International Lawyer

Volume 12 | Number 4 Article 5

1978

A Common Law Lawyer Looks at the Common Market's New Patent Licensing Regulation

Peter D. Ehrenhaft

PETER D. EHRENHAFT*

A Common Law Lawyer Looks at the Common Market's New Patent Licensing Regulation
(Preliminary Draft Regulation IV/262/77-E)

I. Introduction

The President is not the first observer to criticize the specialization of the American bar or the expense and delay that characterize many of the nation's legal processes. But it is not an overstatement to suggest that in no other country are both individual and business interests better able to have their views presented to government regulators or to obtain more pervasive judicial review of the increasing volume of statutes and regulations. It is a part of the American tradition—obviously not without its costs—that wide-ranging norms are enacted in the "sunshine" of public hearings, open debates and recorded votes of legislators and regulators. Moreover, those affected by these rules have opportunities to participate in their adoption and to obtain review of both the process of their enactment and their substance, as measured against constitutional or other statutory standards, such as those of the Administrative Procedure Act.

These, some will say "endless" procedures may defer indefinitely the adoption of any legislative or administrative rule. The point is well illustrated in the case of efforts of many domestic business and legal interests in the past two decades to obtain a "clarification" of the legal principles applicable to the competitive effects of licensing patents and know-how. With the support of the Commerce Department, the patent bar has considered the case-by-case development of rules in a variety of contexts, from patent infringement and antitrust suits to Patent Office procedures for the issuance of patents, to provide business interests with some clear guidance, if not certainty. They claim the result may serve as a disincentive to research or the dissemination of infor-

*Member of the New York and District of Columbia bars, presently Deputy Assistant Secretary and Special Counsel for Tariff Affairs, U.S. Department of the Treasury. The views expressed are entirely those of the author and should not be attributed to any public or private organization.

mation as the validity or enforceability of issued patents is threatened and severe legal liabilities are risked if one has guessed incorrectly. With the support of the Justice Department, the antitrust bar has considered the existing approach adequate, even essential, to the maintenance of uniformity in rules concerning the maintenance of competition in the marketplace regardless of the fact that the restraints emerge from licensing the "lawful monopoly" of a patent. They contend that the allegations of disincentives to research are unproven and that the certainty sought is illusory. In American political, economic and social values a preeminent role has been given to the concept of opportunity. Its corollary is restraint on power not politically responsible. Its expression is in antitrust rules. Therefore, it is not surprising that, at least to date, those opposing the adoption of a comprehensive set of "do's" and "don'ts" for patent licensing have succeeded. Slow evolution, through case-by-case litigation, lengthy and expensive as it is, seems the preferred route for considering such problems in a "real world" context that provides flexibility for changing perceptions of need.

With this perspective, it is of interest to consider a regulation now being prepared by the Commission of the European Community. It is, in essence, a pervasive "laundry list" of permitted and proscribed practices for patent licensing. The first draft was, apparently, unintentionally released and, in light of some comments received (reportedly in greatest volume from American lawyers) somewhat revised. It is the revision that is the subject of this piece. But the important point is that these rules are being adopted by a small group of experts within the Commission, without public hearings and with little real input from those to be affected. The process is one that Americans upset with the "deliberate speed," complexity and expense of our procedures can envy; it is one that Americans persuaded of the need for "due process" must question.

In the hope that at least through the informal route of discussion in the literature read by interested practitioners, the Commission will consider both what it is doing and how. The following thoughts are offered by this lawyer, until recently involved in transnational transactions in which the licensing of patents and know-how within the European Community was a frequent feature. In essence, these remarks provide a running commentary on the proposed regulation as recently released, comparing the provisions of the regulation to the applicable law as it has existed heretofore in the Community and to comparable principles of U.S. law familiar to those involved in the business of technology transfers.

II. Framework for the Regulation

Under Article 85(3) of the Treaty of Rome, Community organs may "declare inapplicable" to "any . . . category of agreements" the provisions of Article 85(1) that prohibit agreements that may adversely affect competition

within the European Economic Community (EEC). Acting under that authority, the Council adopted Regulation 19/65[1] authorizing the Commission to issue implementing regulations granting exemptions to categories of agreements. The validity of such group exemptions has been upheld by the Court of Justice. *See Italy v. EEC Council and EEC Commission,* Case No. 32/65, CCH, COMM. MKT. REP. ¶ 8084 (1966).

The Commission has, from time to time, also issued "Official Notices" indicating its intentions with respect to the application of Article 85 to certain types of agreements. One of these was its "Official Notice on Patent Licensing Agreements," issued on December 24, 1962[2] (hereafter "Patent Notice") in which the Commission stated that "on the basis of its present knowledge of the circumstances" it would not consider agreements with various enumerated clauses within the prohibitions of Article 85(1). Aside from the evolving, but skimpy, case law, this Patent Notice has been the principal published expression of the Commission's views on the relation between licensing agreements and Article 85(1).

