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An American View of the common Market's Proposed Group Exemption for Patent Licenses

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Introduction

On October 9-11, 1979, the Commission of the European Communities held hearings on a proposed group exemption[1] that would remove certain types of patent licensing agreements from the prohibition of Article 85(1) of the Treaty of Rome.[2] Although cast in the form of an exemption from Common Market antitrust rules, the proposed regulation takes an even stricter view of many types of licensing agreements than does United States law. In this article we shall compare the approach taken in the proposed group exemption with the relevant United States law and explore some of the policy considerations which underlie the American precedents and which may also be applicable in the European Community.

I. Territorial Restrictions

Article 1.1(3) and (4) of the proposed group exemption would exclude from the prohibitions of Article 85(1) of the Treaty of Rome, those patent licensing agreements in which (i) the licensor grants the licensee an exclusive

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[1]Proposed Regulation 3 COMM. MKT. REP. (CCH) ¶ 10, 118 [hereinafter cited as Proposal].

[2]Article 85(1) prohibits agreements and concentrated 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. . . ." Article 85(3) then provides that individual exemptions from Article 85(1) may be declared in specified circumstances. Regulation 19, promulgated by the Council of the European Communities in 1965, authorized the Commission to adopt certain group exemptions, including the proposed group exemption for patent licensing agreements.

territory where neither the licensor nor other licensees may sell the licensed product, or (ii) the licensee agrees not to sell the licensed product in a territory reserved for the licensor or for another licensee.[3] The exemption for these two types of territorial restrictions is, however, made subject to certain conditions in Article 1.2, one of which is that the turnover of the licensor or licensee whose territory is to be protected may not exceed 100 million units of account (about $175 million (U.S.)).[4] Thus, the net effect of the draft proposal is to treat territorial restrictions in simple one-way licenses as prima facie unlawful (subject only to possible individual exemption under Article 85(3)) in all cases where the entity being protected is a company of international size. This result is directly contrary to the rules, doctrines and policies of United States law.

A. *The United States Law*

In the United States, territorial restrictions in simple one-way patent licenses have been held lawful in all cases in which they have been considered.[5] As demonstrated below, this rule of virtual per se legality has deep roots in American jurisprudence.

It is a fundamental principle of United States patent law that a licensing agreement is lawful so long as it merely transfers all or a part of the patentee's rights under his patent rather than purporting to enlarge his patent monopoly.[6] One way in which a patentee can transfer a part of his patent rights is by granting a territorially restricted license; that is, the patentee, having the exclusive right to sell a patented product throughout the United States, may transfer a part of that right by granting someone an exclusive license to sell the product in a defined portion of the country. The right of a patentee to parcel out his patent monopoly in this manner has been recognized by statute since the earliest days of the United States. Since 1836, the United States Patent Code has included in one form or another a section comparable to the present section 261, which provides that a patentee may "grant and convey an exclusive right under his application for patent, or patents, to the whole *or any specified part* of the United States" (emphasis added.)[7] There is thus no

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[3]Proposal, *supra* note 1, arts. 1.1(3), 1.1(4).

[4]*Id.* at art. 1.2.

[5]Dunlop Company, Ltd. v. Kelsey-Hayes Co., 484 F.2d 407 (6th Cir. 1973), *cert. denied,* 415 U.S. 917 (1974); Brownell v. Ketcham Wire & Mfg. Co., 211 F.2d 121 (9th Cir. 1954); American Optical Co. v. New Jersey Optical Co., 58 F. Supp. 601 (D. Mass. 1944). *See also* United States v. Crown Zellerbach Corp., 141 F. Supp. 118 (N.D. Ill. 1956).

[6]A licensing agreement might be found to unlawfully enlarge a patent monopoly when, for example, it requires a licensee to purchase unpatented supplies in order to obtain the right to use a patented machine. In such a case, the patentee would be unlawfully using his patent to obtain an advantage in the sale of products outside the scope of the patent grant. *See, e.g.,* International Salt Co. v. United States, 332 U.S. 392 (1947).

[7]35 U.S.C. § 261 (1976). *See* Patent Act of 1836, ch. 357, § 11, 5 Stat. 117 (1836) which refers to the "grant and conveyance of the exclusive right under any patent to make and use . . . the thing patented, within and throughout any specific part or portion of the United States"; Act of July 8, 1870, ch. 230, § 36, 16 Stat. 203 (amended 1897, 1922 & 1941), which is cast in substantially the same terms as the present section 261; 35 U.S.C. § 47 (1946), which also is substantially similar

doubt that under United States law the right to grant territorially exclusive licenses is an inherent part of the patent monopoly.

This principle has also long been recognized in our case law. For example, in 1852 the Supreme Court noted in *Bloomer v. McQuewan*[8] that when a patentee conveys "the exclusive privilege of making or vending [the patented product] for use in a particular place, the purchaser buys a portion of the franchise which the patent confers."[9] More recently, in *United States v. Crown Zellerbach Corp.*,[10] which involved an exclusive license to sell a patented product east of the Mississippi River, the district court held that: "Viewed simply as a territorial limitation upon Crown's license, this agreement is a valid exercise of ALSCO's patent rights. . . . Territorial licenses, without more, are a reasonable means for the patentee to secure the reward granted to him."[11]

The American courts have upheld not only patent licensing arrangements imposing territorial restrictions within the United States, but also those containing export and import restraints. In *American Optical Co. v. New Jersey Optical Co.*,[12] the licensee of two United States patents covering components used in making eyeglasses had covenanted in the license agreement not to sell the patented products in England, Northern Ireland, France or Germany. The court held that:

> [t]he owner or holder of exclusive patent rights to make, use and sell may carve out of his grant a limited monopoly for a license. There is no doubt that a patentee may place territorial restrictions on licenses within the limits of the United States. It seems equally clear that the patentee is free to reserve for himself the advantages of competing in foreign countries by retaining the exclusive right of access to these markets.[13]

Similarly, in *Brownell v. Ketcham Wire & Mfg. Co.*,[14] a German patentee licensed certain United States patents to an American firm, which agreed not to export the patented articles. At the same time, the German licensor agreed not to import the patented articles into the United States. Upholding both restrictions, the court noted preliminarily that "[i]t is a fundamental rule of patent law that the owner of a patent may license another and prescribe territorial limitations."[15] The court then held that the export restriction "was an agreement by [the American company] to honor the territorial limits of the license granted, and was lawful."[16] With respect to the import restriction, the court held: "This was an agreement by [the German patentee] that the li-

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to section 261. 35 U.S.C. § 261 (1976) was adopted in 1952 and was amended in 1975 without any relevant change in substance.

[8] 55 U.S. (14 How.) 539 (1852).

[9] *Id.* at 549.

[10] 141 F. Supp. 118 (N.D. Ill. 1956).

[11] *Id.* at 127.

[12] 58 F. Supp. 601 (D. Mass. 1944).

[13] *Id.* at 606.

[14] 211 F.2d 121 (9th Cir. 1954).

[15] *Id.* at 128.

[16] *Id.* at 129.

cense granted [to the American company] was an exclusive license. . . . Exclusive territorial licenses granted under patents are old in the law. Unless they run afoul of the antitrust laws for other reasons . . . they are legal."[17]

Finally, in *Dunlop Company, Ltd. v. Kelsey Hayes Co.*,[18] a British company with patents in the United States entered into licensing agreements with various non-United States firms regarding its counterpart foreign patents. These agreements prohibited the non-United States firms from selling the patented product in the United States. The court held that

> [The British firm's] agreements with its licensees in Japan, Italy, Germany and Australia cannot be characterized as true horizontal agreements dividing markets. They are merely territorial licenses granted by a patentee such as are permitted by 35 U.S.C. § 261. If one who received a patent from the United States may so restrict his licenses without violating the domestic antitrust laws, it would seem clear that a patentee could do the same thing with foreign licenses without violating the antitrust laws of this country.[19]

It should be noted that, while the legality of territorial restraints in patent licensing agreements is recognized in the United States as a matter of patent law which excludes the application of antitrust, such restraints also would be legal under antitrust principles. The American antitrust laws recognize the legality of restraints which are ancillary to the transfer of various kinds of business assets, including technology. This "ancillary restraints doctrine," which has deep roots in American law,[20] has been specifically applied to uphold territorial restrictions in licensing agreements transferring unpatented know-how.[21] Furthermore, as demonstrated below in the discussion of relevant policy considerations, restraints which are properly ancillary to the transfer of patented or unpatented technology promote rather than restrict competition and, for that reason as well, do not violate the antitrust laws.

Of course, there may be territorial restrictions in reciprocal patent licenses that are part and parcel of some larger cartel agreement to divide markets and

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[17]*Id.*

[18]484 F.2d 407 (6th Cir. 1973), *cert. denied,* 415 U.S. 917 (1974).

