically dependent on him, that as between the natural or legal persons in question there is no kind of agreement or concerted practice in restraint of competition and finally that the respective rights of the proprietors of the right to the design in the various Member States were created independently of one another.

Without the independent origin of the products, the agreement would likely be contrary to Article 85.

2. Incentives and rewards for innovation

In two recent cases, the Court was concerned whether the enforcement of national law was justified, as required by Article 36, by the provision of incentives to or rewards for desirable activity.

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39. *Id.* at 2871, ¶ 18, [1983] 2 C.M.L.R. at 82.
40. *Id.* at 2873, ¶ 24, [1983] 2 C.M.L.R. at 83.
41. *Id.* at 2874, ¶ 29, [1983] 2 C.M.L.R. at 84.
The Court also had to ensure that there was no discrimination against goods imported from another Member State.

In Thetford Corp. v. Fiamma SpA, the Court recognized that the U.K. rule (now repealed) permitting a patent to be obtained if the idea was not published in a patent specification anywhere in the last fifty years was adopted in order to foster creative activity on the part of inventors in the interest of industry. To that end, the “fifty year rule” aimed to make it possible to give a reward, in the form of the grant of a patent, even in cases in which an “old” invention was “rediscovered.” In such cases the United Kingdom legislation was designed to prevent the existence of a former patent specification which had never been utilized or published from constituting a ground for revoking a patent which had been validly issued.

Consequently, a rule such as the “fifty year rule” cannot be regarded as constituting a restriction on trade between Member States.

In Warner Bros. v. Christiansen, the Court refused to follow the traditional case law analysis of Advocate-General Mancini. It focused more on rewards to the holder and on the custom of the industry. The Court reiterated its statement from Keurkoop that given the present state of Community law, it is for national law to define the scope of intellectual property rights. Moreover, the Court considered that the Danish law, under which the letting out for hire of the videocassette of a film that had been bought in London was a separate infringing act, was justifiable on grounds of industrial and commercial property within the meaning of Article 36 in view of the importance of the rental market and of the need

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43. Id. at 3607, ¶ 19-20, [1988] 3 C.M.L.R. at 561-62.
for the film producer to earn a fair reward.47

III. THE COMMISSION'S COMPETITIVE CONCERNS ABOUT TECHNOLOGY LICENSES

A. Limited exclusive licenses foreclose and divide the Common Market

Certainly, from 1972 until after the adoption of the Patent Regulation,48 the Commission considered that a territorially limited license should be treated as a license for the whole Common Market, subject to bans on manufacture and sale in other Member States. For example, once the goods have been sold in France by the holder or with his consent, the holder cannot use his German patent to prevent the import of the goods into Germany because of the principle of free movement. The Court's case law does not go so far as to say that the French licensee cannot be restrained from manufacture in Germany, but the Commission has adopted this view.49

In Davidson Rubber,50 Davidson had developed, and was exploiting in America, an invention for making plastic arm rests for cars and the machinery needed to produce them. In 1957, shortly before the Common Market was established, it granted parallel limited and exclusive licenses to three firms for different territories in the EEC. The Commission stated that each exclusive license had the object and effect of restricting competition within the Common Market, and might affect trade between Member States, because it restrained Davidson from granting another license for another Member State.51 Such a licensee might then have exported to other Member States.

This is a per se rule, subject only to a de minimis limitation when the parties have only a small share of the market at the time

49. COMMISSION FIFTEENTH REPORT ON COMPETITION POLICY ¶ 81 (1985).
the Commission investigates. Since it may be risky to persuade a vehicle manufacturer to adopt a particular kind of arm rest and then set up a production line, the licensee most needs the protection of exclusivity when the invention proves successful. To induce investment despite the risk of commercial failure, the licensee must be able to expect to earn high profits if the venture is successful. In 1957, when the investment was made, there were no Davidson arm rests in the Common Market. By 1972, when the decision was adopted, Davidson’s licensees supplied nearly forty percent of the Common Market. The investment was very successful. The Commission tends to see only the inventions that are successful and may underestimate the risk of failure.

Nevertheless, the Commission did grant an exemption, once the agreement was modified to permit each licensee to sell throughout the Common Market. The Commission stated that without the protection of an exclusive manufacturing territory, the Davidson process would not have been available in Europe. This illustrates that when applying Article 85(1) to an exclusive territory, the Commission does not take realistic possibilities into account. The Commission condemns restrictions on conduct, not only restrictions on competition. The market must have become more competitive when a new competitive pressure was added by the Davidson licensees.