In late 1976, exercising its authority under Regulation 19/65, the Commission prepared a draft regulation (denominated Draft IV/134/76-E [Orig. D.]) (hereafter "Draft 134") providing a group exemption to certain categories of patent licensing agreements.[3] After a number of critical comments concerning this draft were published, the Commission staff has now prepared a revised version (denominated Draft IV/262/77-E [Orig. D.]) (hereafter "Draft 262").

III. Structure of the Draft Regulation

Characteristically of EEC Regulations, the text recites the reasons for its adoption, framed in what are now sixteen "whereas" clauses. Article 1 then enumerates seventeen types of provisions which, if included in a patent licensing agreement between a single licensor and a single licensee, will *not* disqualify the agreement from the group exemption provided by the Regulation. Article 2 of Draft 134 had contained eight "conditions" to be met if an agreement, including provisions of the type listed in Article 1, were to retain exempt status. These conditions have now been incorporated directly into Article 1. As before, they significantly limit the proposed group exemption: thus, exclusive territorial licenses are exempt on the condition the territory is limited to one with 100 million inhabitants; export bans qualify if they last only ten years. Article 2 now enumerates types of clauses, any one of which, if included in the licensing agreement, will automatically disqualify the licensing agreement from the group exemption provided by the Regulation. However, the fact that

[1]CCH, COMM. MKT. REP. 2717 (1971).
[2]CCH, COMM. MKT. REP. 2968 (1971).
[3]CCH, COMM. MKT. REP. 9927 (1977).

such a clause may be included in an agreement does not mean that the Commission cannot, on application, grant an *individual* exemption pursuant to Article 85(3); it means only that the group exemption pursuant to the proposed Regulation will be unavailable. Article 3 prescribes procedures for submitting agreements for individual exemptions; Article 4 describes specific arrangements, such as patent pools and joint ventures, for which the group exemption of Article 1 will not be available. Article 9 authorizes revocation of an exemption once granted. The balance of the Regulation consists essentially of procedural matters.

IV. Section-by-Section Analysis of Substantive Provisions

Introduction

The introductory clauses cite as the legal basis for the Regulation Article 85 of the Treaty and Regulation 19/65. Reference is made to the Patent Notice of December 24, 1962, only in an Annex indicating that the Regulation supersedes the Notice, even though the two are not coextensive in their coverage. The Notice was in some respects less limited in application.

Whereas Clauses

The following "whereas" clauses warrant comment:

No. 3 underscores the right of companies to request the Commission, on an individual basis, to grant an exemption under Article 85(3) with respect to a particular agreement even if it does not qualify for a "group exemption." It is not an essential point—but comforting.

No. 4 includes the critical "finding" that even patent licensing agreements confined to a single Member State "affect trade between Member States." Draft 134 had more boldly found such agreements "are . . . likely as a rule to affect [such] trade." As Article 85 of the Treaty—the foundation of the entire Regulation—applies only to agreements that are likely to affect trade between Member States, this finding is really a jurisdictional prerequisite to application of the Regulation to agreements that, by their terms, are limited to the patents of a single Member State. However, a patent licensing agreement can properly be viewed as simply an agreement on the part of a patentee not to exercise the right granted by the patent-issuing government to bring a legal action against an infringer. If the agreement contains nothing other than the patentee's pledge that no suit will be brought in the patent-issuing State, it would seem difficult to contend that such an agreement is "likely as a rule to affect trade between Member States." Thus, both as a jurisdictional foundation and Article 190 "reason" for the adoption of this Regulation, the prior formulation was questionable. As now phrased, the group exemption is presumably applicable to any patent licensing agreement that at least contains provisions af-

fecting imports into or exports from the licensed territory. Single-State licenses that are, in essence, covenants not to sue, should not require an Article 85(3) "exemption." (If legal clearance were thought desirable, such contracts presumably continue to qualify for a "negative clearance" that Article 85(1) is inapplicable.)[4]

No. 5 indicates that Article 1 of the Regulation is not intended to provide an all-inclusive list of clauses that may fall within the proscriptions of Article 85(1) and nevertheless qualify for exemption. It suggests "certainty . . . is better served if . . . the Regulation lists all those obligations whose anticompetitive effect may be controversial," awaiting "definitive appraisal by the Court of Justice." As indicated above, the desired certainty seems illusory and will probably be elusive. It would better acknowledge that the "rule of reason" is the true foundation of the Regulation, of which the individual clauses treated may properly be seen as important illustrations.

No. 6 recites new findings that the Regulation will "encourage" patent licenses and thus make it easier for undertakings to invest capital in the manufacture and distribution of new products or the use of new processes. Patent licenses may, indeed, have that desired effect. But whether the availability of the group exemption for certain licenses will have a direct impact encouraging the dissemination of technology remains to be seen. Little empirical data concerning the effect of current law exists one way or the other, although it is not infrequently claimed that licensors inhibited from restricting their licenses may be discouraged from sharing their rights or information.