[19]*Id.* at 417.

[20]Indeed, the doctrine goes back to the English common law. As early as 1711, the King's Bench in Mitchel v. Reynolds, 1 P. Wms. 181, 24 Eng. Rep. 347 (1711), upheld a covenant by the assignor of a bakery business not to practice the baker's trade for five years within a certain township. In the United States, the Supreme Court held in 1873 in Oregon Steam Navigation Co. v. Winsor, 87 U.S. (20 Wall.) 64 (1873), that the seller of a steamboat could enforce an agreement made with the buyer that the latter would not operate the steamer in California waters for ten years. Similarly, a contract restricting the territory in which a purchaser of a patent medicine formula could manufacture and sell the product was found to be a reasonable, ancillary restraint in Fowle v. Park, 131 U.S. 88 (1889). The rationale for the "ancillary restraints doctrine" was stated as follows by Judge (later Chief Justice) Taft in United States v. Addyston Pipe & Steel Co., 85 F. 271 (6th Cir. 1898), *aff'd,* 175 U.S. 211 (1899):

> [W]hen one in business sold property with which the buyer might set up a rival business, it was certainly reasonable that the seller should be able to restrain the buyer from doing him an injury which, but for the sale, the buyer would be unable to inflict. This was not reducing competition, but was only securing the seller against an increase of competition of his own creating. 85 F. at 280-81.

[21]*See* Part II, *infra* (discussion of know-how licensing) and cases cited therein.

that consequently would create problems under American antitrust law. Such arrangements, however, are outside the scope of the proposed group exemption in any event: It does not include market division agreements, but also specifically excludes reciprocal patent licensing arrangements.[22] Unfortunately, the proposed group exemption not only excludes such clearly anticompetitive agreements as market divisions and reciprocal patent licensing agreements; it also bars the use by larger companies of properly limited territorial restrictions in simple one-way patent licenses that are not anticompetitive and that unquestionably would be legal under United States law.[23] As we shall show, this result is contrary not only to the patent and antitrust jurisprudence of the United States, but also to policy considerations which are universal in their application.

B. *Policy Considerations*

American law reflects a recognition that permitting territorial restrictions to be imposed in patent licenses is likely to be in the public interest for a number of reasons. For one thing, the net effect of allowing such restraints is likely to be beneficial rather than harmful to competition. On the one hand, a properly limited territorial restraint merely restricts competition which would not exist at all without the patent license. For example, if a licensee is limited to selling a patented product in a specified area, he is not restricted in the use of his own technology or in competing in any other way that was open to him before the license was entered into; he is limited only in his use of patents which would not have been available to him at all without the license. On the other hand, if territorial restrictions are not permitted, the patentee may decide not to license. This will hurt competition in a number of ways. Licensing promotes competition in the long run because it puts the licensee in a position to begin competing with the licensor immediately after the patent expires. It also promotes competition in the short run because the first sale of a patented product usually exhausts the patent monopoly under both European Community and United States law.[24] Thus, even if the licensee is himself precluded from selling outside a particular territory, subsequent purchasers will be able to sell throughout the entire market so that the license will have the inevitable effect of creating immediate competition at the secondary or distributor level. In addition, to the extent that licensing makes a new tech-

[22]*See* Proposal, *supra* note 1, art. 5.3.

[23]A territorial restriction might also create problems under United States law if it extended beyond the scope of the licensed patent, *e.g.*, if it prohibited the licensee from using its own technology in a given area. Again, however, such cases would be beyond the scope of the proposed group exemption in any event.

[24]*See, e.g.*, Centrafarm B.V. & Adriaan de Peijper v. Sterling Drug, Inc., [1974] C.J. Comm. E. Rec. 1147, [1974 Transfer Binder] COMM. MKT. REP. (CCH) ¶ 8246; Adams v. Burke, 84 U.S. (17 Wall.) 453 (1873). In the European Community, under Regulation 67/67, 1 COMM. MKT. REP. (CCH) ¶ 2727 certain restrictions may be imposed after the first sale of nonpatented as well as patented goods in terms of the territories in which distributors may solicit business. Similarly, in the United States, certain restrictions may be imposed with respect to the territories in which distributors may resell goods. *See, e.g.*, Continental TV, Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

nology more widely available than would otherwise be the case, it immediately increases competition between the new technology and competing older technologies. Thus, whether one takes a long- or short-term point of view, legal requirements which discourage patent licensing — and which lead patentees to keep their inventions to themselves — are inherently anticompetitive.

Another social goal to be considered is the development and dissemination of technology. If patentees are discouraged from licensing, one consequence may be to deprive the public of the benefit of new technology. Another result may be that technology available in one part of the Common Market will not be available in other parts. Similarly, if United States, Japanese or other foreign companies are discouraged from licensing, it may impair the flow of technology to the European Community from the rest of the industrialized world.[25] In addition, both foreign and European patentees anxious to find licensees to help them exploit their technology may be unable to do so without territorial restrictions. Particularly where the development of technology is expensive and entails substantial business risks, licensees may be unwilling to make the investment necessary to develop and exploit a new technology without some assurance that neither the licensor nor other licensees will be using the identical technology to compete in the same area.

One objective of the proposed group exemption appears to be to protect the interests of small and medium-sized companies. However, a provision which discourages licensing, even if aimed at relatively large licensors, will inevitably hurt small and medium-sized firms, since these are typically the kinds of businesses that become licensees. If the large companies are forced to either exploit their patents on their own or not at all, it will be the smaller firms that lack research and development capabilities that will suffer.

While the proposed group exemption appears to recognize the general necessity for territorial restrictions in patent licensing agreements, it draws the line at firms having a turnover of more than 100 million units of account. There is no precedent in American law for such a limitation. Indeed, under American law, territorial restrictions may be imposed by companies having turnovers of well over 100 million units of account even with respect to the sale of nonpatented goods.[26]

Furthermore, as a matter of policy, the 100 million unit of account limitation is counterproductive. According to the preamble to the proposed group exemption, it is the firms with turnovers of more than 100 million units of

[25]Foreign firms may find that the prima facie illegality of territorial restrictions under the proposed group exemption forces them to choose among three alternatives: (1) exploiting their patents themselves in the European Community; (2) having a single Community-wide licensee; or (3) not exporting their technology to the European Community. In terms of the social goals of encouraging the development and dissemination of technology, promoting competition and protecting the interests of small and medium-sized businesses, all of these alternatives would appear to be less desirable than having a multiplicity of smaller licensees, each operating in a specified territory.

[26]*See, e.g.*, Continental TV, Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

account that "hold the bulk of the patents in force in the common market."[27] Also, a glance at *Fortune*'s lists of the 500 largest United States firms and the 500 largest non-United States firms shows that all 1,000 of them — including most of the world's chemical, oil, electronics and pharmaceutical producers — have turnovers far in excess of the specified limit.[28] In other words, the effect of limiting the availability of territorial restrictions to companies having turnovers of more than 100 million units of account is to discourage licensing by precisely those companies that have something to license.

Explaining the rationale for the 100 million unit of account limitation, the preamble to the proposed group exemption states:

> The Commission accepts that [territorial] protection is necessary for the majority of undertakings as a determining factor to facilitate decisions on investments relating to the development and marketing of new technologies. For undertakings with very high turnovers this protection would not, on the other hand, seem appropriate having regard to their extensive financial resources.[29]

The preamble does not explain why territorial protection would be any less necessary for larger firms or why their more extensive financial resources would make this protection inappropriate. In fact, it is precisely because of the greater financial resources of larger firms that they are most likely to choose not to license and to exploit their patents on their own, or not at all, if territorial restrictions are not available. Thus, the 100 million unit of account provision would make territorial restrictions prima facie unlawful in the very cases where this result will most probably discourage licensing and thereby hurt competition, retard technological development and subvert the interests of small and medium-sized companies.[30]

Turning to a final policy goal which is of great concern to the European Community — the achievement of economic integration — again there would appear to be no reason to treat territorial restrictions as prima facie unlawful. As previously indicated, territorially restricted patent licenses have been considered lawful in the United States since at least 1836. At no time has anyone suggested that such territorial restrictions have interfered with the functioning of an integrated market in the United States. Indeed, there seems to be no evidence that territorial restrictions in patent licenses have had any adverse social or economic effects in the United States. Furthermore, the exhaustion doctrine — established in such American cases as *Adams v.*

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[27] Proposal, *supra* note 1, at art. 1(2)(a).

[28] Citation omitted.

[29] Proposal, *supra* note 1, at art. 1(2)(a).

