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**Territorial limitations in patent
licensing under EC law**

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Competition Law

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Summary

Preface

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Abbreviations

C.M.L.Rev	Common Market Law Review
ECJ	European Court of Justice
ECLR	European Competition Law Review
ECR	European Court Reports
European L. Rev	European Law Review
IIC	International Review of Industrial and Copyright Law
OJ	Official Journal
TTR	Technology Transfer Regulation

1 Introduction

1.1 Purpose

The aim of this thesis is to examine the way patent licensing is being dealt with under Community law. Patent licensing is commonly used as a means of efficiently disseminating new technologies. The importance of this vehicle has increased during the last decades due to a rapidly changing technological environment. The treatment of these agreements is therefore of great economic importance. Furthermore, the subject calls into consideration a number of different policies and aspects of Community law. The importance and the complexity of the matter is the main reason for me choosing this as the topic of my thesis.

The question I have tried to answer in this thesis is how far, under Community law, territorial protection in patent licensing agreements is allowed. What are the reasons for limiting the freedom of the parties and how has this been done?

1.2 Method and material

In writing this thesis I had pretty much to start from the very beginning because my background knowledge in the area was close to nothing. Therefore I had to work my way through to the case law by reading a number of books and articles written in the subject. The basis for the work is nonetheless the case law of the European Court of Justice.

1.3 Disposition

I have not in any way dealt with patent licensing in a comprehensive way in this thesis. My objective has been to examine the treatment of exclusivity and territorial restraints in these agreements. Other clauses, which are perhaps equally important, have been set aside. Although this might be perceived as a weakness, I found this focusing to be necessary in order to be able to include the underlying principles described in the first part of the thesis.

Although most agreements where technology is transferred contains elements of both patent and know-how, the focus in this thesis has almost entirely been concentrated on the patents. The know-how, which does not confer a legal monopoly upon its owner, does not pose the same threats to Community objectives. However, a clear demarcation line is difficult to draw, and the know-how has been touched upon in various parts of the thesis.

The thesis is divided in two parts. The first part deals with intellectual property rights in general and how the exercise of these comes into conflict with the Treaty. In the second part I look more specifically at the licensing of patents and its conflicts with Community law. The treatment of these cannot, however, be fully understood without the basic knowledge from the first part.

2 Intellectual Property Rights

2.1 Introduction

This thesis will not deal with intellectual property rights as such but instead focus on how the exercise of some of these rights can come into conflict with Community law. However, in order to get a basic understanding of the issue, a brief overview of intellectual property rights might be useful.

There is no legal definition of intellectual property, but the four main types are patent, trade mark, design and copyright. The first three of these are sometimes referred to as industrial property rights. Focus in this thesis will be on patents. In common for all intellectual property is obviously the fact that they are products of intellectual work. These products of mind are intangible. The functions of these rights differ, but in common for all intellectual property rights is the exclusivity. The owner of an intellectual property right has the right to prohibit others from exploiting what he has produced.

2.2 Patent law

The aim of patent law is to promote the development of innovation in society.¹ This is reached by rewarding the innovator with a time-limited exclusive right by which he is capable of prohibiting others from using the protected product or process. A patented invention cannot be commercially made, used, distributed or sold without the patent owner's consent. The patent right is conferred upon the innovator by the State and is enforceable in national courts, which consequently are competent to stop patent infringements. During the time when the owner of the patent benefits from this exclusive right he is able to prevent competition within the same product or process and can thus charge a higher price than would be the case under free competition. This exclusive right is limited in time, usually for a period of twenty years. For the patentee the protection from direct competition gives him a chance of recovering his investments made in developing the innovation.

The innovator, on his side, has to make the innovation public and give a full description of it in order to obtain a patent. This is an important aspect of the functions of patent law. First of all, making the innovation public increases the possibilities of disseminating new technology since the patented invention can be used by competitors as a base for further innovations. Were there no patents, the only way for the innovator to exploit his knowledge would be to keep the innovation as secret as possible since no protection

¹ Bernitz, U., et al., *Immaterialrätt*, p. 83.

against competing actors in the market could be found. Furthermore, the patent gives protection for investments made in developing the innovation. If no such protection were given the incentives for investing in research and development would decrease. Firms without their own investments made in research would consequently be able to benefit from the innovator's work and compete with him on equal terms without having contributed anything to the innovation themselves. The progress of new inventions would thus be slowed down if no protection against such free riding competitors were allowed.

In the short-term perspective patent rights restrict competition since a legal monopoly, however temporary, is conferred upon the innovator. But these restrictions are believed to be compensated by the dynamic effects of the intellectual property rights. The rewarding of innovators serves as an incentive for others to invest in research and development in order to come up with new innovations, which in turn will be rewarded. Even though patents are not the only way of promoting innovation in society it is today generally regarded as the most suitable.² However, the economic effects of the patent system are complex and its justification is not uncontroversial.³

The patent does not in itself confer market power to the proprietor. The patent is merely a legal monopoly. As the Court has emphasised in a number of judgements, the market share obtainable is dependent upon whether or not there are substitutable products on the market.⁴

2.3 European Patent Law

Intellectual property rights are territorial. This means that a Swedish patent only has effect within Swedish territory. Thus, a Swedish patent can be used to prevent the exploitation of the protected product or process in Sweden, but not in any other country. The inventor of a product or process may therefore wish to seek parallel protection in a number of countries in order to obtain an effective protection against competitors.

In international trade, the territoriality of these national patents can this way also be used to create market divisions. By using parallel patents a patentee can not only prevent competitors from exploiting the product but also prevent the same products from circulating freely between the territories of the different patents. This way the patentee is able to discriminate in his pricing and obtain higher profits. This use of intellectual property rights clearly collides with the fundamental objective of the Community – the integration of national markets into one common market where goods,

² One apparent drawback of the patent system is that, because the innovator is rewarded in the market, innovations are directed to the economically most profitable areas. These are not always the same as the areas where the need for inventions is the greatest.

³ Cornish, W.R., *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights*, chapter 3.4., Gutterman, A., *Innovation and Competition Policy*, chapter 3.

⁴ See e.g. 40/70 *Sirena v Eda*, [1971] ECR 69 at para. 16.

services, workers and capital can move around freely.⁵ The European Court of Justice, in the following referred to as the Court, recognised this problem already at the early stages of the development of Community law:

*“the national character of the protection of industrial property and the variations between the different legislative systems on this subject are capable of creating obstacles both to the free movement of the patented products and to competition within the Common Market.”*⁶

The most straightforward way of approaching this problem would be to create uniform intellectual property laws and rights for the Community. This way the problem of territoriality would be avoided and no division of markets within the Community could be created by the use of intellectual property rights. The first step taken in this direction in a European context was the co-operation within the European Patent Convention, EPC.⁷ The measures taken within the EPC have been aimed at harmonising the national patent laws of the contracting states. By making the differences as small as possible the drawbacks of having parallel patents are minimised. The EPC is not an instrument enacted within the Community but under traditional international law and has apart from the member states of the Community also other signatory countries.⁸

The cooperation within EPC, which entered into force in 1978, has led to a simplified application procedure when seeking patents throughout Europe. This can now be done in the same way as when seeking a patent nationally. However, the patents conferred are still just a bundle of national patents. Even if these are also materially harmonised to some extent, the problems of national patents dividing the Common Market still remain and will continue to do so until a Community-wide patent is created. Efforts to create such a patent were being made within the work of the Community Patent Convention, CPC.⁹ The CPC was more far reaching than the EPC since it not only provided for a common application procedure but also comprehensively regulated substantive matters. The CPC, which only applied to member states of the Community, was signed in 1975 in Luxembourg and amended in 1989. However, it never entered into force since it was not fully ratified. New attempts have been taken after the failure of the CPC, this time within the normal legislative process of the Community. The Commission issued a Green Paper in 1997 and a Council Regulation is currently being worked on.¹⁰

⁵ See 56 and 58/64 *Consten and Grundig v Commission* [1966] ECR 299 at p. 340, where the Court recognised market integration as the most fundamental object of the Community. The establishing of a Common Market is also set out as an objective in Article 2 of the Treaty.