In Nungesser, however, the Court held that an open exclusive license for plant breeders’ rights for an important new variety does not infringe Article 85(1), although export bans on parallel importers and other licensees give absolute territorial protection and “manifestly” go too far to be exempted. The Court is very formal, giving considerable protection to products for which freight is a significant cost, but virtually none when it is not. The Commission accepts in principle that the Court’s judgment applies also to patents, but has never applied the precedent. The Commission always states that the product is not new, even when better than competing

52. Id. at 36-37, ¶ 16-18, [1972] 11 C.M.L.R. at D62-63, ¶ 50-55.
products. The Commission’s broad application of the prohibition of Article 85(1) to exclusive licenses is the main reason why business people turn to the Know-how Regulation for automatic exemption without notification.

B. No challenge clauses foreclose when the patent is not valid

In Davidson, the Commission granted the exemption only after the parties removed the restraint on the licensee challenging the validity of the patent. In some of the countries that later joined the Common Market, patents were not examined, even for novelty, when the patent was granted, and the Commission considered that the licensee had the greatest interest in and means of challenging invalid patents. Nevertheless, it is doubtful whether making no challenge clauses invalid is the best way of dealing with the entry barrier caused by dubiously valid patents. The decision must have reduced the propensity of holders to grant licenses to those over whom they have no control. Under the group exemption, however, one may provide that the licensor shall have the right to terminate the license in the event of challenge, so the licensee cannot have his cake and eat it too.

C. Strong obligations to share improvements are unfair and reduce the incentive to invest in improvements

“Fair competition” is mentioned in the preamble to the EEC Treaty, and the Commission considers it unfair to require a licensee to enable the holder to obtain intellectual property rights in improvements discovered by the licensee. The Commission does, however, accept reciprocal obligations to pass on improvements with a right for the licensor to sub-license that are not exclusively in his favor. Again we have clear rules, based on legal classifica-

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55. Know-how Regulation, supra note 18.
57. It seems misguided to try to provide control over particular clauses in a contract. It is the balance of the contract as a whole that matters. Civil law lawyers are, however, more category-oriented than common law lawyers.
tions, rather than economic analysis as to whether the agreement affects the sort of industry where the licensee is likely to learn by doing, in which case the innovations are probably not discouraged and their exploitation is increased, or would have to invest to provide innovations, which investment might be discouraged by the need to share the improvements.

IV. THE GROUP EXEMPTION REGULATIONS FOR PATENT AND KNOW-HOW LICENSES

Detailed analysis of the Patent Regulation and the Know-how Regulation\(^58\) is beyond the scope of this paper. Briefly, their structure is similar: Article 1 of each Regulation exempts an exclusive territory, plus associated limited export bans on licensor and licensees, but not on purchasers from the licensor or licensees.\(^59\) Little protection can be conferred on each licensee against others within the Common Market. Market integration is thought by many to be served by these limitations, but they may encourage licensors to grant larger territories than they would if more protection were possible. Article 2 provides a non-exhaustive list of provisions that rarely restrict competition contrary to Article 85(1), but are exempted just in case.\(^60\) Article 3 provides the black list of conditions and provisions that prevent the application of the Regulations.\(^61\) Sometimes these circumscribe the lists in Articles 1 and 2; sometimes there is intermediate ground.

Usually one can achieve more of what a client wants by use of the Know-how Regulation, provided that secret, substantial, and recorded information\(^62\) is included. Note the words at the beginning

\(^{58}\) Patent Regulation, supra note 18; Know-how Regulation, supra note 18.

\(^{59}\) Patent Regulation, supra note 18, art. 1, recitals 9, 12; Know-how Regulation, supra note 18, art. 1.

\(^{60}\) Patent Regulation, supra note 18, art. 2, recital 18; Know-how Regulation, supra note 18, art. 2.

\(^{61}\) Patent Regulation, supra note 18, art. 3, recitals 19-24; Know-how Regulation, supra note 18, art. 3.

\(^{62}\) Note the definitions in Article 1(7). Where a licensee is prepared to pay for a license, these requirements will almost always be fulfilled. They were inserted to satisfy the Economic and Social Committee and European Parliament but drafted to
of Article 1—it is only agreements that are exempted by the Patent Regulation that are excluded. If they are exempted by that Regulation, I do not mind that they are not exempted by this. A license of mixed patents and know-how may, however, benefit from the more qualified black list of the Know-how Regulation, whether or not the patent is ancillary to the know-how, which avoids some impossible decisions as to which of two complementary things is ancillary to the other.63

A. Two clauses taken through the group exemption for know-how licensing as an example of how it operates

The way to apply the Regulation is to go through both the white and black lists, Articles 1 or 2 and 3, in relation to each clause. I have analyzed them at some length in my book on the Regulation.64

1. Extent of territorial protection of the licensor

If one has technology, partly protected by patents and partly consisting of secret know-how, and wants to exploit it oneself in parts of the Common Market, can the technology be licensed to another for particular territories without exposing the areas where the licensor wants to exploit the technology to competition?