[30] In addition, even if it did make sense to make the availability of territorial restrictions in patent licenses dependent upon the market power of the licensor or licensee being protected, the overall turnover of a company has no necessary relation to its economic power. The teaching of American antitrust jurisprudence is that economic power must be examined in terms of a company's share of some relevant market. Many American firms may have annual turnovers of more than 100 million units of account but still be insignificant factors in any conceivably relevant European market.

Burke,[31] and in the European Community in cases such as *Centrafarm B. V. & Adriaan de Peijper v. Sterling Drug, Inc.,*[32] — virtually ensures that territorial restrictions in patent licenses cannot have any significant adverse effect on economic integration because there will always be free movement of goods throughout the entire market after the first sale. On the other hand, treating territorial restrictions in patent licenses as prima facie unlawful — and thereby discouraging patent licensing — can significantly harm economic integration by (among other things) impeding the flow of technology among the various parts of the Common Market.

In sum, all relevant policy considerations, as well as American legal doctrine, support the legality of appropriately limited territorial restraints in simple one-way patent licenses. Significantly, not even the most ardent critics of patent licensing restrictions in the United States appear to question the necessity for, or legality of, such territorial provisions. The American experience thus would strongly suggest a need to reevaluate the sections of the proposed group exemption that would severely limit the availability of territorial restraints in patent licenses even in cases where there is no apparent doctrinal or policy justification for this approach.

II. Know-How Licensing Restrictions

The proposed group exemption contains a number of provisions which appear to be fundamentally hostile to the licensing of know-how:

Article 3(10) condemns licensing agreements that prohibit licensees from using know-how after the expiration of the license, although it permits licensors to require payment for the use of their know-how for an "appropriate period" after the agreement terminates. The effect of this provision is that know-how can never be transferred except in perpetuity.[33]

Article 3(11) condemns field-of-use restrictions in know-how licenses, subject only to the licensor's right to charge an "appropriately higher" royalty for unauthorized uses.[34]

The proposed group exemption contains no provision covering territorial restrictions in know-how licenses, which means that all such agreements presumably would be subject to Article 85(1) of the Treaty of Rome unless an individual exemption were granted under Article 85(3).[35]

Underlying all of these provisions is the assumption that the licensing of know-how is somehow less desirable than patent licensing and that agreements which, in the words of the preamble, are "designed to give the licensor the same protection for secret know-how as for a patent,"[36] should be condemned. As demonstrated below, both the know-how provisions of the pro-

[31] 84 U.S. (17 Wall.) 453 (1873).
[32] [1974] C.J. Comm. E. Rec. 1147, [1974 Transfer Binder] COMM. MKT. REP. (CCH) ¶ 8246.
[33] Proposal, *supra* note 1, at art. 3(10).
[34] *Id.*, art. 3(11).
[35] *See* note 2, *supra*.
[36] Proposal, *supra* note 1, at art. 1(2)(a).

posed group exemption and the assumption which lies beneath them are contrary to United States law and to the legal doctrines and policies upon which the American jurisprudence is based.

A. *The United States Law*

While Article 3(10) condemns all licensing provisions that require know-how to be returned after the expiration of a license, under American law, such clauses clearly are valid. Indeed, if they were not, know-how would only be subject to sale (i.e., a transfer in perpetuity) and could never be licensed. The American authorities leave no doubt that the licensing of know-how is deemed to be very much in the public interest.

In *Painton & Co. v. Bourns, Inc.*,[37] a licensee contested its licensor's right to demand the return of drawings, data and other know-how materials at the expiration of the license. Holding for the licensor, Judge Friendly noted that

> [i]n thousands of contracts businessmen have divulged such secrets to competitors, dealing at arms' length and well able to protect themselves, on the faith that mutually acceptable provisions for payment, for the preservation of confidentiality, and for the return of the secret information on termination or default will be enforced by the courts.[38]

The court added:

> The district judge [who held for the licensee] cited no data to prove that licensing of trade secrets had worked adversely to the public interest. To the contrary, such facts as have been brought to our notice indicate that the sharing of technological know-how on the basis of proper agreements has been beneficial not only within this country but in its relations with others.[39]

The court found that know-how licensing has a pro- rather than an anticompetitive effect: "[R]ather than having a monopolistic tendency . . . the upholding of private agreements for the sharing of trade secrets on mutually acceptable terms tends against the owner's hoarding them."[40]

The court also found that a rule invalidating the licensing of know-how "will have the detrimental effect of limiting the use to which the ideas are put, contrary to the public interest in maximizing the utilization of intellectual resources."[41]

The holding and reasoning of the *Painton* case were adopted and endorsed by the Supreme Court in *Kewanee Oil Co. v. Bicron Corp.*,[42] discussed more fully below.

American law also disagrees with the proposed exemption's position on field-of-use restrictions in know-how licenses.[43] In *A.&E. Plastik Pak Co.*

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[37]442 F.2d 216 (2d Cir. 1971).
[38]*Id.* at 225.
[39]*Id.* at 225-26.
[40]*Id.* at 223.
[41]*Id.*
[42]416 U.S. 470 (1974).
[43]Proposal, *supra* note 1, at art. 3(11).

Inc. v. Monsanto Co.,[44] the court upheld the legality of an agreement in which a licensee was authorized to use know-how to produce a certain chemical product for its own use but not for sale to others. The court held:

> The agreement between Monsanto and A. & E., on its face, appears to be a license of technology or "know-how," to which restraints of competition are attached as conditions of the license. Thus, on its face, it does not appear to be an agreement between competitors not to compete, for absent the licensed know-how A. & E. is in no position to compete.[45]

The American cases have similarly upheld territorial restrictions in know-how licenses. Indeed, such restraints have been held lawful in Supreme Court cases dating as far back as 1889.[46] In a 1911 case, *Dr. Miles Medical Co. v. John D. Park & Sons Co.*,[47] the Supreme Court stated that a "secret process may be the subject of confidential communication and of sale or license to use with restrictions as to territory. . . ."[48] The rationale for this rule was explained as follows in *Shin Nippon Koki Co., Ltd. v. Irvin Industries, Inc.*:[49]

> The rationale behind the rule is that since the owner of a secret process, so long as he keeps it secret, is entitled to use it or not, as he pleases, with impunity from the antitrust laws, he should be encouraged to make it available for the benefit of the public at large. As an incentive to the accomplishment of this goal, and to insure him a satisfying reward for his creative skill and diligence, he should, like the owner of a patent, be allowed to place reasonable competitive restraints upon those to whom he has granted the right to its use and who, but for such grant, would be unable to compete with him.[50]

Finally, the assumption underlying the know-how provisions of the proposed group exemption—i.e., that know-how is inherently less worthy of protection in licensing agreements than patents—is contrary to United States law. In *Kewanee Oil Co.*,[51] the Supreme Court made clear its view that the protection of trade secrets or know-how "will encourage invention in areas where patent law does not reach, and will prompt the independent innovator to proceed with the discovery and exploitation of his invention. Competition is fostered and the public is not deprived of the use of valuable, if not quite

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[44] 396 F.2d 710 (9th Cir. 1968).

[45] *Id.* at 714-15.

[46] *See* Fowle v. Park, 131 U.S. 88 (1889).

[47] 220 U.S. 373 (1911).

[48] *Id.* at 402. *See also* Thoms v. Sutherland, 52 F.2d 592 (3d Cir. 1931); United States v. du Pont & Co., 118 F. Supp. 41, (D. Del. 1953), *aff'd on other grounds*, 351 U.S. 377 (1956); Foundry Services v. Beneflux Corp., 110 F. Supp. 857 (S.D.N.Y. 1953), *rev'd on other grounds*, 206 F.2d 214 (2d Cir. 1953).

[49] [1975] TRADE CAS. (CCH) ¶ 60,347. (N.Y. Sup. Ct., N.Y. Co. 1975).

[50] *Id.* at ¶ 66,440. The court in *Shin Nippon Koki Co.* held that a territorial restriction in a know-how license is "ancillary," and therefore lawful, if

> (1) the subject matter of the license is substantial, valuable, secret know-how; (2) such restraint is limited to the 'life' of the know-how; *i.e.*, the period during which it retains its secrecy; and (3) such restraint is limited to those products only which are made by use of the know-how. . . . *Id.*

[51] 416 U.S. 470 (1974).

patentable, invention."[52] In *Aronson v. Quick Point Pencil Co.,*[53] the Supreme Court reaffirmed its adherence to the position stated in the *Kewanee Oil Co.* decision. The Court noted that "[p]ermitting inventors to make enforceable agreements licensing the use of their [nonpatented] inventions in return for royalties provides an additional incentive to invention."[54] It is thus clear that under United States law the protection and licensing of know-how is considered to be in the public interest for much the same reasons that the protection and licensing of patents is deemed to be socially and economically desirable.