No. 8 of Draft 134 had suggested that certain of the restrictive clauses described in Article 1 of the Regulation were "indispensible to the growth of production and the improvement of . . . technology." The factual foundation for this proposition was not recited and this "reason" appeared dubious. Little evidence exists that the relatively "strict" U.S. rules of misuse and antitrust liability applicable to the use of restrictive clauses in patent licensing agreements have had a significant adverse effect on licensing activity or the growth of production and improvement of technology. To the extent that the Regulation must be based on stated and court-reviewable "reasons," this "finding" could have been vulnerable. The new draft states that Article 1 includes "no restrictions . . . not indispensible to the attainment" of the objective of facilitating technology dissemination. But this formulation is no less dubious. "Useful" would seem the strongest suitable substitute for "indispensible."

No. 12 had stated that "in practice patent licensing agreements are hardly ever concluded without . . . ancillary provisions [concerning the right to use

[4]The "negative clearance" procedure is prescribed by Article 2 of Regulation 17, CCH, COMM. MKT. REP. ¶ 2411.

secret manufacturing process or knowledge]." It is appropriate and desirable to include within this group exemption Regulation provisions applicable to the licensing of secret "know-how," but it was doubtful that "in practice" know-how agreements are a "usual" part of most patent licenses. They are frequently part of a single business transaction, but hardly necessarily so. Draft 262 now reflects merely that know-how clauses "are very frequent."

No. 13 is less of a "whereas" clause than a substantive point indicating that the regulation applies to licenses issued in respect of the national patents of the Member States, the Community patents to be issued pursuant to the Convention for the European Patent for the Common Market of 15 December 1975,[5] and the European patents under the Convention of 5 October 1973 (the last now added to the draft). Notice is added that assignments as well as licenses of patents are to be covered by the Regulation. The clause does not indicate whether a patent license agreement that also purports to grant rights under patents other than those within the Community will be ineligible for the group exemption. Certainly it is not unusual for a patent license agreement under patents of one or more Member States of the Community to provide that the licensor will also not assert counterpart patents in other countries against imports of the products made under license. The inclusion of such a clause should not take the agreement outside the group exemption.

* * *

Article 1. Section 1

Article 2(1) of Reg. 19/65 provides that group exemptions shall be issued "for a limited period of time." Thus, the introduction of Article 1(1) of Draft 262 indicates that the Regulation will apply "until 1 December 1988." It is unclear whether agreements that qualify for the group exemption before that date but remain in effect beyond it, will continue to enjoy the exemption. A number of contract clauses contemplated by the Regulation may well ordinarily extend beyond the expiration date of the Regulation. But the apparent intent of the Commission staff is that the exemption, once obtained, will remain in effect only until the indicated date, at which time the *group* exemption may be extended. If it is not, an individual exemption under Article 85(3) may be sought. This is the approach adopted with respect to Reg. 67/67 providing a group exemption for certain exclusive distribution agreements

Subsections 1 through 5 define various arrangements appropriate to the grant of an exclusive patent license. Subsections 1 and 3 authorize a licensor to agree to refrain from, itself, manufacturing or selling a patented product within the licensed territory; subsections 2 and 4 permit a licensor to agree not to grant additional licenses within the territory and to impose contractual prohibitions on other licensees against selling patented products within the ter-

[5]CCH, COMM. MKT. REP. ¶ 5795 (1976).

ritory. Subsection 5 permits a licensee to agree to refrain from selling patented products or products manufactured by a patented process within the exclusive territories of the licensor or other licensee. Subsections 1 through 5 find their counterpart in Article I.E.(1) and (2) of the 1962 Patent Notice and are, thus, not "news." However the exclusive manufacturing licenses authorized by subsections 1 and 2 of Draft 262 are significantly limited by the conditions of subsection (2) which are new. They authorize exclusivity only where—

(a) the licensed territory has a maximum of 100 million inhabitants,
(b) the licensor can revoke the exclusivity (not the entire agreement as had been the case in Draft 134) no more than five years after the date of the contract in the event the licensee inadequately utilizes the license, and
(c) where two or more licensees have "economic connections," their licensed territories do not have a population exceeding 100 million.

The limitation of exclusive licenses to areas with a population of 100 million inhabitants could, in some cases "Balkanize" the Common Market—which it is one of the aims of the Community to avoid. However, the Commission staff contends its aim is to ensure multiple production sources and a minimum of sale restraints.

The sale restrictions authorized by subsections 3 to 5, including export bans, are limited by the "conditions" that—

(a) they are for no more than a ten-year period from the date of the base patent licensed,
(b) they are for the benefit of an enterprise with an annual turnover of no more than 100 million units of account, including all companies with which the licensee has "economic connections,"[6]
(c) there are no inhibitions on sales of the patented product by companies without "economic connections" to the licensee or licensor, and
(d) the licensee is a manufacturer and not merely a seller of the patented goods.