⁶ 24/67 *Parke, Davis v Centrafarm*, [1968] ECR 55, at p. 71.

⁷ Convention on the grant of European patents of 5 October 1973.

⁸ Switzerland, Liechtenstein, Cyprus and Monaco.

⁹ Convention for the European patent for the common market of 15 December 1975 [1976] OJ L17/1.

¹⁰ Commission proposal for Council Regulation COM [2000] 412 final.

The CPC never entered into force much because of the huge costs of applying for a patent and the complicated judicial system it would be based on. The large costs were due to the fact that an application had to be translated into all the official languages of the Community. As regards the judicial system, national judges would have the competence to declare a Community patent invalid with effect for the entire Community. The legal uncertainty of this system was criticised by representatives for European industrial groups.¹¹

In conclusion, patent law is today still not regulated within the Community. The national patents are still the most important. The EPC has simplified the application procedure, but it can be seen as a transitional stage where the basic problem of the territoriality of national patents within the Community remains. The lack of progress in Community legislation until now can be at least partly explained by the fact that the Member States have not been willing to subject their national laws to Community competence. This reluctance is based on the importance of patent law to the economic growth of a country. The degree of protection of innovations in its own territory is an important element in the trade policy of a state. We shall now look a bit closer at in what ways the present state of national patent laws comes into conflict with Community law.

¹¹ See Commission proposal for Council Regulation COM [2000] 412 final, chapter 1.1.

3 Conflicts with Community Law

3.1 Introduction

In this chapter focus will be on Community law and the provisions that can come into conflict with the exercise of intellectual property rights, which are still mainly national as described in the previous chapter.

Not much is said about patents or intellectual property generally in the Treaty. The only provision directly covering this is Article 30, which states that the protection of industrial and commercial property rights can be a legitimate reason for the Member States to hinder the free movement of goods within the Community. Thus, national patents can be used to depart from the main rule of free movement of goods within the Community

Another provision of importance is Article 295, which states that “*the Treaty shall in no way prejudice the rules in Member States governing the system of property ownership*”. This Article read in conjunction with Article 30 could give the impression that the national intellectual property laws fall outside the scope of Community competence. In other words, one can question whether the Community is at all competent to interfere with how the intellectual property laws of its Member States are shaped. We will later return to see how the Court dealt with this issue in its early case law, but suffice to say at this stage that the Court would not tolerate a situation where the use of national intellectual property rights could be used to circumvent the rules of the Treaty. At the same time it had to respect the competence of the Member States to legislate in the area.

The use of national intellectual property rights can come into conflict with the overriding objective in the Community of creating a single market of the different national markets.¹² In its case law the Court has used two sets of rules in the Treaty to address this problem: the rules on competition and the rules on free movement of goods. The owners of intellectual property rights have not, as will be shown below, been allowed to divide the Community by using their national rights to restrict the movement of protected goods across the national borders.

Without the protection of the national borders competition will be enhanced and the most competitive firms in the Community will expand on behalf of the less competitive ones. The rules on free movement of goods and the rules on competition both aim at securing this, however from different perspectives. Broadly, the rules on free movement of goods are aimed at the

¹² See n. 5 above.

actions of the Member States, while the provisions at issue under competition law are aimed at agreements between private undertakings. We shall now look at them in turn to see at the similarities and differences between them.

3.2 EC Competition Law

The EC competition law is based upon Articles 81 and 82 of the Treaty. Article 81 prohibits collusion between undertakings that may affect trade between the Member States and Article 82 prohibits the abuse of a dominant position. The anti-monopoly provision will be left outside the scope of this thesis and focus will be on Article 81.¹³

Exemption under Article 81.3 can be obtained either by notification to the Commission for individual exemption or by qualification under a block exemption issued by the Commission. There are certain clauses, which infringe Article 81.1 and are not exemptible under Article 81.3 because of their serious anti-competitive effects. An example of this is market sharing which, as will be seen below, has been condemned without any extensive market analysis.¹⁴

¹³ Article 81: 1. *The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decision by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:*

- (a) directly or indirectly fix purchase or selling prices or any other trading conditions;*
- (b) limit or control production, markets, technical development, or investment;*
- (c) share markets or sources of supply;*
- (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;*
- (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.*

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

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- any agreement or category of agreements between undertakings;*
- any decision or category of decisions by associations of undertakings;*
- any concerted practice or category of concerted practices;*

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

- (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;*
- (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.*

¹⁴ See e.g. *56 & 58/64 Etablissements Consten SA and Grundig-Verkaufs-GmbH v EEC Commission* [1966] ECR 299.

Most agreements have effects or objects that are both restricting and enhancing competition. The traditional way of treating these has been to automatically consider them to be infringing Article 81.1 and then take on a more economic analysis under Article 81.3. This way most of these agreements have not been cleared under Article 81.1 but instead exempted under Article 81.3.

3.2.1 Objective of EC Competition Policy

Competition law in general can have different and sometimes mutually inconsistent objectives. One objective is to enhance efficiency, which can be reached through maximising consumer welfare and obtaining an optimal allocation of resources. Another possible objective can be the protection of consumers and small- and medium-sized companies in the market.¹⁵ In such a market cartels aimed at price fixing and limiting output are struck down on just as firms with a dominant position are prevented from abusing their market power. In EC competition law, there are apart from these traditional anti-trust objectives other objectives of a particular kind. Article 3(g) states that the activities of the Community shall include “*a system ensuring that competition in the internal market is not distorted*” in order to achieve the objectives set out in Article 2, one of these objectives being the creation of a common market. The Court expressed its view on the objectives of EC competition law in the *Metro case*¹⁶, where it held that the requirements in Article 3 and 81¹⁷ “*implies the existence on the market of workable competition, that is to say the degree of competition necessary to ensure the observance of the basic requirements and the attainment of the objectives of the Treaty, in particular the creation of a single market.*”¹⁸ Furthermore, the protection of small and medium-sized companies within the Community is an explicit political goal, which should be considered when applying EC competition law.¹⁹

It is thought that the creation of a Common Market where goods, services, capital and workers can move around freely will let firms do business on a more efficient scale throughout the Community. The role of competition law in this development is two-folded.²⁰ Primarily, competition law can prevent actions aiming at isolating the different national markets. Examples of these are market sharing and national cartels, which will be prohibited. Secondly,

¹⁵Craig, P., and de Búrca, G., *EU Law – Text, Cases, and Materials*, p. 891.

¹⁶ 26/76 *Metro SB-Grossmärkte GmbH & Co. KG v Commission* [1977] ECR 1875. See also 6/72 *Europemballage and Continental Can v. Commission* [1973] ECR 215 at para. 24.

¹⁷ Then Article 3 and 85. I will throughout this thesis use only the new numbering of the Treaty which entered into force with the Treaty of Amsterdam.

¹⁸ 26/76 *Metro SB-Grossmärkte GmbH & Co. KG v Commission* [1977] ECR 1875 at page 1904.

¹⁹ 23rd Report on Competition Policy 1993, p. 22.

²⁰ Whish R., *Competition Law*, p. 19.

competition law can be laid down in a way to facilitate trade between the Member States and in that way speed up the integration.

These objectives, the more traditional objective of enhanced efficiency on one hand and the characteristic EC objectives of market integration on the other, are sometimes mutually inconsistent. As will be shown later in this thesis, these objectives have been given shifting priority during the development of the Community.

3.2.2 Intellectual Property and Competition Law

At first a clear conflict between intellectual property rights and competition law can be detected. The holder of an intellectual property right is conferred legal protection from competition while competition law aims at ensuring that competition is not distorted. In spite of this conflicting feature the two legal areas can be said to be complementing each other rather than in conflict. Competition law aims generally at creating efficiency in the market economy. The intellectual property rights are also aimed at increasing efficiency, although in a longer perspective. As stated above intellectual property rights functions as rewarding the innovator as well as inducing others to come up with new innovations. If no intellectual property rights existed, copying would be widespread and innovators would be less rewarded for their innovations, which in turn would decrease incentives for others to invest in research and development. Without these investments the technological development would be slowed down and the resulting efficiency gains missed out.