It may also be noted that *Aronson* held that a licensing agreement for the manufacture and sale of a nonpatented device could provide for the payment of royalties after the know-how involved had entered the public domain. The case is thus directly contrary to Article 3.4(d) of the proposed group regulation, which would prohibit all agreements obligating licensees to pay royalties on know-how that had entered the public domain.[55]

B. *Policy Considerations*

The public interest factors discussed in Part I of this article, which support the legality of territorial restrictions in patent licenses, apply *a fortiori* to justify the kinds of restraints in know-how licenses that we are dealing with here. As in patent licenses, a proper ancillary restraint in a know-how license merely limits competition that would not exist at all without the license, i.e., competition in the use of technology to which the licensee would have no access but for the license. On the other hand, the proposed group exemption presents an owner of know-how with more disincentives to licensing than is the case with a patentee. The know-how owner is faced with a probable ban, not only on territorial restraints, but also on all field-of-use restrictions and even on the basic concept of a terminable license. When one also considers that an owner of unpatented technology is under no compulsion to license or sell his know-how without adequate provisions to protect him from the competition of his licensee or buyer and without reasonable compensation for the use of his property, it appears highly probable that, under the proposed group exemption, many companies with valuable know-how will choose not to license. Moreover, the socially undesirable consequences of decisions not to license will be more severe in the case of know-how than in the case of patents. Unlike a patentee whose invention will enter the public domain within a fixed number of years, an owner of know-how can hoard his technology forever unless someone else happens to develop it independently. Thus, in terms of the goal of promoting competition, legal provisions which discourage licensing are likely to be even more counterproductive in the case of know-how than with patents.

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[52]*Id.* at 485.
[53]99 S. Ct. 1096 (1979), [1979] TRADE CAS. (CCH) ¶ 62,477 (1979).
[54]*Id.* at 1099, [1979] TRADE CAS. (CCH) ¶ 62, 477 at p. 76, 795, FORTUNE, May 7, 1979 at 268.
[55]Proposal, *supra* note 1, at art. 3.4.(d).

The same is true with respect to promoting the development, dissemination and efficient use of technology. As the United States Supreme Court stated in *Kewanee Oil Co.*,[56] if know-how cannot be protected, then, instead

> of licensing others to use his invention and making the most efficient use of existing manufacturing and marketing structures within the industry, the trade secret holder would tend either to limit his utilization of the invention, thereby depriving the public of the maximum benefit of its use, or engage in the time-consuming and economically wasteful enterprise of constructing duplicative manufacturing and marketing mechanisms for the exploitation of the invention.[57]

In addition, if contractual clauses generally regarded as essential to know-how licensing are treated within the Community as prima facie unlawful, one would expect that American, Japanese and other foreign firms would necessarily become extremely cautious about licensing in Common Market countries. In that case, the flow of technology from the rest of the industrialized world to the European Community could be adversely affected.

With respect to the policy goal of protecting small and medium-sized businesses, legal provisions which discourage know-how licensing again would appear to be harmful. As the United States Supreme Court pointed out in *Kewanee Oil Co.*, "Trade secret law promotes the sharing of knowledge, and the efficient operation of industry; it permits the individual inventor [or, one might add, the small company with potentially valuable know-how] to reap the rewards of his labor by contracting with a company large enough to develop and exploit it."[58]

Similarly, know-how licensing also permits smaller companies without significant research and development capacity to share technology developed by larger companies. The proposed exemption would make it impossible to have a terminable license,[59] which would be particularly harmful to small and medium-sized companies. If a license must be perpetual, the natural impulse of most owners of know-how will be to license only very large firms that can be depended upon to exploit the know-how and to generate royalty income for a very long period of time, rather than to take chances with relatively small, unknown licensees. Thus, by depriving licensors of the flexibility of having a terminable license, the proposed group exemption may prevent many smaller companies from obtaining technology licenses at all.

The provisions in the proposed group exemption with respect to know-how will also interfere with patent licensing. Many patent licenses contain provisions for the licensing of unpatented know-how, which is often necessary to allow licensees to exploit licensed patents. The draft regulation will in many

[56]416 U.S. 470 (1974).

[57]*Id.* at 486-87.

[58]*Id.* at 493.

[59]*See* Proposal, *supra* note 1, at art. 3.10. *Kewanee* also makes the point that, if know-how cannot be adequately protected by law, it may require companies to take increasingly expensive security precautions. As a result, the Court noted that "[s]maller companies would be placed at a distinct economic disadvantage, since the costs of this kind of self-help could be great, and the cost to the public of the use of this invention would be increased." 416 U.S. at 486.

cases encourage patentees to license their patents without the accompanying know-how—a practice which will redound to the disadvantage of licensors, licensees and the general public to the extent to which the latter has an interest in the efficient dissemination of technology.[60]

There is, then, no support in either American law or policy for adopting provisions which discourage know-how licensing or for regarding know-how as inherently less worthy of protection in licenses than patents. Significantly, in *Shin Nippon Koki Co., Ltd. v. Irvin Industries, Inc.*[61] the authority apparently relied upon by the licensee in that case in support of a contrary view "consist[ed] of quotations from published articles by employees of the U.S. Department of Justice and certain other commentators."[62] The court noted that

> [t]hese views, however, are unmistakably those of advocates and seem to represent little more than the personal politico-economic philosophies of their authors. In any event, they appear to go well beyond the compass or intendment of any existing judicial determinations upon the questions at issue and are, accordingly, rejected.[63]

In sum, all legally cognizable authority in American jurisprudence fully supports the legality of proper ancillary restraints in know-how licenses, and the policies underlying that authority would appear to be every bit as applicable in Europe as in the United States.

III. Field-of-Use Restrictions

Article 2.1(1) of the proposed group exemption exempts from the prohibitions of Article 85(1) licensing provisions which impose on a licensee "the obligation to restrict the manufacture of the patented product or the use of the patented process to one or more different technical fields of application of the invention within the patent claims."[64] To the extent that this provision would permit field-of-use restrictions in patent licensing agreements, it is in accord with United States law.[65] On the other hand, Article 3(8) of the pro-

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[60]It is unclear to what extent the proposed group exemption applies at all to licenses covering both patents and know-how. The preamble states that

> It is appropriate to extend this Regulation to patent licensing agreements containing *ancillary provisions* concerning the assignment or the right of use of secret manufacturing processes or know-how relating to the use or application of industrial technology, as in practice patent licensing agreements with such ancillary provisions are very frequent. (emphasis added.) Proposal, *supra* note 1 at art. 1(2)(a)

However, the regulation does not define the term "ancillary provisions" and it is consequently impossible to tell from the text of the proposed group exemption whether, for example, a blanket agreement licensing a company's patented and unpatented technology in a given field would be covered by the draft regulation.

[61][1975] 1 TRADE CAS. (CCH) ¶ 60,347. (N.Y. Sup. Ct., N.Y. Co. 1975).

[62]*Id.* at 66, 443.

[63]*Id.*

[64]Proposal, *supra* note 1, at art. 2.1(1).

[65]The clause continues however, "For the purposes of this subparagraph there are different technical fields of application where the relevant products in each of the fields from which the licensee is excluded differ in a material respect from the products for which the license is granted." *Id.*

posed exemption prohibits "restrictions on one or both parties as to uses of the licensed products going beyond the patent claims, particularly as regards the way in which and the customers to whom the products are to be sold."[66] As we shall show, this latter provision is contrary to the rules, doctrines and policies of American jurisprudence.

A. *The United States Law*

The leading American case in this area is the Supreme Court's 1938 decision in *General Talking Pictures Corp. v. Western Electric Co.*,[67] which upheld the legality of a field-of-use restriction. The defendants in that case licensed patents for vacuum tubes and amplifiers for use in the "private" field, i.e., in home radio equipment, and reserved the commercial field to themselves. The Court found these licensing arrangements to be lawful on the ground that a patentee "may grant licenses . . . upon conditions not inconsistent with the scope of the [patent] monopoly. . . ."[68]

The Court was not making new law in *General Talking Pictures;* that decision was antedated by a line of cases going back at least to the middle of the nineteenth century sustaining the validity of field-of-use licensing. For example, in 1869 the Supreme Court decided *Rubber Co. v. Goodyear*[69] which held it to be an infringement for a licensee to practice a patent beyond the limited purposes authorized in the license. Similarly, in 1872, the Supreme Court decided *Mitchell v. Hawley,*[70] which it later cited[71] in *General Talking Pictures* for the proposition that restrictive patent licenses are clearly legal. In another case, decided four years prior to *General Talking Pictures,* the Eighth Circuit upheld a field-of-use restriction in a manufacturing license, writing that ". . . the patentee is not compelled to choose between granting full and complete use under the patent or granting no use. He may attach such limitations upon the use as do not go beyond the influence of his complete monopoly without granting licenses."[72]

General Talking Pictures, therefore, can be viewed as affirming the long-established doctrine that field-of-use restrictions are inherent in the statutory patent grant. Because the patentee possesses a legal monopoly in the patented product or process—the right to exclude others entirely from exploitation of

As Part III of the article shows, American law does not adopt—nor would any policy consideration appear to justify—such a limited view of permissible field-of-use restrictions.