Conditions (c) and (d) are new to Draft 262 and apparently underscore the Commission staff's aim to encourage the expansion of EEC-wide *sales* rights, even if manufacturing rights are more limited. They represent a step beyond the European Court's *Centrafarm*[7] decision prohibiting resale bans after the exhaustion of patent rights on the first licensed sale. But the sources or reasons for these numbers and principles are not indicated.

It is of interest that Draft 262 has dropped what had been a particularly

[6]*Economic connection* is a new term of art, defined by new Article 11 of the Regulation, as the ability of one company to "exert a decisive influence" on another with respect to the exploitation of a patent.

[7]Centrafarm BV & Adriaan de Peijper v. Sterling Drug Inc., CCH, COMM. MKT. REP. ¶ 8246 (1974).

egregious form of new lawmaking in Act 2(3) of Draft 134. That clause contemplated compulsory licensing of patents in "unlicensed" fields of use. Field-of-use limitations to "technical" areas within a licensee's competence were to be sanctioned. However, if a licensee entered fields of use to which its license did *not* otherwise extend, the Regulation would have entitled the licensee to operate in such fields upon the payment of an appropriately increased royalty. This "automatic" expansion of licensed rights would have failed to reserve to the licensor its full rights to charge what the market will bear in each field of use. In effect, this would have authorized compulsory licensing at lowest common denominator rates for all uses. Deletion of this clause attests to the value of the limited comments that have been made and received.

With respect to the balance of these provisions, it is a fact that the application of more "liberal" standards only to smaller enterprises has a history in Regulation 2779/72,[8] authorizing specialization agreements between enterprises having an aggregate turnover of 150 million units of account. Thus, applying an expansive "*de minimis* rule," the Commission regards restrictive practices by small companies as outside the intended reach of Article 85(1) of the Treaty. On the other hand, expressly granting an exemption for a license agreement including *any* export prohibition would appear to sanction a type of restraint not normally regarded as ancillary to a licensed patent. Since patents are territorial in scope to the country of grant, they are not normally regarded as providing a basis for a prohibition on sales *outside* that territory. In that connection, it is of interest to note that the Patent Notice of 1962 did not include any authorization for export prohibitions. Article I.A.(4).

Subsection 6 authorizes field-of-use licenses in "technical" fields of application. In the Patent Notice, the concept of sanctioning only limits on the "application of the patented process to specified fields of *technical* application" had been adumbrated. The basis for the "technical" limitation is unknown and, if field-of-use licenses are to be authorized, there would seem to be little reason why only a "technical" differentiation of fields is appropriate. Valid distinctions may also exist between classes of customers (e.g., governmental v. private; large v. small volume makers or users; original equipment manufacturers v. retail sellers). However, that the Commission intends only true "technical" distinctions is evident from the condition authorizing field-of-use limitations only when the differentiated products "differ in a material respect." (Draft 134 had suggested it was the burden of the licensor to prove that the licensee could not "guarantee technically proper workmanship in the excluded applications." This harsher formula has been dropped.)

Field-of-use limitations based on non-"technical" distinctions have been approved even in the more "hostile" climate of U.S. antitrust law. *See* ABA,

[8]CCH, COMM. MKT. REP. ¶ 2713A (1973).

ANTITRUST LAW DEVELOPMENTS 347-48 (1975). The distinction between "technical" field-of-use limits and customer limits seems hard to justify and has no analogy in existing case law. U.S. law has recognized—and condemned—a series of exclusive field licenses only if they are used as a device to achieve a horizontal division of markets. *See United States v. Associated Patents,* 134 F. Supp. 74 (E.D. Mich. 1955), *aff'd,* 350 U.S. 360 (1956). This seems correct. The law's aim ought to be to prevent market allocations. At least, a distinction should be drawn between the rights of a patentee *user* of its patent to create field-of-use licenses (so as to protect its own business operations to which its invention directly relates), and the rights of a mere licensor of patents in a market in which it does not itself operate.

Subsection 10 authorizes terms requiring the licensee to respect quality specifications and to permit their verification by the licensor. But it is severely limited by the condition restricting such obligations to situations in which the patented product is identified through the licensor's trademark or some other distinctive quality that attributes the product to the licensor. There are bases other than trademarks or distinctive associations with the licensor upon which a licensor may have an interest in assuring quality controls. First, as its licensing income depends upon the successful exploitation of its patent, and a grant of the license to one company may limit its ability to grant a license to another, the patentee has a legitimate concern that any license granted is properly used and ought to be able to prescribe that such quality will be maintained to assure its own return by whoever practices under the patent. Second, a licensor may have legitimate concerns about the safety of the practice of its invention and may seek to assure quality controls to avoid possible liability to the licensee or its customers.

Subsection 11, to be read together with 10, authorizes a licensor to require that its licensee procure supplies of intermediate products from the licensor or designated sources of supply. This, too, is limited by situations in which the goods are trademarked or identified with the licensor. Further, such tie-ins are permitted only when the licensor "proves that the intermediate product is necessary to meet a quality standard." Tie-in clauses, to preserve the quality of trademarked goods, have been sanctioned in U.S. law, primarily in the context of franchise agreements. *See* ABA ANTITRUST LAW DEVELOPMENTS 339 n.77 (1975). But they may also rest on the broader bases discussed in connection with subsection 10.