Thus the common objective of increased welfare is reached in different ways. The granting of a patent entails a market imperfection, which is justified because of its dynamic effects. Competition law is aimed at increasing welfare in a shorter perspective by removing obstacles to the creation of an effective market. This way intellectual property rights and competition law can be seen as areas of law with complimenting rationales.²¹

3.3 Free movement of goods

The rules on free movement of goods are based on the main rule in Article 28, which states that *”quantitative restrictions on imports and all measures having equivalent effect shall...be prohibited between Member States”*.²²

²¹ OECD, *Competition Policy and Intellectual Property Rights*, p. 10.

²² Article 28: *Quantitative restrictions on exports and all measures having equivalent effect shall be prohibited between Member States.*

Article 29: *Quantitative restrictions on exports, and all measures having equivalent effect, shall be prohibited between Member States.*

Article 30: *The provisions of Article 28 and 29 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of ...the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however,*

Article 29 contains a similar rule on restrictions on export. The exception from this basic rule is found in the first paragraph of Article 30, which holds that “*articles 28 and 29 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on...the protection of industrial and commercial property.*”

Judging from this the intellectual property rights would be untouched by the rules on free movement of goods and could consequently be used, without restrictions, to prevent the integration of national markets into one single market. Thus a patent right used to prevent the import of infringing products, which would be seen as a measure having an equivalent effect to a quantitative restriction and therefore violating Article 28 would be justified according to the first paragraph of Article 30. The rules on free movement of goods would thus not be applicable to patent protected products. However, the second paragraph of the same article states that such restrictions on free movement of goods “*shall not ... constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States*”. This second paragraph of Article 30 has been used by the Court as a proportionality test of the measures taken to protect the national intellectual property right. As will be shown below, it has proven to be a very useful way for the Court to mitigate the negative effects of the use of intellectual property rights on the objective of market integration.

The rules on free movement of goods are aimed at the governments of the Member States. It is therefore not obvious how these rules can be applied to private undertakings using their rights to prevent imports of patented protected goods. Although the Court has never explicitly explained how this has been done, it is generally regarded that it is the national court’s enforcement of the legislation which is seen as a measure equivalent to a quantitative restriction on trade between Member States.²³

3.4 Relationship between the two sets of rules

In conclusion the national intellectual property rights are affected by Community law under two sets of rules – the rules of free movement of goods and the rules on competition. These two areas of law share the same objective of unifying the national markets through an undistorted trade where goods can move freely. In its case law the Court has promoted integration, *inter alia* by conferring on the Member States an obligation to guarantee the free movement of goods. In practice these liberties will not be fully used unless firms acting in the Common Market will be forced to do it. They will only be forced to do so if competition is unrestricted.²⁴

constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States.

²³ White, E., *In search of the limits to Article 30 of the EEC Treaty* [1989] C.M.L.Rev. 264.

²⁴ Ullrich, H., *Patents and Know-How, Free Trade, Interenterprise Cooperation and Competition Within the Internal European Market*, IIC [1992] 583.

There are also some basic differences. Article 81 applies to private undertakings and is only applicable if there exists an agreement between two independent parties. As mentioned above, the rules on free movement of goods are aimed at action taken by the governments of the Member States. Furthermore these rules only apply when goods are imported or exported between two Member States. The Court in several judgements has also expressed these differences.²⁵ The rules on free movement are also more categorical once they do apply. Under the rules on competition there exist a possibility of viewing the economic impact of an agreement as a whole when exempting it under Article 81.3. This exception does not, as far as the exercise of intellectual property rights is concerned, exist under the rules on free movement. Another difference between these provisions is the *de minimis* rule in competition law. According to this the competition rules only apply where an agreement has a significant effect on trade between Member States. This rule was introduced by the Court in *Völk v Vervaecke*²⁶ and has also been adopted by the Commission.²⁷ This criterion has no equivalence in the rules under free movement of goods, which are applicable as soon as trade between Member States is affected.

The enforcement of the rules also differs fundamentally. The competition rules are enforced by the Commission under Regulation 17, while the enforcement of the rules on free movement is carried out in national courts.²⁸ Another difference would be evident in the case of a complete unification of the national patent laws with a complete transfer of competence to the Community. The rules on free movement of goods would then become inapplicable since no parallel patents would exist within the Community. The rules on competition, however, would still be used to the same extent since it is directed to private parties.²⁹

The exception in Article 30 regarding intellectual property rights does not exist in Article 81. One could therefore believe that EC competition applies without restrictions to the use of national intellectual property. However, the Court has in its case law transposed some of its reasoning under the rules on free movement of goods to the rules on competition and this way created a part of national intellectual property rights where EC competition does not apply.³⁰ Although every use of the exclusive rights of a patent could literally be seen as restricting competition the Court has held that there exists an area

²⁵ See for example 177 and 178/82 *Van der Haar v. Kaveka* [1984] ECR 1797 at para 14.

²⁶ 5/69 *Franz Völk v établissements J. Vervaecke* [1969] ECR 295.

²⁷ *Commission notice of 3 September 1986 on agreements of minor importance which do not fall under Art. 85.1 of the Treaty establishing the European Economic Community* [1986] OJ C231/2 as amended by *Commission of the European Communities notice concerning the updating of the 1986 communication on agreements of minor importance* [1994] OJ C368/20. The notice is being rewritten at present, see draft 2001/C 149/05.

²⁸ Regulation 17, [1956-62] OJ Spec.Ed. 87.

²⁹ Govaere, I., *The use and abuse of intellectual property rights in E.C. law*, ch. 3.29.

³⁰ 24/67 *Parke, Davis v Centrafarm* [1968] ECR 55 at p. 71.

of legitimate use where competition law does not apply. This distinction between the improper and proper way of using national intellectual property rights will be examined in the following chapter.

4 Principles developed by the Court

4.1 Introduction

Due to the lack of harmonising of the national intellectual property rights the Court of Justice has had to mitigate the effects of these under Community law. This has been done in a series of cases starting some forty years ago. These cases all have in common the underlying motive of the Court not to let national intellectual property rights come in the way of creating a Common Market. The cases described in this chapter all deal with the use of national intellectual property rights to prevent imports from one Member State into another.

4.2 Distinction between existence and exercise of a right

The fundamental distinction between the existence and exercise of an intellectual property right serves as the basis for the relationship between the national intellectual property rights on one hand and EC law and its overriding goal of market integration on the other. The distinction was first introduced in the well known *Consten and Grundig* judgement as early as in 1966.³¹ In the case the German manufacturer Grundig tried to enter the French market by appointing a French company, Consten, as exclusive distributor of Grundig products in France. In order to protect Consten from parallel imports the agreement contained export bans imposed on Grundig's other distributors. In addition to this Grundig also gave Consten the right to register the Grundig trademark "GINT" in France. Grundig entered into the same agreement with distributors in other Member States and could this way create an international market segmentation and charge different prices in the different countries. Because of the differences in price another French firm started buying Grundig products in Germany and reselling them in France. Both Consten and Grundig tried to prevent this parallel import by using the "GINT" trade mark as well as referring to the export bans of the agreement. The parallel trading French firm complained about these actions to the Commission. The Commission held that the export bans were in breach of Article 81.1 and not possible to exempt under Article 81.3. More important in this context was the way that the Commission treated the use of a trademark to prevent infringing imports.

Consten and Grundig claimed that Articles 30 and 295 of the Treaty protected the national sovereignty regarding intellectual property rights and

³¹ 56 and 58/64 *Consten and Grundig v Commission* [1966] ECR 299.

the use of these could therefore not be limited by EC competition rules. The Commission disregarded this argument and held that the use of trademarks to prevent parallel imports was contrary to Article 81.1 of the Treaty.