[66]Proposal, *supra* note 1, at art. 3(8).

[67]304 U.S. 175, *aff'd on rehearing,* 305 U.S. 124 (1938).

[68]304 U.S. at 181.

[69]76 U.S. (9 Wall.) 788 (1869).

[70]83 U.S. (16 Wall.) 544 (1872).

[71]305 U.S. at 127.

[72]Vulcan Mfg. Co. v. Maytag Co., 73 F.2d 136, 139 (8th Cir. 1934), *cert. granted,* 293 U.S. 553 (1935), *cert. dismissed per stipulation,* 294 U.S. 734 (1935); *accord,* Good Humor Corp. of America v. Popsicle Corp. of United States, 59 F.2d 344 (D. Del. 1932), *aff'd,* 66 F.2d 659 (3d Cir. 1933); Curtiss Aeroplane & Motor Corp. v. United Aircraft Eng'r Corp., 266 F. 71, (2d Cir. 1920).

the invention—he inherently possesses the right to relax a portion of that monopoly by waiving part but not all of the patentee's right to exclude.

Despite numerous challenges, *General Talking Pictures* has not been overruled and numerous courts have followed its teaching that field-of-use licensing is a lawful exercise of rights encompassed by the grant of a patent monopoly.[73]

Thus, insofar as Article 2.1(1) permits field-of-use restrictions in patent licenses, the proposed group exemption is fully in accord with United States law.[74] The proposed group exemption and American jurisprudence part com-

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[73]*E.g.*, Bela Seating Co. v. Poloron Prods., Inc., 297 F. Supp. 489, (N.D. Ill. 1968), *aff'd*, 438 F.2d 733 (7th Cir. 1971), *cert. denied*, 403 U.S. 922 (1971); A. & E. Plastik Pak Co., Inc. v. Monsanto Co., 396 F.2d 710 (9th Cir. 1968); Armstrong v. Motorola, Inc., 374 F.2d 764 (7th Cir. 1967), *cert. denied*, 389 U.S. 830 (1967); Coats Loaders & Stackers, Inc. v. Henderson, 233 F.2d 915 (6th Cir. 1956); Hazeltine Research v. Admiral Corp., 183 F.2d 953 (7th Cir. 1950), *cert. denied*, 340 U.S. 896 (1950); Automatic Radio Mfg. Co. v. Hazeltine Research, 176 F.2d 799 (1st Cir. 1949), *aff'd on other grounds*, 339 U.S. 827 (1950); Turner Glass Corp. v. Hartford-Empire Co., 173 F.2d 49 53 (7th Cir.), *cert. denied*, 338 U.S. 830 (1949); Carter-Wallace, Inc. v. Otte, [1978] 1 TRADE CAS. (CCH) ¶ 61,976 (E.D.N.Y. 1978) 49, 53 (7th Cir.) Munters Corp. v. Burgess Indus. Inc., 450 F. Supp. 1195, (S.D.N.Y. 1977); Duplan Corp. v. Deering Milliken, Inc., 444 F. Supp. 648, 671 (D.S.C. 1977), *aff'd in part, rev'd in part on other grounds*, 594 F.2d 974 (4th Cir. 1979); United States v. Ciba-Geigy Corp., [1976] 1 TRADE CAS. (CCH) ¶ 60,908 (D.N.J. 1976); Ansul Co. v. Uniroyal, Inc., 306 F. Supp. 541 (S.D.N.Y. 1969); *aff'd in part, rev'd in part on other grounds*, 448 F.2d 872 (2d Cir. 1971), *cert. denied*, 404 U.S. 1018 (1972); Barr Rubber Prods. Co. v. Sun Rubber Co., 277 F. Supp. 484 (S.D.N.Y. 1967); *aff'd in part, rev'd in part on other grounds*, 425 F.2d 1114 (2d Cir. 1970), *cert. denied*, 400 U.S. 878 (1970); Chemagro Corp. v. Universal Chemical Co., 244 F. Supp. 486 (E.D. Tex. 1965); Reliance Molded Plastics, Inc. v. Jiffy Products, 215 F. Supp. 402 (D.N.J. 1963), *aff'd per curiam*, 337 F.2d 857 (3d Cir. 1964); Harte & Co., Inc. v. L. E. Carpenter & Co., 138 U.S.P.Q. (BNA) 578 (S.D.N.Y. 1963); Kaz Mfg. Co. v. Chesebrough-Pond's, Inc., 211 F. Supp. 815 (S.D.N.Y. 1962), *aff'd*, 317 F.2d 679 (2d Cir. 1963); Eversharp, Inc. v. Fisher Pen Co., 204 F. Supp. 649 (N.D. Ill. 1961); Sperry Products, Inc. v. Aluminum Co. of America, 171 F. Supp. 901 (N.D. Ohio 1959); *aff'd on this issue; rev'd in part on other grounds*, 285 F.2d 911 (6th Cir. 1960), *cert. denied*, 368 U.S. 890 (1961); Deering, Milliken & Co. v. Temp-Resisto Corp., 160 F. Supp. 463 (S.D.N.Y. 1958), *rev'd in part on other grounds*, 274 F.2d 626 (2d Cir. 1960); United States v. Birdsboro Steel Foundry & Mach. Co., 139 F. Supp. 244 (W.D. Pa. 1956); Westinghouse Elec. Corp. v. Bulldog Elec. Prods. Co., 106 F. Supp. 819 (N.D. W. Va. 1952), *aff'd*, 206 F.2d 574 (4th Cir. 1953), *cert. denied*, 346 U.S. 909 (1953); United States v. Consolidated Car-Heating Co., 87 U.S.P.Q. (BNA) 20 (S.D.N.Y. 1950); Atlas Imperial Diesel Engine Co. v. Lanova Corp., 79 F. Supp. 1002 (D. Del. 1948), *following* Lanova Corp. v. Atlas Imperial Diesel Engine Co., 44 Del. 55, 55 A.2d 272 (1947). (Super. Ct. 1947); Shaw v. E.I. du Pont de Nemours and Co., 126 Vt., 206, 226 A.2d 903 (1967). *Cf.* United States v. Ethyl Gasoline Corp., 27 F. Supp. 959 (S.D.N.Y. 1939), *aff'd*, 309 U.S. 436 (1940).

[74]*See* the following cases that uphold the validity of field-of-use limitations without citing to *General Talking Pictures:* Williams v. Hughes Tool Co., 186 F.2d 278 (10th Cir. 1950), *cert. denied*, 341 U.S. 903 (1951); Extractol Process v. Hiram Walker & Sons, 153 F.2d 264, 266 (7th Cir. 1946); American Lecithin Co. v. Warfield Co., 105 F.2d 207 (7th Cir. 1939), *cert. denied*, 308 U.S. 609 (1939); Ethyl Corp. v. Hercules Powder Co., 232 F. Supp. 453 (D. Del. 1964); United States v. Westinghouse Elec. Corp., 471 F. Supp. 532 (N.D. Cal. 1978); United States v. Parker-Rust-Proof Co., 61 F. Supp. 805 (E.D. Mich. 1945).

The few cases in which field-of-use restrictions have been struck down involved reciprocal restraints which were found to be part and parcel of horizontal agreements to divide markets (*see* Hartford-Empire Co. v. United States, 323 U.S. 386 (1944)), or restrictions on the sale of unpatented products produced under a patented process, (*see* United States v. Studiengesellschaft Kohle, m.b.H., [1978] 2 TRADE CAS. (CCH) ¶ 62,291 (D.D.C. 1978)). *Cf.* Ethyl Corp. v. Hercules Powder Co., 232 F. Supp. 453 (D. Del. 1963).

pany, however, when it comes to the handling of restrictions on the way in which, and the customers to whom, patented products may be sold.[75] In contrast to Article 3(8), the United States cases treat such restraints as legitimate field-of-use restrictions that are an inherent part of the patent monopoly.

This is clear from *General Talking Pictures* itself, where the restriction at issue precluded licensees from selling patented amplifiers to customers that would use them in the commercial field and permitted sales only to those customers that would use the amplifiers in the private field.[76] *General Talking Pictures* squarely held that such restrictions on the customers to whom a patented product may be sold are "not inconsistent with the scope of the patent monopoly. . . ."[77]

Rubber Co. v. Goodyear, the 1869 case relied upon in *General Talking Pictures,* is to the same effect. The patent license in that case provided among other things that it was not intended to convey to the licensee "any right to make any contract with the Government of the United States."[78] Thus, the agreement upheld by the Supreme Court in *Rubber Co. v. Goodyear* specifically restricted the licensee's sales to a particular customer.