Subsection 12 authorizes a grant-back clause obligating the licensee to license its improvements to the original licensor. It is limited, however, to nonexclusive licenses back, and must also provide that new technology will similarly be licensed by the licensor to the licensee. The former draft stated the regime must authorize the original licensor to issue sublicenses under licensee improvements to other licensees, but this has now been dropped. Assignment

grant-backs are expressly precluded by Article 2(13). These provisions are substantially reflective of the corresponding Article I.D. of the Patent Notice. However, the requirement that a grant-back regime obligate the *licensor* to make its own improvements available to the licensee is an extension of principles generally recognized in U.S. patent/antitrust law. *See* ABA, ANTITRUST LAW DEVELOPMENTS 337 (1975). Grant-backs are generally justified on the theory that the licensor that originally discloses technology ought not to be left behind its licensees that may improve upon it. That does not—and should not—necessitate an obligation on the licensor to continue updating its own initial disclosure.

Subsection 13 authorizes clauses obligating the licensee to pay a minimum royalty or to produce a minimum quantity. However, it is limited to a five-year period, whereafter the provision may be terminated by the licensee (the old draft had permitted termination by either party) on an annual basis. Why minimum payments should be terminable by the licensee is not indicated. For payment of the minimum fee, it retains the *opportunity* to exercise the licensed rights and should be held to the contract. Since Article 1(2)(b) in any event requires the retention by the licensor of the right to terminate for inadequate utilization by the licensee, the minimum royalty obligation cannot be utilized to suppress the invention.

Subsection 14 authorizes confidentiality clauses obligating the licensee not to divulge secret know-how during the term of the license and thereafter. The stress on the secret character of information that may not be divulged is consistent with current U.S. law concerning appropriately protectable "know-how." *See Kewanee Oil Co. v. Bicron Corp.,* 416 U.S. 470 (1974). This clause permits only a restraint on disclosure. On the other hand, Article 2(12) of Draft 262—new to this version—prevents an exemption for an agreement including a clause prohibiting the licensee from *using* secret know-how after expiration of the license (although added royalties for three years may be required). This is a further type of compulsory licensing arrangement that is obviously novel. (It is discussed below under Act 2(12).)

Subsection 15 sanctions most-favored-licensee clauses. However, it has not been carefully drafted. It does not articulate the bases upon which license terms are to be compared to determine which are more favorable. *Shatterproof Glass Corp. v. LOF,* 482 F.2d 317 (6th Cir. 1973), cert. denied, 415 U.S. 918 (1974), holding that patent assignments, releases of past infringement and traditional running royalty license terms all had, in some way, to be reduced to a common denominator to enable a court to interpret an "MFL" clause, illustrates the problems with ambiguous references to "terms." The subsection should also stipulate that MFL clauses may require a licensee invoking such rights to accept less favorable terms included in the third party license and that

they apply only to agreements entered into following the license containing the clause.

Subsection 16 is new to Draft 262 and fills an important gap in the prior draft by including the treatment of unlicensed competition clauses. Patent licenses will qualify for exemption if they include obligations on the licensee (a) to inform about infringements, (b) to take legal action against infringers and (c) to assist licensor actions. (Subclause (b) would be possible in present U.S. law only with respect to an exclusive licensee.) But the provision does not deal with other troublesome aspects of this theme: May a licensee properly be compelled to continue to pay royalties despite the existence of unlicensed competition? Is such competition a proper basis for establishing an escrow account either internally or with a third party (in lieu of withholding the payment of royalties)?

Subsection 17 authorizes arbitration "arising out of the patent licensing agreement." The subsection does not expressly indicate that the arbitrator can consider disputes involving the validity and infringment of the licensed patents, but the present wording does not preclude them.

An important change from the prior draft is the deletion of the clauses that would sanction arbitration only if it were conducted within the Community and the contracting parties were assured the right to judicial review of the award by a court within the Community. If arbitration is to be sanctioned at all, it would seem that broad rights to submit all relevant disputes to arbitration should be permitted.[9] Further, since judicial review may take place whenever a party seeks to enforce its award, there should be no obligation to compel such review in the Community or elsewhere. Judicial review, if needed at all, should be allowed wherever the parties are jurisdictionally present or they have assets with which to satisfy an award made. On the other hand, the Regulation properly retains the clause conditioning an exempted arbitration clause on the agreement of the parties to notify the Commission of awards. This is essential if the integrity of the Regulation is to be retained and not subverted through awards that might otherwise require or sanction conduct outside the scope of the Regulation.