On appeal the Court upheld this decision and stated that the exercise of national intellectual property rights could not be used to frustrate the competition rules.³² To reach another conclusion would, as the Court pointed out, render Article 81 meaningless. But the Court still had to address the problem of competence regarding national intellectual property rights, which when reading Articles 30 and 295 could be seen as falling within the exclusive competence of the Member States and outside the jurisdiction of the Court of Justice. In the judgement the Court solved this problem by making a distinction between the existence and the exercise of national intellectual property rights. The existence of these rights was protected by Articles 30 and 295 and thus outside the scope of the Treaty and the jurisdiction of the Court. Nevertheless, these provisions did “*not exclude any influence whatever of Community law on the exercise of national industrial property rights.*”³³ This way the Court could at least get some control over the intellectual property rights, the existence of which could not be questioned.

In the *Parke Davis* judgement, delivered two years later, this distinction was reaffirmed and also expressly extended to patents.³⁴ In this case the American company Parke Davis held a Dutch patent relating to a chemical antibiotic process called Chloramphenicol. Another company, Probel, manufactured and sold Chloramphenicol in Italy, where patent protection for pharmaceuticals was not available at the time. Probel and two other firms started selling Chloramphenicol, manufactured in Italy, in the Netherlands without the permission of Parke Davis. The latter tried to use its Dutch patent to prevent the importation from Italy into the Netherlands. The question arose whether or not this way of using a patent was compatible with the Treaty. In its judgement the Court followed the reasoning from *Consten and Grundig* based on the rules of competition. The use of a patent to prevent importation from a country where patents were not available was not in breach of the competition rules or any other provision in the Treaty. The Court once again stated that the existence of the rights granted by a Member State to the holder of a patent is not affected by the rules of the Treaty. The improper exercise of these rights was however in conflict with the Treaty and would be struck down on by the Court.

This demarcation created by the Court has been criticised.³⁵ Usually, the existence of a right to a large extent depends on what ways it can be

³² 56 and 58/64 *Consten and Grundig v Commission* [1966] ECR 299 at p. 346.

³³ *Ibid.*, p. 345.

³⁴ 24/67 *Parke, Davis v Probel* [1968] ECR 55.

³⁵ Guy and Leigh, *The EEC and Intellectual Property*, p. 9, Korah, V., *Technology Transfer Agreements and the EC Competition Rules*, p. 34. For another view, see Marengo and

exercised.³⁶ Clearly the distinction is neither natural nor self-evident but rather a way out of a peculiar situation for the Court. By making such a distinction some control could be taken over the intellectual property rights. The threat from these rights to the objective of market integration was not foreseen by the founding fathers in the 1950s and the Court was consequently forced to create this distinction. At this time the importance of the parallel traders for market integration became evident in Community law.

Nevertheless, what can be said with certainty is that the Court in its judgements is using the existence/exercise-doctrine ever since *Consten and Grundig*. The Court has by introducing this concept given itself a very flexible tool when dealing with the problems of national intellectual property rights and Community law. For a practitioner, on the other hand, this distinction is quite uncertain and does not give much help on to act when for example drafting a licence agreement.³⁷

The distinction between the existence and the exercise was as shown first elaborated under the rules on competition. This may be a result of the level of development of Community law at the time. These first cases were all delivered during the time of the transitional period leading up to the creation of the Common Market. During this time the rules on free movement of goods had not yet entered into force as opposed to the rules on competition.³⁸ In the following development the Court mainly used the rules on free movement of goods when dealing with the use of national intellectual property rights to divide the Common Market. The distinction between existence and exercise was then used also in these cases. The rules on free movement of goods proved to be a more useful instrument in the cases where intellectual property rights were used to prevent imports mainly because there was usually no agreement between the parties of the dispute.

4.3 Principle of exhaustion

The principle of exhaustion is a principle developed by the Court concerning the national intellectual property rights and their compatibility with the rules on free movement of goods. The first judgement where this was analysed was in the important *Deutsche Grammophon*.³⁹ A German record manufacturer, Deutsche Grammophon, distributed its products to retailers as well as to wholesalers in Germany as well as through subsidiaries in several other Member States. Deutsche Grammophon sold its records under the brand "Polydor" using a resale price maintenance system, which was

Banks, *Intellectual Property and the Community Rules on Free Movement: Discrimination Unearthed*, 15 European L. Rev. [1990], p. 226.

³⁶ Korah, V., *Technology Transfer Agreements and the EC Competition Rules*, p. 34.

³⁷ Ibid.

³⁸ Quitzow, C M, *Fria varurörelser i den Europeiska Gemenskapen*, p. 273.

³⁹ 78/70 *Deutsche Grammophon Gesellschaft GmbH v Metro SB Grossmarkt GmbH and Co.*[1971] ECR 487.

permitted under German law at the time. In order to become an authorised reseller the companies had to apply the price maintenance system to Polydor records supplied directly by Deutsche Grammophon as well as those acquired from third parties. Metro S.B. had previously been an authorised reseller of Polydor records but had failed to observe the price maintenance system and relations to Deutsche Grammophon were subsequently cut off. Some time after this Metro obtained Polydor records sold by a wholesaler in Hamburg. These records had been manufactured in Germany and then exported to a subsidiary company in Paris and were then re-exported back into Germany. Metro in its turn sold these records at a price lower than the price set by Deutsche Grammophon. The latter claimed that Metro had infringed its right of exclusive distribution in Germany and went to court. The national court in Germany having to deal with the case referred a request for a preliminary ruling from the Court of Justice on the compatibility with Community law according to Article 234 of the Treaty. The question referred was whether the exclusive right, conferred by national law, to distribute the intellectual property protected records was in breach of Community law. The Court of Justice held that this use of a national intellectual property right was in conflict with Community law if the owner of the protected products had marketed them, or consented to do so, in another Member State. By marketing the protected products in another Member State the right to prevent parallel imports of goods from this state is exhausted.

The Court had thus created a Community-wide principle of exhaustion of national intellectual property rights. This principle, which was first developed in Germany in the beginning of the last century, already existed at a national level in many Member States.⁴⁰ It was here used for the same reasons as the Court introduced it in *Deutsche Grammophon* - to prevent the use of intellectual property rights from partitioning off the market. It is thought that the distribution and use of genuine goods shall not be controlled after the owner, a licensee or a related company has put it on the market.⁴¹ Since the main purpose of the intellectual property right is to prevent the manufacture and distribution of infringing goods, these rights cannot be used to control the genuine goods once these are put on the market. In Community law, the national intellectual property rights can only prevent infringing manufacture and distribution up until the first sale by the owner of the right. Once this is done, the right of the holder is exhausted. Since the rules on free movement of goods, upon which this principle is based, only applies to trade between Member States the exhaustion takes place when the product is marketed in another Member State. When products are marketed in a third country, outside the Community, the intellectual property right is

⁴⁰ Beier, F-K, *Industrial Property and the Free Movement of Goods in the Internal European Market*, 21 IIC 131 [1990] p. 151.

⁴¹ *Ibid.*

not exhausted and can thus still be used to prevent infringing imports into the Community.⁴²

The intellectual property right in *Deutsche Grammophon* was according to the Court a right closely related to a copyright. This right could, according to the principle of exhaustion under German law, not be used to control the records if they had been sold to a German distributor. In this case the French subsidiary had bought the product and Deutsche Grammophon tried to use its right to prevent the selling of these records in Germany. The Court held that since the right could not be used to prevent the distribution of goods put on the market by the owner in Germany, there was no reason that the outcome would be different only because the products were put on the market in another Member State.⁴³ Otherwise an isolation of the national markets would be legitimate and the essential purpose of the Community, to unite national markets into a single market, would not be achieved.