This a major problem. Under Article 1, a licensor can restrain a licensee from exploiting in the licensor’s territory, as long as the licensor holds a patent there65 or for ten years from the first license for “the same technology” in the licensee’s territory.66 Unfortunately, “the same technology” includes the original version, even if it has later been improved.67 Sometimes, it is hard to tell what is improved technology and what is a new license—the difference may consist largely of careful drafting.


65. Know-how Regulation, supra note 18, art. 1.1.3, 1.4.
66. Id. art. 1.2.
67. Id. art. 1.7.8.
If the licensee sells the goods to dealers in his territory, the licensee can use another group exemption\textsuperscript{68} to restrain the dealers from actively selling outside the licensee's territory. The licensee can restrain dealers from accepting unsolicited orders, but why should he? If the licensor requires the licensee to do so, their license agreement will be outside the Know-how Regulation.\textsuperscript{69} The licensee has no independent interest in protecting the licensor's territory. Sometimes the licensee is dependent on the licensor or values the relationship and might impose such a restriction on dealers, but the Commission easily detects a concerted practice between parties to an agreement, so even that might be dangerous.

A patent holder can exercise his patent to prevent parallel imports from outside the Common Market,\textsuperscript{70} but not to prevent goods from coming from another Member State, once the goods have been sold there with the holder's consent. The extent of the exclusivity exempted by Article 1(1) is narrow, especially when freight is not a significant cost.

2. Agreement to pay monies in advance

Recitals are very important in EEC law and may govern the operative part of the Regulation. Recital 15 states that the parties are free to negotiate royalties as they want. Article 2(9) white lists an obligation to pay minimum royalties, or a requirement to produce a minimum amount. Recital 10 states that the obligations listed in Article 2 rarely restrict competition, but are exempted just in case they may do so in a particular case. It adds that the list is not exhaustive.

A payment up front has much the same effect as a minimum royalty in that once the obligation is accepted, there is a smaller payment for increasing production. Payments up front were cleared


\textsuperscript{69} Know-how Regulation, supra note 18, art. 3.12(b) blacklists a requirement to make it difficult for users or resellers to obtain the contract goods within the Common Market.

as outside the prohibition of Article 85(1) in Boussois/Interpane,\textsuperscript{71} before the Regulation was adopted.

Article 3(9) is not a great danger—the Regulation does not apply where one party is restricted from competing, e.g., by using rival technology. A licensee who made a payment up front is probably paying lower royalties than he would otherwise have done, so is less tempted to resort to rival technology. Nevertheless, a payment up front is less foreclosing than a requirement to use the technology for a minimum number of operations—a white listed clause—so I am pretty sure in the light of recital 10 that such a clause rarely infringes the prohibition of Article 85(1) and may be exempted by Article 2(1)(9) and 2(2) or (3) if it does.

B. The Commission's plans for when the Patent Regulation expires next year

The Patent Regulation expires at the end of 1994. Mr. Guttuso, drafter of the Know-how Regulation, is considering amendment of the latter to cover pure patent licenses, which are not now within its scope. If the Commission adopts this view, there will be no need to renew the Patent Regulation, although some transitional provisions will be needed to cover patent licenses that are currently outside the Know-how Regulation and are adapted to come within it.

V. CONCLUSION

EEC law is formalistic, and based on pigeon holes. The Commission hopes that this gives rise to greater certainty. Lawyers are able to read a license and decide whether it is valid, without having to take market considerations into account under Article 85(1). The Commission will be able to make a more realistic appraisal under Article 85(3), but the Commission lacks the resources to grant many formal exemptions and comfort letters stating that the agreement merits exemption may be unhelpful when one tries to enforce the ancillary provisions. The Know-how Regulation is probably the most useful of the group exemptions, but expressly

excludes copyright and software licenses,\textsuperscript{72} not because the Commission is hostile towards them, but because it has not had sufficient experience to grant a block exemption—to make them legal per se. Signor Guttuso, who is responsible in the coordination of Directorate A of the Commission's competition directorate, is very liberal.

I would prefer the use of a rule of reason under Article 85(1), modelled along the lines of Abbott B. Lipsky's speech on "the nine no-noes,"\textsuperscript{73} but that is not the European way.

\textsuperscript{72} Know-how Regulation, \textit{supra} note 18, art. 5(1)(4). The Regulation is also applicable to trademark licenses, unless the mark is ancillary to the technology.