Clauses Not Covered by Article 1(1)

Although Article 1(1) enumerates a variety of restrictive clauses that, when read together with the "conditions," will not disqualify from a group exemption the contract in which they appear, the list fails to treat a number of provisions that are frequently found in patent licensing agreements. These raise

[9] For a more detailed discussion of this occasionally troublesome issue see, Ehrenhaft, *Effective International Commercial Arbitration*, 9 LAW & POL. INT'L BUS. 1191, 1198-200 (1978).

issues that should be covered by any further redraft of the Regulation and include:

A. ROYALTY BASE CALCULATIONS

Substantial law has developed in the United States concerning the appropriate definition of the "royalty base" on which a licensor may require the payment of royalties. The classical definition limits the royalty base to the products or processes described by the actual claims of a licensed patent. However, in some cases it may also properly include the licensee's total production, of which the patent claims describe only a part. The Regulation should recognize that the royalty base for a composition-of-matter patent can often properly embrace the value of fillers, additives, coloring agents and similar items that are added to the patented product before it is actually sold to the public, or for a patent claiming an electronic circuit or mechanical device, the royalty base may most conveniently be the entire apparatus of which the circuit or device is a part. *See* ABA ANTITRUST LAW DEVELOPMENTS 342-43 (1975). The new draft Article 2(5)(a) says flatly that "products not covered by the patent" cannot be included in the royalty base. That is simply too broad a statement of a proper rule.

B. DIFFERENTIAL ROYALTIES

The draft Regulation authorizes the use of most-favored-licensee clauses. Article 1(1)(15). However, it does not indicate whether a licensor is obligated to extend MFL treatment to competing licensors. One, perhaps unusual, series of U.S. cases held that a licensor's discriminatory royalty rates were, when combined with the predatory intent of injuring the licensee's ability to compete with another (partly owned) licensee, constituted misuse of the patents. *LePeyre v. F.T.C.*, 366 F.2d 117 (5th Cir. 1966); *Laitram v. King Crab*, 244 F. Supp. 9, 245 F. Supp. 119 (D. Alaska 1965). *But cf. Bela Seating Co. v. Poloron Products*, 438 F.2d 733 (7th Cir.), *cert. denied*, 403 U.S. 922 (1971).

C. SIZE OF ROYALTIES

Is a licensor permitted to charge whatever "the market will bear"? Although this is generally thought to be an inherent right of a patentee, some decisions in this country have suggested there may be situations in which an "oppressive" or "exorbitant" royalty may constitute misuse. *See American Photocopy Equip. Co. v. Rovico, Inc.*, 359 F.2d 745 (7th Cir. 1966), on remand, at which the charge was held not proven, 257 F. Supp. 192 (N.D. Ill. 1966), *aff'd*, 384 F.2d 813 (7th Cir. 1967).

D. RECORD KEEPING AND REPORTING OBLIGATIONS

The draft Regulation would permit the licensor to control a licensee's

adherence to quality standards in certain cases. May the licensor even more broadly include provisions in a license agreement obligating the licensee to maintain certain types of records, to make certain types of reports and to permit verification of those records and reports by the licensor or its designated agents?

E. ROYALTY REMITTANCE PROCEDURES

The regulation might appropriately address a series of problems not unusual in patent licensing agreements concerning royalty remittances, including: the obligation of a licensee to obtain foreign currency with which to make royalty remittances and the consequences of its inability (from government regulation or otherwise) to do so during the license term; the right of a licensor to require remittances net of all taxes imposed by the country from which the royalties are remitted (even if the royalties come from a country other than the one within which the licensed invention is practiced); the right of a licensee to place into an escrow account royalties that accrue while a licensed patent is being challenged in the courts either by the licensee itself or by a third party. While such issues are not traditionally the "stuff" of the concern of competition regulators, they may be areas in which leverage by one or another of the parties is exercised to extract inappropriate anticompetitive concessions.

* * *

Article 2

The group exemption authorized by the Regulation shall not apply if the patent license agreement contains one or more of the provisions enumerated by Article 2. Many of these are already firmly established in EEC jurisprudence and are familiar to the American practitioner:

Subsections 1 and 2 prohibit licensee estoppel clauses, which either directly or indirectly make it difficult for the licensee to contest the validity of the licensed patents. As such, the proposed Regulation reflects the current status of EEC law as enunciated in the *AOIP/Beyrard* decision[10] and developments in the United States since *Lear v. Atkins,* 395 U.S. 653 (1969), *discussed at* ABA, ANTITRUST LAW DEVELOPMENTS 345 (1975). However, under the revised Draft 262, the licensor may terminate the license if the licensee challenges validity. This may act as a signficant deterrent to the licensee's exercise of challenge rights. While it may be unfair to hold the licensor to the bargain if the licensee challenges the validity of the patent, the equities—and public interest—seem better served if, for example, a licensee can prevent licensor termination by paying royalties into escrow while the patent is challenged.

---

[10]Commission Decision 76/29, AOIP/Beyrard, of Dec. 2, 1975, CCH COMM. MKT. REP. ¶ 9801 (1976).