By introducing the principle of exhaustion the territoriality of the national intellectual property rights was curtailed. This was necessary in order to avoid a division of markets within the Community. Of central importance to the market integration is the work of the parallel traders. These traders act independently of the owner of the intellectual property right and re-sells goods already put on the market. As long as there exists differences in prices within the Community, the parallel trading will take place and this way contribute to the market integration. As a result of the introduction of the principle of exhaustion in the Community, intellectual property rights could not any longer be used to prevent parallel imports into a Member State when the product was marketed by the owner or with his consent in another Member State.

4.4 Specific subject matter

In *Deutsche Grammophon* the Court also further developed the distinction between the proper and improper exercise of intellectual property rights. The basic distinction made by the Court in *Consten and Grundig* needed to be more precisely laid down. How was the line between the main rule of free movement of goods under Article 28 and the exception thereof under Article 30 to be drawn?

The Court held in *Deutsche Grammophon* that Article 30 only permitted an exception from Article 28 as far as it is justified in order to safeguard the rights constituting the *specific subject matter* of the intellectual property right in question. The specific subject matter is thus equivalent to the functions of an intellectual property right which are regarded in Community law as falling within the proper exercise of the right. A major part of the

⁴² See 270/80 *Polydor Ltd & RSO Records Inc. v Harlequin Record Shops Ltd & Simons Records Ltd*, [1982] ECR 329.

⁴³ 78/70 *Deutsche Grammophon Gesellschaft GmbH v Metro SB Grossmarkt GmbH and Co.* [1971] ECR 487 at para. 12.

Court's case law in the area has dealt with defining the specific subject matter of the different types of intellectual property rights.

As concerns the specific subject matter of patents this was first developed in *Sterling Drug*.⁴⁴ The case concerned the American firm Sterling Drug, which through its subsidiaries held parallel patents for the drug "Negram" in several Member States. Centrafarm bought the drug from wholesalers in the United Kingdom and imported it into the Netherlands, where the price was nearly twice as high because the Dutch government did not, as in the United Kingdom, subsidise the prices of pharmaceuticals. Sterling Drug tried to prohibit this parallel trade by claiming its patent was being infringed through the activities of Centrafarm. The question came before the Court under a reference for a preliminary ruling from the Dutch court. In the judgement the Court gave its view on what constituted the specific subject matter of a patent:

*"In relation to patents, the specific subject matter of the industrial property is to guarantee that the patentee, to reward the creative effort of the inventor, has the exclusive right to use an invention with a view to manufacturing industrial products and putting them into circulation for the first time, either directly or by grant of licenses to third parties, as well as the right to oppose infringements."*⁴⁵

The Court found that the exercise of such rights to prevent the sales of parallel imports was an unjustified obstacle to the free movement of goods. The fact that the prices in the United Kingdom were subsidised and therefore held artificially low could not be a reason to allow prohibition of parallel imports. As a result of this judgement Sterling Drug could not draw advantage of the existing price differences between the Member States since they were not able to prevent the parallel imports by using their patent.

It is here clear how these three concepts described all are connected with each other. The existence of a national patent cannot be questioned under Community law. The proper exercise, i.e. an exercise of rights belonging to the specific subject matter, of the property right does not violate Community law. The specific subject matter of patents amounts to an exclusive right to use an invention to manufacture and putting the products into circulation for the first time as well as to oppose infringements. Measures going beyond this are thus disproportionate and cannot be saved by the exception in Article 30. Once the product is put into circulation for the first time within the Community by the holder of the right, or with his consent, the patent right is exhausted and cannot be used to prevent imports of genuine goods. We shall now look a bit closer at some of the most important case law of the Court regarding these concepts.

⁴⁴ 15/74 *Centrafarm B.V. v Sterling Drug Inc.* [1974] ECR 1147.

⁴⁵ *Ibid.*, para. 9.

A slightly different situation from the one in *Sterling Drug* arose in the *Merck v. Stephar* case.⁴⁶ In this case no parallel patents existed, since patent protection of pharmaceuticals did not exist in Italy at the time. Merck was, like Sterling Drug, an American firm holding patents for the manufacturing process of the drug "Moduretic" in several Member States. In spite of the fact that no patent protection was available in Italy, Merck marketed the product there. A competing firm, Stephar, then bought the drug cheaply in Italy and imported it into the Netherlands. Merck tried to use its Dutch patent to prevent the import and sued Stephar for patent infringement.

On a reference under Article 234, the Court held that the patentee only had the right to first market his product. A patent does not guarantee the profits of a monopolist and the holder had to take into account all the relevant circumstances when deciding to market his product. In this case, such a relevant circumstance was the fact that patent protection was not available in Italy at the time. As a consequence, free riding competitors on the Italian market were able to produce an identical product and Merck had to charge competitive prices.

The Court thus focused solely on the right to first market the protected product and disregarded the legal situation in Italy at the time. Because there was no patent protection available in Italy, Merck never had a chance to protect itself from direct competition. Logically, there was no patent right that could be exhausted. The function of the patent could therefore scarcely be seen as fulfilled. Nevertheless, Merck's patent right was, according to the Court, exhausted throughout the Community and could not be used to prevent infringing exports. Thus, Merck had no chance of charging a higher price than its competitors in Italy since no patent protection was available. Furthermore, the marketing in Italy exhausted the right to prevent infringing imports into the Netherlands. This way the chance of recovering on the Dutch market the investments made was also very small since parallel imports could not be stopped. The Court had a chance to overrule this criticised judgement a couple of years ago in *Primecrown*.⁴⁷ However, the Court expressly held on to its reasoning from *Merck/Stephar*.⁴⁸

The first marketing, on which the Court focused, must on the other hand be done by the proprietor or with his consent. Furthermore this consent must be voluntary. This was held by the Court in *Pharmon v. Hoechst*⁴⁹, where Hoechst held parallel patents in the United Kingdom and the Netherlands. A British company obtained a compulsory license under British law and sold the products to Pharmon, which imported them into the Netherlands.

⁴⁶ 187/80 *Merck and Co. Inc. v Stephar BV* [1981] ECR 2063.

⁴⁷ C-267 and 268/95 *Merck & Co. v Primecrown Ltd* [1996] ECR 6285. For critical comments on *Merck/Stephar* see, e.g., Marengo, G., and Banks, K. *Intellectual Property and the Community Rules on Free Movement: Discrimination Unearthed*, 15 *European L. Rev.* [1990] p. 247, Rothnie, W., *Parallel Imports*, p. 351.

⁴⁸ C-267 and 268/95 *Merck & Co. v Primecrown Ltd* [1996] ECR 6285, p. 6385.

⁴⁹ 19/84 *Pharmon BV v Hoechst AG* [1985] ECR 2281.

Hoechst did not approve and sued for patent infringement. The key question was whether or not the marketing of the goods by the British firm under the compulsory licence could be seen as marketing with the consent of Hoechst. Pharmon argued that Hoechst when seeking a patent in the United Kingdom had accepted the possibility that a compulsory licence could be issued. The Court of Justice held in its judgement that when a compulsory licence is granted the holder of the patent cannot be regarded as having consented to the grant and Hoechst was consequently still able to sue for infringement under Dutch law.

It is evident that the case law of the Court diminished the value of national intellectual property rights. These could no longer be used to prevent the import of protected goods if the goods have been marketed in another Member State by the owner of the right, or with his consent. This was even so if no patent protection existed in the exporting state. The reason for the restrictive view of the Court is the threat the national laws pose to the objective of creating a Common Market. Since these laws are territorial they preserve the division of the Common Market, which the Community aim at eliminating. The Community rules on free movement of goods were thus given priority over the exclusive right granted by national legislation.

5 Patent Licensing

5.1 Introduction

From now on focus will be on patent licensing agreements and the treatment of these under Community law. These agreements are commercially important but have been treated very differently in Community law over time. This can partly be explained by the fact that the patent licensing agreement touches upon a number of different areas of law, which are not always mutually consistent. Over the years these different objectives have been balanced in shifting ways and so has the approach towards licensing agreements. Since licensing involves an agreement between two parties it is mainly the rules on competition that set the limits on how the licensing agreements can be shaped. However, also the rules on free movement affect the way licensing agreements are viewed under Community law.