The cases which have come down since *General Talking Pictures* reaffirm the same principle. In *Deering, Milliken & Co. v. Temp-Resisto Corp.,* decided in 1958,[79] certain textile converters entered into license agreements which in effect granted them the right to use and sell a patented heat-resistant cloth provided that they limited their sales to customers in specified fields such as apparel, bed coverings, gloves or footwear. Citing *General Talking Pictures,* the New York federal district court stated that a "licensor can grant

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[75]Article 3(8) prohibits restrictions as to "uses of the licensed products going beyond the patent claims . . . ." It is unclear how any use of a patented product can go beyond the patent claims, since the function of a patent is to secure for its owner all rights to use, as well as manufacture and sell, the patented invention. In any event, as shown in the text, to the extent that Article 3(8) assumes that restrictions as to the way in which and the customers to whom patented products may be sold go beyond the applicable patent claims, the provision is contrary to American doctrine.

[76]In *General Talking Pictures,* American Telephone and Telegraph, General and R.C.A. together exclusively licensed their patents to some fifty companies for the manufacture of vacuum tubes and amplifiers in the private field. The commercial field was apparently reserved to the patentees' own subsidiaries, such as Western Electric. American Transformer, a licensee in the private field, manufactured a common amplifier chassis that could be used in both the private and commercial fields. It sold the amplifiers to General Talking Pictures, a producer of projectors for commercial movie houses, even though both parties were aware that the buyer intended to use the amplifiers commercially and that the seller was not licensed to manufacture them for such use. The patentees sued General Talking Pictures, the buyer, to enjoin its use of the amplifiers as an infringement. The Court found that because the licensee had knowingly made sales outside the scope of its license and because the defendant had purchased the amplifiers knowing this to be the case, both parties had infringed the patent. In so deciding, the Court upheld the legality of the underlying field-of-use restriction.

[77]304 U.S. at 181.

[78]76 U.S. (9 Wall.) at 799.

[79]160 F. Supp. 463 (S.D.N.Y. 1958), *rev'd in part on other grounds,* 274 F.2d 626 (2d Cir. 1960).

a license to sell in certain areas of trade. . . ."[80] Moreover, in 1967 the Seventh Circuit squarely upheld license provisions restricting "the classes of consumers to whom manufacturer-licensee could sell," rejecting the argument that *General Talking Pictures* was no longer good law.[81]

The United States law is the same with respect to patent licensing agreements which contain the other type of provision specified in Article 3(8), i.e., clauses that restrict the way in which a patented product may be sold. Thus, in *United States v. Ciba-Geigy Corp,*[82] the court upheld a field-of-use restriction that limited the licensee to manufacturing and selling the patented drug in dosage form only, and not in bulk form. Rejecting the Justice Department's position, the court followed *General Talking Pictures* in holding that the restraint was a lawful field-of-use restriction which was within the scope of the licensor's patent rights. Judge Meanor stated that

> [a]ny limitation contained in a patent license, by definition, results in a restraint of trade. The restraint inheres in the grant of the patent itself which by its terms conveys the power to exclude. . . . [T]he legality of a limitation or series of limitations can only be judged with reference to the scope of the monopoly created by the letters patent.[83]

Finding that the restriction in that case did not improperly augment the patent grant,[84] the court concluded: "The inescapable fact is that the license . . . opened up competition in an area in which [the patentee] had the legal right to shut off all competition. . . . The restraint on competition inheres in the patent monopoly itself."[85]

B. *Policy Considerations*

The policy considerations which support field-of-use restrictions in patent licenses are much the same as those relating to territorial restraints. Both types of provision limit only competition which would not exist at all without the license, i.e., competition involving the use of the licensed patent. And both make possible the licensing of patents that would otherwise not take place in situations where the licensor, or a licensee, requires the protection of having an exclusive geographical or commercial area in which to practice the licensed technology.

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[80] 160 F. Supp. at 481.

[81] Armstrong v. Motorola, Inc., 374 F.2d 764, 774 (7th Cir.), *cert. denied,* 389 U.S. 830, *rehearing denied,* 389 U.S. 997 (1967). *See also* Channel Master Corp. v. JFD Electronics Corp., 260 F. Supp. 568 (E.D.N.Y. 1966). *See also* Hazeltine Research v. Admiral Corp., 183 F.2d 953, (7th Cir. 1950), *cert. denied,* 340 U.S. 896 (1950); Coats Loaders & Stackers, Inc. v. Henderson, 233 F.2d 915, (6th Cir. 1956); Channel Master Corp. v. JFD Electronics Corp., 260 F. Supp. 568, (E.D.N.Y. 1966).

[82] [1976] 1 TRADE CAS. (CCH) ¶ 60,908 (D.N.J. 1976).

[83] *Id.* at 68,961.

[84] The court distinguished Hartford-Empire Co. v. United States, 323 U.S. 386 (1945), and Ethyl Gasoline Corp. v. United States, 309 U.S. 436 (1940), where through horizontal combinations the patentees were able to exercise monopoly power greater than the legitimate monopolies conferred by the patents. [1976] 1 TRADE CAS. (CCH) ¶ 60,908 at 68,962.

[85] *Id.* at 68,963.

As with territorial restrictions, the patent licensing which field-of-use provisions encourage favors competition. In the long run, competition is aided because the license puts the licensee in a position where it can begin competing with the licensor immediately after the patent expires. In the short run, competition will become immediately possible at the secondary or distributor level since, regardless of the purpose for which the patented product is initially sold, after the first sale the patent monopoly will be deemed to be exhausted, which means that thereafter the product can be sold without restriction as to use. In addition, by making new technologies more widely available than would otherwise be the case, licensing tends to increase competition between newer and older technologies.

In addition, as with territorial restraints, field-of-use restrictions promote the development and dissemination of technology. For example, some licensees may be unwilling to make the investment necessary to develop the licensed technology in a particular commercial field without some assurance that the licensor or other licensees will not be using the same patents to compete for the business of the same group of customers. Similarly, some patentees may be unwilling to license—and thereby to make their technology more generally available—if they cannot reserve some designated commercial area for themselves. In addition, licensors from other industrialized countries may be unwilling to transfer technology to licensees in the Common Market if they cannot impose any restrictions at all as to the way in which, or the customers to whom, the products manufactured under their patents may be sold.

Field-of-use restrictions also promote the interests of small and medium-sized firms. First, by making possible the licensing of patents that might otherwise not take place, such restrictions increase the opportunities for small and medium-sized firms to obtain technology as licensees. In addition, field-of-use restrictions allow smaller firms to license their patents to large companies while preserving for themselves at least some commercial areas in which they can practice their own technology without facing the competition which the greater financial resources of their licensees would otherwise make possible. It may be noted in this connection that, unlike the provisions relating to territorial restrictions, Article 3(8) prohibits restrictions as to methods of sale and customers in the licensing agreements of all companies, regardless of size.[86] Thus, not even small and medium-sized companies can avail themselves of these restraints regardless of how necessary they may be to protect such companies in a given licensing transaction.

Finally, there is no way that field-of-use restrictions can conceivably have an adverse impact on economic integration. Unlike territorial restraints, which may in some cases divide a common market into exclusive geographic areas, perhaps coinciding with national boundaries, for the exploitation of

[86]Proposal, *supra* note 1, at art. 3(8).

technology, field-of-use restrictions cut across such divisions and promote the development of technology in commercial fields that extend geographically to the whole market.

In sum, in terms of every possible policy consideration, as well as in terms of legal precedent and doctrine, the arguments for allowing properly ancillary field-of-use restrictions in patent licenses affecting customers and methods of sale are at least as strong as the arguments previously discussed for allowing territorial restraints.

IV. Quantity Restrictions

Article 3(6) of the proposed group exemption prohibits licensing agreements containing "restrictions on the maximum quantity of products to be manufactured or marketed by the licensee or on the maximum number of operations employing the patent."[87] The rationale for this provision is set forth in the preamble to the regulation as follows:

> Since the Commission considers that control over the marketing of a licensed product within the common market is not a matter that relates to the existence of the patent, and since such control can be exercised indirectly by setting a maximum to the quantity of products the licensee may manufacture or market or to the number of operations for which he may employ the patent, the benefit of this Regulation is for this reason alone not available for such an obligation.[88]

American law again is directly to the contrary. Indeed, no United States judicial decision has ever questioned the legality of a provision in a patent license restricting the quantity of patented articles produced. As noted in *United States v. E.I. du Pont de Nemours & Co.*:[89] "The cases are to the effect [that the] owner of a valid product patent may by license restrict production of the licensee to a specified quantity, at a specified place."[90] Furthermore, quantity restrictions are upheld in the American cases precisely because they *are* deemed to relate to the existence of a patent, i.e., to be inherent to the patent monopoly. In *Q-Tips, Inc. v. Johnson & Johnson,*[91] which held lawful a restriction as to the number and type of unpatented products that could be manufactured with a patented machine, the court pointed out that "[d]uring the period of time in which the patent remained valid, the plaintiff could forbid entirely any use whatsoever of its patent."[92] Consequently, the licensing of the patent subject to a quantity restriction did nothing to improperly expand the scope of the patent monopoly.