Subsection 3 prohibits perpetuation of a patent license agreement through an unlimited improvements clause. Thus, to assure qualification for the group exemption a patent license agreement must be terminable on a year-to-year basis following the expiration date of the patent most recently issued prior to the date the agreement is signed. This reflects current EEC law as expressed in the *AOIP* case. It is also to be read together with the rules preventing package licensing contained in subsection 17 of Art. 2 of the new draft. A license containing a grant-back and improvements clause without any termination could enable a licensor to require a licensee to accept a license under unknown patents in order to obtain a license under existing rights. Therefore, such a clause is properly proscribed as a necessary adjunct to the rules prohibiting "package" licenses.

Subsection 4 proscribes restrictions preventing competition in research, manufacture, use or sales even though exclusive licensing is authorized by Article 1, subject to certain reservations with respect to the size of the territory and the enterprises involved. Presumably, this provision will be read together with Regulation 2779/72, which authorizes agreements by small and medium size enterprises to divide research activities and to conclude specialization arrangements. In that connection, it is worth noting that new Article 4(2) precludes application of the group exemption regulation to joint ventures. Thus, the type of shared research activity usual to a joint venture would not be subject to the group exemption, even though, presumably, Reg. 2779/72 would permit it by qualifying independent companies. This subsection would seem to require revision to recognize these unintended anomalies.

Subsections 5 and 6 are detailed manifestations of the prohibition on package licensing. Subsection 5 prohibits clauses requiring royalties on invalid or expired patents or on the use of know-how that has entered the public domain. It is firmly rooted in the *AOIP/Beyrard* decision. Subsection 6 proscribes obligations to pay royalties despite the expiry of a licensed patent merely because a licensed trademark may subsist. This was formerly subsection 7, and should provide that *level* royalties are proscribed if "one or more" critical patents has expired or has been held invalid, or "one or more" trademarks licensed is invalidated or has expired. These provisions also do not adequately address the royalty base problems mentioned above in connection with Article 1. They should probably incorporate the "rule of convenience" familiar to U.S. law, under which a licensee may voluntarily agree to pay a level royalty for the right to use a portfolio of patents and trademarks whether or not such patents and trademarks are all actually used. *See, e.g., Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 139 (1969); *Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.*, 339 U.S. 827, 834 (1950).

Subsection 7 (formerly 8) proscribes quantity limitations in a patent license agreement. To this extent it is directly opposite to the Patent Notice of 1962,

Article I.A.(3) which had authorized such limitations. Quantity limitations have been assumed valid in the relatively small number of U.S. cases in which they have been considered. *See, e.g., United States v. E.I. Dupont de Nemours & Company,* 118 F. Supp. 41, 224-26 (Del. 1953), *aff'd,* 351 U.S. 377 (1956), *but see* 351 U.S. at 419-20 (dissent).

Subsection 8 prohibits price limitations either in the form of actual contractual restrictions or through procedures for recommending or coordinating prices and price terms. They would seem fully consistent with the general prohibitions of Article 85(1)(a) of the Treaty on price fixing agreements. Current U.S. law on the subject is often described as unclear. In 1926 a U.S. Supreme Court decision upheld the right of a manufacturing patentee to set the price at which a competing manufacturing licensee could sell the patented product. *United States v. General Electric Co.,* 272 U.S. 467 (1926). But the current view is that such arrangements are probably vulnerable. *See* ABA, ANTITRUST LAW DEVELOPMENTS 346 (1975).

Subsection 9 (formerly 11) proscribes restrictions on any party concerning its utilization of licensed products. This seems inconsistent with the authorization of field-of-use licenses provided by Article 1(1)(6). On the other hand, if it is intended only to proscribe *post*-sale restrictions on the use of licensed products, it simply reflects the common principle of patent law that a licensed sale exhausts the right of the patent, and that further restrictions and/or royalty obligations cannot be imposed on such products. *See* ABA, ANTITRUST LAW DEVELOPMENTS 348 n.139 (1975); *Centrafarm BV & Adriaan de Peijper v. Sterling Drug Inc.,* CCH COMM. MKT. REP. ¶ 8246 (1974).

Subsection 11 would prohibit field-of-use licenses for know-how. To the extent that field-of-use licensing is to be authorized for patents, there would seem to be no reason why it is not as appropriately permitted in the case of know-how. The argument is made that patents, being government monopoly grants, properly support submonopolies (such as field-of-use limitations), while know-how is not so protected and cannot be used to create monopolies. However, at least to the extent know-how is disclosed ancillary to a patent license (and as long as the law does not obligate an inventor to patent know-how in order to collect consideration for its disclosure), it would seem appropriate to permit field-of-use limitations also for know-how.

Subsection 12 would prohibit clauses that prevent a licensee from *using* secret know-how following the expiration of a license agreement; provided, however, that the licensee may be required to continue the payment of royalties for three years following the expiration of the agreement should it in fact use the know-how previously disclosed. The clause appears to be a reflection of the general view that most industrial know-how is either out of date or passes into the public domain after a relatively short period of time. Nevertheless, the proposed provision is a form of compulsory licensing with no

demonstrated competitive purpose. If a licensee is willing to accept a license for only a limited term, it should not be permitted to appropriate for its own use information disclosed in confidence and still secret after the expiration of the license terms. Article 2(5)(d) would adequately prevent the obligation to pay royalties on information that has, in fact, entered the public domain.