Licensing agreements are one of the most frequently used forms of business collaboration. These can have different shape and functions but some elements are in common for all licensing agreements. The licensor owns, or in another way controls a valuable legal right and grants to the other party, the licensee, a right to utilize this legal right.⁵⁰ The licensee on his side compensates the licensor, usually by paying a flat fee or royalty. The licensing of an intellectual property right has important differences compared to selling the same. The licensor never loses the ownership of the right and after the licensing agreement has expired the right of the licensee is usually withdrawn. It can therefore be seen as a rental arrangement of an intellectual property. Licensing represents an important instrument in exploiting the intellectual property.

A licensing agreement can be classified either by the licensed subject matter or by its function.⁵¹ The licensed subject matter can be for example a patent, trademark or copyright. The most common functions licensed are the right to manufacture, distribute or sell the protected product.

The value of a license is to a large extent depending on the possibilities for the licensee to exploit the invention without facing competition from others. This can be in the form of competition from the licensor as well as from other licensees. There are three different types of licensing agreements as regards the level of protection from competition. If a non-exclusive licensing agreement is entered into between the licensor and the licensee, the licensee can face competition from other licensees as well as the licensor. A sole licence gives the licensee protection from other licensees, but competition from the licensor is still possible. The third and most

⁵⁰ Gutterman, A., *Innovation and Competition Policy*, p. 121.

⁵¹ *Ibid.*, p. 122.

advantageous form of licence, in the view of the licensee, is the exclusive licence. This protects him from competition both from other licensees as well as the licensor himself.⁵²

5.2 Licensing and Competition Law

In the first section of this thesis we looked at the relation between intellectual property rights and competition law. In this section we will elaborate on this a little bit further by examining briefly the relationship between the licensing of these rights and competition law. Starting out with competition in general we will later focus on conflicts with the particular aspects of EC competition law.

The licensing agreement is generally seen as being pro-competitive. This is so mainly because it introduces a new competitor on the market and consequently increases inter-brand competition, i.e. competition between different brands of similar products. This is most likely to happen in a vertical agreement where the licensor and licensee are placed at different levels in the production of the product. In these situations the parties to the agreement are neither actual nor potential competitors. Here the patentee has an interest in keeping the margin of profit of the licensee not higher than necessary to induce him to make the investments needed to introduce the new technology into the market. Collusion restricting competition is therefore less plausible in vertical agreements.

A licensing agreement can however also be used to create a cartel when entered into between two competitors, actual or potential, on the market. Such horizontal agreements are more likely to have serious anti-competitive effects, but this is not necessarily always true. The relationship between the parties to the agreement can only serve as an indicator to whether the competition authorities should be concerned.⁵³ Most licensing agreements contain both pro- and anti-competitive aspects and a balancing has to be done on a case-by-case basis. As will be shown below the competitive effects are to a large extent depending on the economic context in which they are entered into.

⁵² Pehrson, L., *EG och immaterialrätten*, p. 119.

⁵³ Anderman, S., *EC Competition Law and Intellectual Property Rights – The Regulation of Innovation*, p. 27.

5.2.1 Pro-competitive aspects of licensing⁵⁴

Overcoming barriers to entry. Small- and medium-sized firms might not always have the economic strength needed to fully exploit its innovations. A licensing agreement with a firm equipped with complimentary resources can be a way of creating economies of scale and this way overcome barriers to entry and penetrate new markets.

Maximising profits. By entering into licensing agreements the licensor has the opportunity to subdivide his customers in order to be able to charge them different prices according to the value they place on the innovation. This price discrimination will, under perfect conditions, enhance output and in that way be pro-competitive. Price discrimination can be reached through various clauses in a licensing agreement. The licensor can isolate the different markets where he charges different prices by taking in clauses with vertical territorial restraints and customer allocation. By including these clauses the licensor can prevent the goods sold at a lower price from being imported into areas where he charges a higher price. Also field of use clauses can uphold this price discrimination.

Intellectual property development. In order to increase the incentives for the licensee to develop the invention the licensor can use field of use clauses. This way a licensee who develops the innovation in a way, which is not patentable can be protected from other licensees free-riding on his developments.

Risk sharing. A licensing agreement usually involves a certain amount of risk. Measures taken to reduce these risks will result in an increased diffusion of new technology and a following increase in inter-brand competition. The risk sharing can be achieved through tie-in clauses and royalties.⁵⁵ Royalties, which is part of most licensing agreements, permits the licensee to pay a lower price initially for the license and instead be paid in relation to the success of the innovation on the market. A tie-in clause can for example require the licensee to purchase particular products from the licensor apart from the patented product. By drafting a tie-in clause the licensor can lower the price of the patented product since the licensee will have to purchase the connected products from him if he is pleased with the patented product.

5.2.2 Anti-competitive aspects of licensing

As seen above, the pro-competitive effects of licensing typically arise when the licensor and licensee are vertically related to each other. Consequently, the anti-competitive aspects are more commonly found in horizontal agreements, i.e. in agreements entered into between actual or potential competitors.

⁵⁴ OECD, *Competition Policy and Intellectual Property Rights*, p. 18.

⁵⁵ Lohmann, N., *The New EC Technology Transfer Regulation 240/96*, p. 37.

Cartelization. A licensing agreement can be used to cartelize a market, which is often done by price fixing, limiting output or dividing markets. Cartelization poses the biggest threat to competition in licensing agreements. Actual or potential competitors may formally enter a licensing agreement where the transfer of technology is only of marginal importance but instead fix prices or limit output.

Exclusionary effects. Licensing agreements can also be used to exclude other firms from the market in an anticompetitive way. By drafting non-competition clauses, according to which the licensees are obliged to use the licensed technology only, with a large number of licensees the potential licensors are shut out of the market. Another licensor trying to enter the market would have to enter the market at both licensor level and licensee level if the original licensor had drafted non-competition clauses with a large number of licensees.

5.3 Licensing and EC Competition Law

In the previous section we have looked generally on the effect on competition when licensing. It is now time to turn to the more specific problems arising regarding EC competition. As noted above the overall objective of the Community is to create a single European Market. This objective has also had an influence on the character of competition law in the Community. Consequently, certain features of a licensing agreement will be met with hostility although they under traditional anti-trust analysis would be accepted. This is most evident when looking at clauses containing territorial exclusivity and export bans, which is one of the most debated aspects of licensing agreements under EC law. These clauses are the most common of all clauses in the licensing agreement and certainly the most fundamental.⁵⁶ For a licensee such protection is often a condition for being willing to accept the risks following from bringing a new product or process onto the market.

How far then is a licensor capable of protecting a licensee? By conferring on the licensee exclusive territories and at the same time imposing export bans on the other licensees preventing them and their customers from entering the licensed territory the licensor can create a territory where the intra-brand competition is totally eliminated. In a situation where there is a certain degree of inter-brand competition the advantages of this approach are several. A licensee who knows he will not face competition in his own territory will be more willing to invest in new technologies. Since the licensee in such a case can be sure he will not face competition from competitors free-riding on his investments made in manufacturing, distributing and marketing the new product, his incentive to make these investments are greater than would be the case if no protection from competitors existed. The diffusion of new technology would therefore

⁵⁶ OECD, *Competition Policy and Intellectual Property Rights*, p. 12.

increase. This is clearly pro-competitive since it enhances efficiency. However, this isolation of markets collides with the overriding goal of market integration within the EC. Exclusivity in licensing agreements is therefore restricted under EC law.

Before looking at how the Commission has dealt with the licensing agreements in its case law the legal basis for this, Article 81, will be analysed.

As mentioned above the Commission generally interprets Article 81.1 widely and then exempts those agreements fulfilling the conditions in Article 81.3.⁵⁷ As a consequence there are two different processes of estimating the effects on competition of an agreement. Firms entering a licensing agreement can either aim at getting it cleared altogether under Article 81.1 or getting their agreement exempted according to Article 81.3. We shall now look at them in turn.