In fact, the general premise stated in the preamble—that the marketing of a licensed product does not relate to the existence of a patent—is contrary to

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[87] *Id.* art. 3(6).
[88] *Id.*
[89] 118 F. Supp. 41 (D. Del. 1953), *aff'd on other grounds,* 351 U.S. 377 (1956).
[90] *Id.* at 226.
[91] 109 F. Supp. 657 (D.N.J. 1951), *aff'd in part, modified in part,* 207 F.2d 509 (3d Cir. 1953), *cert. denied,* 347 U.S. 935 (1954).
[92] *Id.* at 660.

United States doctrine.[93] It is elementary in American law that a patent secures to the inventor the exclusive right "to make, use *and vend* the thing patented. . . ."[94] Thus, the right to control the initial marketing of patented products is an inherent part of the patent monopoly. What is more, both territorial and field-of-use restrictions obviously apply to the marketing of licensed products; yet, as shown above, both are deemed to be within the legitimate scope of the patent monopoly and therefore lawful. It follows a fortiori that quantity restrictions, which only indirectly control the marketing of licensed products, should be permitted as a matter of law and policy.

V. Royalties Covering Nonpatented Products

Article 3.4(a) of the proposed regulation would make it improper for a licensee to agree to pay royalties on products not covered by the licensed patent.[95] This would seem to prohibit common agreements such as those in which a licensee obtains the right to use a whole portfolio of patents in exchange for a royalty based on some percentage of the licensee's total sales. Under American law such arrangements are lawful so long as they are adopted as a mutually convenient method for determining royalties rather than being forced on the licensee as a condition to obtaining any license at all.[96] As we shall show, the United States rule is in accord with common sense as well as sound doctrine.

In *Automatic Radio Manufacturing Co. v. Hazeltine,* the defendant licensed a group of 570 patents and 200 applications relating to the manufacture of radio broadcasting apparatus. The plaintiff-licensee agreed to pay royalties based upon a percentage of its total sales of radio broadcasting receivers—regardless of the extent (if any) to which a given receiver was produced under the licensed patents—as well as a fixed minimum royalty. Holding that this arrangement did not constitute patent misuse, the Supreme Court recognized that the royalty provision "was a convenient mode of operation designed by the parties to avoid the necessity of determining whether each type of petitioner's product embodies any of the numerous Hazeltine patents."[97] The Court also concluded that "[t]his royalty provision does not create another monopoly; it creates no restraint of competition beyond the legitimate grant of the patent."[98]

The holding and rationale of *Automatic Radio Manufacturing Co. v. Hazeltine* were reaffirmed by the Supreme Court in *Zenith Radio Corp. v. Hazeltine.* While ruling that a patentee may not *condition* the grant of a

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[93]Proposal, *supra* note 1, at art. 1(2)(a).

[94]Patent Act of July 8, 1870, ch. 230, § 22, 16 Stat. 198, as quoted in Bauer & Cie v. O'Donnell, 229 U.S. 1, 10 (1913) (emphasis added).

[95]Proposal, *supra* note 1, at art. 3.4(a).

[96]*E.g.,* Automatic Radio Mfg. Co. v. Hazeltine, 339 U.S. 827 (1950); Zenith Radio Corp. v. Hazeltine, 395 U.S. 100 (1969).

[97]339 U.S. at 833.

[98]*Id.*

license upon the payment of royalties on nonpatented products, the Court reiterated that the parties may agree to use a percentage of the licensee's sales as a convenient method for calculating the royalty to be paid. The Supreme Court stated:

> It could easily be, as the Court indicated in *Automatic Radio,* that the licensee as well as the patentee would find it more convenient and efficient from several standpoints to base royalties on total sales than to face the burden of figuring royalties based on actual use. If convenience of the parties rather than patent power dictates the total-sales royalty provision, there are no misuse of the patents and no forbidden conditions attached to the license.[99]

The Court also upheld a clause providing for the payment of a fixed minimum royalty: ". . . [the licensee] must anticipate some minimum charge for the license—enough to insure the patentee against loss in negotiating and administering his monopoly, even if in fact the patent is not used at all."[100]

As a matter of policy, there would appear to be no reason for not allowing percentage-of-sales royalties and minimum royalty provisions that serve the convenience of the parties and that make possible agreements on licensing which might otherwise be difficult or impossible to effectuate. Where such royalty provisions are adopted by mutual agreement and without coercion, they have no anticompetitive or other socially undesirable effects. On the other hand, they clearly facilitate commercial dealings and transfers of technology that provide important benefits for society. For these reasons, it would appear that the pragmatic approach adopted by United States law, which permits voluntary agreements on royalties and condemns only those coercive arrangements that are likely to have anticompetitive effects, is preferable to a doctrinaire condemnation of all agreements to pay royalties on nonpatented products regardless of the economic and business consequences.

VI. Grantbacks

Article 2.1(8) of the proposed regulations exempts from Article 85(1) those license provisions which impose on a licensee "the obligation to pass on to the licensor any experience gained in working the invention and to grantback licenses in respect of inventions relating to improvements and new applications of the original invention, *provided that this obligation is non-exclusive and the licensor is bound by a like obligation.*" (emphasis added)[101] Article 3(12), on the other hand, condemns licensing agreements which include "the obligation on the part of the licensee to assign to the licensor rights in or rights to patents for improvements or new applications of the licensed patent."[102] The effect of the regulation is thus to permit grantbacks so long as they are

[99]395 U.S. at 138.
[100]*Id.* at 140.
[101]Proposal, *supra* note 1, at art. 2.1(8).
[102]*Id.* art. 3(12).

nonexclusive and impose a reciprocal obligation on the licensor.

It is unclear, however, what is meant by the proviso in Article 2.1(8) that a grantback be "non-exclusive." In particular, the regulation does not distinguish between an exclusive grantback which allows the licensee the right to practice his improvement patent and one which does not.[103] Yet the distinction between those two types of exclusive grantback provisions may be significant as a matter of both law and policy. The leading American case on the legality of grantbacks is the Supreme Court's 1947 decision in *Transparent-Wrap Machine Corp. v. Stokes & Smith Co. (Transwrap).*[104] There the Court upheld the legality of a grantback clause requiring the licensee to assign improvement patents to the licensor. However, the licensing arrangement sustained in *Transwrap* allowed the licensee to utilize the granted-back improvement patents; and, for that reason, the Court found there was no disincentive for the licensee to make inventions.[105] On the other hand, the Court recognized that a licensee might well be discouraged from innovating where he was required to assign to the licensor *all* rights to improvement patents, including rights to his own inventions. In the words of Justice Douglas's opinion in *Transwrap,* a grantback provision might give the licensee "less incentive to make inventions when he is bound to turn over to the licensor the products of his inventive genius."[106]

Similarly, in terms of its impact on competition, a grantback clause which precludes the licensee from retaining rights to his own inventions is more severe than one which merely prevents the licensee from licensing improvement patents to others. Among other things, the former type of clause insulates the licensor from competition not only from third parties but also from the licensee himself.

Another factor which the proposed group exemption apparently fails to take into account is the duration and scope of the grantback provision. Where the duration of the licensor's exclusive rights under the improvement patents is limited to the life of the original patents licensed, and where the patent in the main license is a basic or blocking patent which would preclude the practice of the improvement patents in any event, then a grantback which is exclusive as against third parties would have no anticompetitive effect. As the Second Circuit concluded on remand in *Transwrap,* where the original patents dominated the improvement patents, the patentee-licensor's "control over the industry will be no greater by virtue of the improvement patents. . . ."[107]

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[103]*Id.* art. 2.1(8).

[104]329 U.S. 637 (1947).

[105]329 U.S. at 646. The licensee in *Transwrap* also incurred no additional royalty for utilizing the improvement.

[106]329 U.S. at 646.

[107]Stokes & Smith Co. v. Transparent-Wrap Machine Co., 161 F.2d 565 (2d Cir. 1947), *cert. denied,* 331 U.S. 837 (1947). *See also* United States v. du Pont Co., 118 F. Supp. 41, (D. Del. 1953), *aff'd on other grounds,* 351 U.S. 377 (1956).