Subsection 14, proscribing "territorial restrictions on manufacture or use," is not further explained. There are certainly situations in which a licensee may wish an exclusive manufacturing license within a specified territory and a broader marketing area within which to sell its products. The Regulation provides no indication why such an arrangement is not lawful if the other parameters of the Regulation are followed.

Subsection 15 prohibits restrictions on manufacture, use or sale in the areas of the Common Market where the licensor holds no patent rights. Although this may be regarded as inconsistent with the provisions of Article 1(1)(3)-(5) permitting export bans, these clauses can be reconciled. The export ban provisions should be read as declarative only of the law that a contract may provide that the licensee will not infringe the licensor's patents in areas in which it has no license. Obviously, that principle does not apply if *no* patents exist in a given territory.

Subsection 16 prohibits agreements making it "difficult or impossible" for anyone—including "consumers"—to obtain or sell licensed products within the Community, except as sanctioned by the exclusivity Articles 1(1)(3)-(5). It is not a sanction for contributory infringement or the acquisition of unlicensed goods and is consistent with one of the basic tenets of EEC law: private contracts cannot recreate barriers to trade it was the purpose of the Treaty to overcome. On the other hand, the exceptionally broad language might be used to suggest a licensor could not deny a license to an applicant if doing so made it "difficult" to obtain licensed products.

Subsection 17 proscribes package licenses as did the prior draft Article 5(4).

Former subsection 20 proscribing provisions that have as their "purpose or effect a result corresponding to items 1-19" is now eliminated. It suggested that substance rather than form would govern the application of the prohibitory language of Article 2, but expression of that rubric is probably unnecessary.

* * *

Article 3

This Article creates a procedure under which patent licensing agreements containing restrictions other than those enumerated in Article 2 may be notified to the Commission. If so notified, they will be deemed exempt from Article 85(1) of the Treaty if the Commission takes no adverse action within six months. The procedure may be utilized only if the notification to the Com-

mission expressly mentions the Regulation. Objection to this provision has been made on the ground that the procedure is not authorized by Regulation 19/65. Article 1 of Regulation 19/65 does indicate that group exemption regulations must include a definition of the agreements to which they apply and "specify, in particular: (a) what restrictions or clauses may not appear in the agreements." However, since companies may, in any event, request an exemption under Article 85(3) for any agreement not covered by a group exemption, Article 3 of the proposed Regulation may be read as simply a procedure for facilitating such notifications and streamlining the request for an Article 85(3) exemption.

* * *

Article 4

This Article excludes from the exemption procedures certain groups of patent arrangements. These include all patent pools, joint ventures and reciprocal license agreements. These exclusions do not suggest that no exemption under Article 85(3) will be available for those types of agreements; it is only that they will not qualify for group exemption.

* * *

Article 9

This Article authorizes the Commission to determine whether Article 7 of Regulation 19/65 is applicable in specific cases, under which the Commission may, on its own initiative or upon the request of a Member State or of a natural or legal person showing a legitimate interest therein, determine whether any particular agreement that has been granted a group exemption should have that exemption withdrawn so that the agreement may then be regarded as a violation of Article 85(1). It is a "safety valve" clause authorizing later review of particular arrangements even though, on their face, they appeared to qualify for a group exemption. No case has been found in which an agreement qualifying for a group exemption under any of the existing group exemption regulations has been later disqualified on particular application. Therefore, the inclusion of this type of provision should not create concern.

V. Conclusion

The draft Regulation could be an important step in attempting to clarify the rules in an area of the law in which the EEC Commission has been remarkably inactive in the twenty years during which the Treaty of Rome has been in effect. The Patent Notice of 1962 has served as an interim guide; but its status was uncertain as it was not in the form of a regulation or decision. If a Regulation is adopted, important areas should be revised, others considered for inclu-

sion or exclusion. Hopefully, with the benefit of intense comment by interested parties both in Europe and elsewhere, as has already followed publication of the first draft, the Commission will adopt rules suited to business realities while remaining faithful to the purposes of Article 85(1) and (3). It may equally appropriately conclude that the American case-by-case approach is, after all, the most practical and adopt no regulation.

Even more important, however, the method by which the Commission decides the issue should be of concern to businessmen and lawyers on both sides of the Atlantic. The most voluminous and best-intentioned unsolicited comments from interested persons are no substitute for procedures by which such matters are published officially for public scrutiny and debate. As the Community moves toward the direct election of its Parliament and increasingly assumes responsibilities of government, its American well-wishers must hope that it remains, in the words of the Preamble of the Rome Treaty, "resolved to strengthen the safeguards of . . . liberty." To that end, no step seems more important than the continuous public participation we call "due process."