5.3.1 Clearance

There are three main conditions which have to be met in order for Article 81.1 to be applicable. First of all there must be an agreement entered into between two independent undertakings. In *Centrafarm* the Court held an agreement between a parent company and its subsidiary to fall outside Article 81.1 since it was seen as an internal allocation of functions between members of the same economic unit. The second condition is that the agreement must have an appreciable quantitative effect on the trade between Member States. Thirdly, the agreement must have as the object or effect of preventing, restricting or distorting competition. This condition is usually examined in a two-part test.⁵⁸ The Court and the Commission has in its case law first evaluated whether the agreement restricts the freedom of action of the parties. The freedom of action of the parties is restricted in exclusive agreements since they do not, as a consequence of the exclusivity, have the freedom to enter into agreements with other parties in the territory. A non-exclusive agreement on the other hand does not restrict the freedom of action of the parties. In the second part of the test the question is whether the intention or effect is appreciable or not. If all three conditions are fulfilled and the agreement infringes Article 81.1, the only way to prevent it from being void according to 81.2 is to get it through the process of exemption.

⁵⁷ Although in recent years the Commission has increasingly adopted a more economical and less formalistic analysis under Article 81.1, see e.g. Commission notice – Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements, para. 6.

⁵⁸ Anderman, S., *EC Competition Law and Intellectual Property Rights – The Regulation of Innovation*, p. 48.

5.3.2 Exemption

This can be done either by notifying the agreement to the Commission for an individual exemption or by fitting the agreement under a block exemption. The individual exemption is usually a less attractive solution than the block exemptions. The procedure for granting an individual exemption is time consuming and in most cases ending up with the Commission issuing a comfort letter stating that it does not intend to take any action based on the information they have been sent. Even though the Commission follows this, the comfort letter is not enforceable in national courts.

The block exemption, on the other hand, offers automatic legal validity to the parties of the agreement. The procedure of fitting an agreement under a block exemption does usually not require much work as long as the agreement is of a category covered by a block exemption. By fitting the agreement under a block exemption the parties obtain legal validity quickly and is therefore usually seen as a more attractive way of dealing with the rules on competition than through clearance under Article 81.1.

6 View of the Commission

6.1 The Christmas Message

In December 1962 the Commission first gave indications of its future attitude towards patent licensing agreements, delivered in a non-binding message.⁵⁹ It was later to be known as the Christmas Message, not only because it was issued on Christmas Eve but also because of the liberal view towards patent licensing the Commission expressed in it. At this time the Commission regarded a patent licensing agreement as merely extending to the licensee the exclusivity conferred upon the holder of the patent. No measures would be taken by the Commission as long as the agreement was kept within the scope of the patent. This scope of the patent doctrine was already used in competition law in Germany and United States. By viewing the licensing agreement as merely subdividing the right of the patentee, no one's freedom of action would be restricted. Thus, because of the scope of the patent doctrine the exclusive licensing was treated differently than the exclusive distribution, which was seen as restricting competition because it limited the freedom of the parties to enter agreements with third parties. However, as soon as the agreement contained clauses going beyond the scope of the patent the rules on competition would apply. The scope of the patent doctrine could ultimately be used to justify restrictions, which traditionally was viewed as *per se* violations of competition law.⁶⁰

This represented a formalistic analysis of the limitations in the licence of a patent. The Commission did not at this time consider the position of third parties nor analyse the economic effects of the clause on the market when evaluating the competitive effects of a licensing agreement.⁶¹ Territorial restraints came within the scope of the patent just as much as a division of technical applications and neither provision fell within the prohibition of Article 81.1.

This liberal view, which was later to be abandoned, can partly be explained by the fact that the Commission in the early days of the work of the Community did not foresee the power of national intellectual property rights to isolate the national markets and prevent market integration. The Commission did not in this message use the distinction between the existence and exercise of intellectual property rights, which the Court would two years later in *Consten and Grundig*. However, the Commission made a distinction between licensing agreements, which fell within the scope of the

⁵⁹ *Communiqué Concerning Patent Licence Agreements* [1962] OJ C139/2922.

⁶⁰ Gutterman, A., *Innovation and Competition Policy*, p. 207.

⁶¹ Anderman, S., *EC Competition Law and Intellectual Property Rights – The Regulation of Innovation*, p. 54.

patent and therefore were compatible with the rules of competition and provisions that fell outside and therefore were not immune to these rules. The reasons for the Commission's acceptance of exclusive licensing agreements at this time were several. The Commission was at the time heavily influenced by German competition law where the same liberal view was taken. Moreover the Commission was focusing its limited resources on exclusive distribution and purchasing agreements.⁶² By taking this liberal view towards licensing agreements the Commission would not be forced to deal with too many notifications.

One problem arising out of this doctrine was the fact that national patent laws determined the scope of the patents. This could in the end have the effect of national law prevailing over Community law. Thus, the differences in national law could threaten the uniform application of EC competition law in a way that could not be accepted.⁶³

6.2 Change in the approach

After the Court gave its judgement in *Consten and Grundig* in 1964 a change in the attitude of the Commission took place. In this landmark judgement the Court held that Article 81.1 applies to both vertical and horizontal agreements and therefore the attempt to partition off markets was seen as restricting competition. In reaching this conclusion the Court explicitly considered the position of third parties when looking at the competitive effects of sole distributorship contracts. This way of reasoning would later influence the view of the Commission on licensing agreements. Also, the use of the trademark from Grundig increased the awareness of the potential of intellectual property rights to seal off markets and limit interstate competition.⁶⁴

Clearly affected by this development the Commission in the following decisions on patent licensing departed from its original view expressed in the Christmas Message. In the *Burroughs-Delplanque*⁶⁵ decision from 1971 the Commission had to deal with an exclusive patent and know-how manufacturing licence. In this decision the Commission took the first step in abandoning the view expressed in the Christmas Message when indicating that it was possible that an exclusive patent licence was a restriction of competition coming within Article 81.1. However, because of the low market share of Delplanque in the French market in carbon papers, restrictions on competition would not be noticeable and did therefore not come under the prohibition in Article 81.1. In the following year the Commission went one step further in the *Davidson Rubber*⁶⁶ decision.

⁶² Goyder, D. G., *EC Competition Law*, p. 290.

⁶³ Johannes, H., *Industrial Property and Copyright in European Community Law*, p.12.

⁶⁴ Anderman, S., *EC Competition Law and Intellectual Property Rights – The Regulation of Innovation*, p. 55.

⁶⁵ 72/25 *Burroughs-Delplanque*, OJ [1971] L13/50.

⁶⁶ 72/237 *Davidson Rubber Company*, OJ [1972] L143/31.

Davidson Rubber Company had set up a network of licensees to manufacture and sell their patented products, elbow-rests for cars. The Commission found that the network of exclusive licences in combination with the limited number of competing processes considerably altered the position of third parties and therefore noticeably restricted competition.⁶⁷ The licences were thus found to be in breach of Article 81.1. The Commission had by reaching this conclusion completely abandoned its liberal view expressed in its Christmas Message. However, the agreement was exempted under Article 81.3 since the Commission found that the exclusivity was an indispensable part of the agreement. If the licensees could not be guaranteed exclusivity in their own territory, they would not have agreed to make the required investments in the new process, according to the Commission.