Thus, for a number of reasons, United States law and policy suggest that the blanket condemnation of exclusive grantbacks in the proposed group exemption may be overly broad. On the other hand, as a practical matter, exclusive grantback provisions which would prevent a licensee from using his own technology are seldom used by American companies.[108] Grantback provisions which are exclusive as against third parties are usually of little consequence because the patents in the main license generally do block the use of improvement patents, and the duration of the grantback generally is limited to the life of the original patents. Consequently, this is one area of the law where the disparity between American jurisprudence and the proposed group exemption may not be overly disruptive.

Somewhat more disturbing is the requirement in the proposed group exemption that a grantback clause must impose a like obligation on the licensor to license future improvement patents to the licensee. This provision has no parallel at all in American law. Moreover, there may be many cases where such a requirement of reciprocity would be commercially unacceptable to a licensor. For example, a licensor may be unwilling to license a patent without some assurance that it will obtain the benefits of its licensee's improvements. If the licensor is a large company which invests huge sums in research and development, it may likewise be unwilling to promise the licensee all of its future related technology, which may consist of a great many improvement patents, in exchange for the uncertain prospect that the licensee may come up with a few improvements of its own. The result, then, may be that the licensor will refuse to license at all if it cannot obtain a grantback clause without incurring a reciprocal obligation. In short, while there may be many cases where reciprocity in the licensing of improvement patents is eminently reasonable, there are likely to be other cases where such a requirement makes no commercial sense. For this reason there would appear to be a good deal to be said as a matter of policy for the American rule, which in effect leaves this matter to the parties to be resolved by negotiation.

VII. Price Restrictions

Article 3(7) of the draft regulation would proscribe licensing agreements which contain "restrictions on one or both parties concerning prices, price components or rebates, or *recommendations* from one party to the other concerning any of such matters." (emphasis added)[109]

The prohibition of price recommendations in patent licenses is contrary to United States law. As far back as 1919, the Supreme Court in *United States v. Colgate & Co.*[110] recognized the legality of price recommendations under the

[108]Oppenheim & Scott, *Empirical Study of Limitations in Domestic Patent and Know-How Licensing: A Preliminary Report,* 14 IDEA 193, 200 (1970), sets forth the result of a poll which shows, *inter alia,* that, "Generally the companies using exclusive-license and assignment grantsback find it necessary to use them only 'occasionally' or 'seldom.'"

[109]Proposal, *supra* note, 1 at art. 3(7).

[110]250 U.S. 300 (1919).

Sherman Act. That case held that a manufacturer could unilaterally refuse to sell to dealers who did not maintain the manufacturer's suggested resale prices. Moreover, the Court stated that the manufacturer or trader "may announce in advance the circumstances under which he will refuse to sell."[111] As the law has evolved since *Colgate,* when a supplier goes beyond a mere announcement of suggested resale price and a simple refusal to deal and employs other means to effect adherence to the suggested prices, a combination in violation of the Sherman Act may be found. But price recommendations without more are valid, and, indeed, such recommendations have been upheld in the specific context of a patent license agreement.[112]

The proscription of restrictions on price in patent licenses set forth in Article 3(7) is also contrary to the Supreme Court's 1926 decision in *United States v. General Electric Co.*[113] In that case, by the terms of Westinghouse's license under General Electric's process and product patents, which covered "completely the making of modern electric lights,"[114] General Electric had the right to fix, and to change at its discretion, the prices charged for electric lamps manufactured and sold by Westinghouse.[115] The Court upheld the price-fixing restrictions on the grounds that a patentee may license his patent "upon any condition the performance of which is reasonably within the reward which the patentee by the grant of the patent is entitled to secure."[116] The Court reasoned that the price restrictions were "normally and reasonably adapted to secure pecuniary reward for the patentee's monopoly" because the price at which a licensee sells the patented product is directly related to the profit that a patentee, himself, can derive from the sale of the same article.[117]

General Electric has survived challenge twice[118] when there was no majority on the Court to either reaffirm or overrule the *General Electric* doctrine; and although qualified and limited by subsequent decisions,[119] the case remains valid law. As with grantbacks, however, the disparity between the

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[111] *Id.* at 307.

[112] *See, e.g.,* American Indus. Fastener Corp. v. Flushing Enterprises Inc., 362 F. Supp. 32, 40 (N.D. Ohio 1973) (patent license clause providing suggested retail price for patented device held permissible in the absence of steps to induce adherence to suggested prices). *Accord,* Ansul Co. v. Uniroyal, Inc., 306 F. Supp. 541, 558 (S.D.N.Y. 1969), *aff'd in part, rev'd in part on other grounds,* 448 F.2d 872 (2d Cir. 1971), *cert. denied,* 404 U.S. 1018 (1972).

[113] 272 U.S. 476 (1926).

[114] *Id.* at 481.

[115] *Id.* at 488.

[116] *Id.* at 489.

[117] *Id.* at 490. The *General Electric* decision followed the Supreme Court's 1902 decision in Bement v. National Harrow Co., 186 U.S. 70 (1902) which held that the Sherman Act did not refer to restraints arising from reasonable and legal conditions imposed by a patent owner or a licensee, such as restricting the terms upon which the article may be used and the price to be demanded therefor.

[118] United States v. Huck Mfg. Co., 382 U.S. 197 (1965); United States v. Line Material Co., 333 U.S. 287 (1948).

[119] *E.g.,* United States v. Line Material Co., 333 U.S. 287 (1948) (two or more patent owners cannot combine their patents and fix prices); United States v. United States Gypsum Co., 333

proposed group exemption and United States law is not of major significance. As a practical matter, American companies rarely seek to impose price restrictions in patent licenses, and thus, at least in this regard, the proposed group exemption would not have a material impact on their operations. However, the prohibition of pricing recommendations does run counter to American law, and this provision of the regulation, like some of the other provisions previously discussed above, might well discourage some American firms from licensing in the European Community.

Conclusion

As demonstrated above, the proposed group exemption will effectively prevent companies with both patented and unpatented technology from engaging in a wide variety of practices that are legal under United States law and that generally serve significant, legitimate commercial and social purposes. Thus, under the draft regulation, no licensor or licensee of any appreciable size would be able to impose a territorial restriction or have an exclusive sales area; it would be impossible for any company to enter into a terminable know-how license or to impose territorial or field of use restrictions in such licenses; no company could seek assurances as to the manner in which, or customers to whom, products manufactured under its patents would be sold; no quantity restrictions in patent licenses would be allowed; no licensing agreements would be permitted which, for the convenience of the parties, based royalty payments on a percentage of the licensee's total sales; grantbacks would be forbidden except in cases where the licensor was willing to license all improvement patents to the licensee; and no licensing agreement would be sanctioned under which the licensor could make pricing recommendations to the licensee.

All of these types of restraints are generally accepted in the United States—and, we believe, throughout the industrialized world—as appropriate means by which transferors of patents and know-how can protect themselves against having their own technology used against them and/or assure themselves of a fair return on their research and development investments. The net effect of the multiple prohibition of all of these standard provisions will inevitably be to discourage patent and know-how licensing and force those who own technology to hoard it—in the case of patents, for the life of the patent grant; in the case of know-how, indefinitely or at least until such time as the invention is honestly discovered by someone else.

As we have stated, patent and know-how licensing promotes competition;

U.S. 364 (1948) (patentee cannot "acting in concert with all members of an industry . . . issue substantially identical licenses to all members of the industry under the terms of which the industry is completely regimented . . ." (*Id.* at 400)); United States v. Vehicular Parking, 54 F. Supp. 828 (D. Del. 1944) (patentee cannot fix prices of unpatented articles even though related to patented articles).

it promotes the development and dissemination of technology; it helps small and medium-sized businesses in a variety of ways; and, by making possible the transfer of technology, it fosters economic integration. Hence, by imposing disabilities calculated to discourage licensing, the proposed group exemption is likely to be counterproductive with respect to each of these policy goals.

It is also important to note that the prohibitions in the proposed group exemption which we have enumerated have never existed in United States law. Nevertheless, the United States has maintained an unexcelled record for vigorous antitrust enforcement; it has experienced tremendous investment in research and development and a high level of technological progress; it has fostered the interests of small and medium-sized businesses; and it has without question achieved economic integration and a common market among its fifty states. Thus, based on the American experience, there would appear to be no basis for concluding that the licensing practices which the proposed group exemption would forbid have ever operated to the detriment of the economy, the consumer interest or society at large.

In sum, the objections to the practices which the draft regulation would condemn would appear to be more theoretical than practical, and more doctrinaire than rooted in a meaningful analysis of the relevant policy considerations. We believe that there is something to be learned from the American experience in this area; and that before the European Community codifies a set of rules which departs radically both from the law that has evolved in the United States and from worldwide commercial practice, it would do well to make sure first that the practices it is eliminating are in fact harmful rather than socially beneficial.