This issue is yet another to consider when regulating patent licensing agreements. The possibility of restricting the freedom of the other party can often be a precondition for entering into the licensing agreement in the first place. The licensor will usually be more willing to grant a license if he can control the exploitation of the invention by restricting the licensee in various ways. Also, the licensee might not be willing to make the investments required to fully exploit the invention if he is not granted exclusive rights. At the same time as these restrictions impairs competition, they are an essential part in collaborations between companies leading to dissemination of new technology. The restrictive view of the Commission during this period was severely criticized by the industry. One argument often used has been that there is no competition to restrict in the event of new technologies. If no exclusivity is granted, the agreement is not entered into and consequently the new technology is not disseminated. In other words, the restriction of competition in the shape of exclusivity is needed in order to open doors that would otherwise be closed.⁶⁸

However, in the following years the Commission continued its interventionist approach towards patent licensing agreements. In *Kabelmetal*⁶⁹, the Commission held that clauses restricting the licensor from appointing other licensees in a given territory infringed Article 81.1. The peak of this development was perhaps reached in the *AOIP/Beyrard*⁷⁰ decision from 1976. Here, the Commission held that the grant of exclusive territorial rights and prohibitions on the ability of the licensee to export the licensed goods to any country in which the licensor has either licensed the patent or assigned its rights to third parties infringed Article 81.1 and could not be exempted under 81.3.

The view of the Commission towards exclusivity in patent licensing agreements had thus completely changed in not much more than 15 years

⁶⁷ Ibid., para. 37.

⁶⁸ Van Bael – Bellis, *Competition Law of the European Community*, p. 303.

⁶⁹ 75/494 *Kabelmetal/Luchaire* [1975] OJ L222/34.

⁷⁰ 76/29 *AOIP/ Beyrard* [1976] OJ L6/8.

time. In 1962 it was thought that exclusivity conferred upon a licensee was not infringing Article 81.1 and in 1976 the same restrictions in the agreement were seen as an infringement, which could not be exempted. The Commission generally applied a formalistic view under Article 81.1 and then a more realistic one based on market conditions under 81.3. Before looking further into how the Commission has more recently dealt with patent licensing, e.g. by issuing block exemptions, we will in the following chapter take a look on how the Court in one judgement changed the way to examine these agreements under EC competition law.

7 View of the Court

7.1 Introduction

The case law of the Court concerning intellectual property licensing is limited. The most important case as regards territorial exclusivity is *Maize Seed*, which was not even about patent rights but plant breeders' rights. This judgement has however influenced the view on licensing generally and will therefore be carefully analysed in this chapter. Also, *Windsurfing International*.⁷¹, dealing with patent licensing and *Erauw-Jaquery*⁷², once again a case of plant breeders' rights, will be looked at.

In the *Maize Seed*⁷³ decision from 1978 the Commission had held on to the restrictive view of exclusive licences that it developed during the preceding years. Because of its exclusive nature the agreement automatically infringed Article 81.1, since it could not be saved by the *de minimis* rule. This case did not concern patents but plant varieties rights, but since the decision of the Commission was later overruled by the Court of Justice in a very important judgement it has affected the view in EC law on licensing of intellectual property rights generally.⁷⁴ The facts of the case were as follows. INRA, a French state-owned research institute had developed a new variety of maize seed that could be grown in the colder climate in northern Europe. INRA assigned the plant breeders' right in Germany to Mr. Eisele, a German citizen who registered the right. In the agreement entered into between the parties Eisele was given the exclusive right to manufacture and sell the maize seed variety in Germany. Furthermore, the licensor, INRA, agreed not to export its seeds to Germany and also to prevent its customers from doing so.

The Commission was informed about the agreement and applied the same policy as it had done in the earlier cases on exclusive licensing. It thus regarded the agreement as restricting competition under Article 81.1 because of the fact that the grant of an exclusive licence prevented INRA from granting a licence to other competing firms. The obligation on INRA not itself to manufacture or sell the seeds in Germany consequently infringed Article 81.1 as well, since hereby INRA eliminated itself as a supplier in the territory. This part of the Commissions' decision was in line with its earlier decisions, but had never been tested by the Court.

⁷¹ 258/78 *Nungesser KG and Kurt Eisele v EC Commission (Maize Seed)* [1982] ECR 2015, 193/83 *Windsurfing International Inc. v Commission* [1984] ECR 611.

⁷² 27/87 *Erauw-Jaquery Spri v La Hesbignonne Société Co-opérative* [1988] ECR 1919.

⁷³ 78/823 *Kurt Eisele-INRA* O.J. [1978] L286/23.

⁷⁴ Korah, V, *Technology Transfer Agreements and the EC Competition Rules*, p. 50.

The other part of the agreement infringing Article 81.1 was the prevention of third parties from exporting the seeds to Germany. INRA had agreed to ensure that the seeds would not be exported into Germany other than through Eisele. This would be reached by preventing its French customers to export the seed into Germany. The Commission regarded this as an agreement conferring absolute territorial protection on the parties and therefore found it to be infringing Article 81.1 and not deserving an exemption under Article 81.3. This part of the decision was in line with earlier case law from the Court, most notably *Consten and Grundig*.

7.2 The Maize Seed judgement

The decision was later appealed and came under the jurisdiction of the Court⁷⁵, which did not share the view of the Commission in all aspects. The applicants did not question the view of the Commission that the agreement contained clauses, which together with German national legislation in practice conferred on Eisele an absolute territorial protection in Germany. This protection was however justified, according to the applicants, because of the particular nature of plant breeders' rights. These should be distinguished from patents and trademarks since the quality of the seed has to be carefully monitored in order to safeguard the stability of the variety. The applicants therefore argued that the plant breeders' rights were not suited for the traditional competition law. The Court compared with pharmaceuticals, which are in a similar situation and protected by patents, and found that plant breeders' rights did not require a special system under competition law.⁷⁶

Furthermore, the applicants criticized the Commission's view that an exclusive licensing agreement was automatically infringing Article 81.1, since in a situation like this it was the only way of penetrating a new market with a new product. If a licensee would not enjoy protection from direct competition from other licensees in the territory, or the licensor, he would not take the risk of launching the new maize seed.⁷⁷ Moreover, the governments of Germany and the United Kingdom intervened and brought forward the view that this *per se* prohibition of exclusivity was not a sensible competition policy.⁷⁸

The Court found that the concern expressed by the applicants, and the intervening governments, on this issue was justified and stated that an exclusive licence agreement did not automatically infringe Article 81.1. Instead, the Court created a new way of looking at these licences by making a distinction between the open exclusive licences and exclusive licensing agreements conferring absolute territorial protection on the parties. The Court saw the former as under certain conditions being compatible with

⁷⁵ 258/78 *Nungesser KG and Kurt Eisele v EC Commission (Maize Seed)* [1982] ECR 2015.

⁷⁶ *Ibid.*, para. 43.

⁷⁷ *Ibid.*, para. 44.

⁷⁸ *Ibid.*, para. 45.

Article 81.1. According to the Court, an exclusive licence agreement was open when *”the exclusivity of the licence relates solely to the contractual relationship between the owner of the right and the licensee, whereby the owner of the right merely undertakes not to grant other licensees in respect of the same territory and not to compete himself with the licensee in that territory.”*⁷⁹ This was opposed to the absolute territorial protection, which was defined in the judgement as *”territorial protection, under which the parties to the contract propose, as regards the products and the territory in question, to eliminate all competition from third parties, such as parallel importers or licensees for other territories.”*⁸⁰

However, not all open exclusive licenses were compatible with Article 81.1. The Court had only stated that such an agreement did not automatically infringe this provision. The open exclusive license was only accepted under certain conditions. The Court held that the open exclusive licence was in this case not restricting competition since the agreement concerned a new variety of maize seed, which was developed after years of research and was unknown to German farmers at the time of the agreement.⁸¹ In order for the new maize seed to be disseminated throughout the market, protection through exclusivity was justified. The licensee would this way be protected from free riders, which would otherwise be able to profit from the investments made in marketing the product in the territory of the licensee. Since the product was new in the German market, such marketing had to be done in order to create a demand. The absence of such protection would be damaging to the dissemination of new technology in the Community and would hinder inter-brand competition, according to the Court. These advantages have to be balanced against the negative impact of exclusive licensing agreements on intra-brand competition and the objective of market integration. The Court focused on the role of the parallel traders and their importance for market integration. As long as these and licensees for other territories can operate there is no absolute territorial protection and Article 81.1 is not infringed.

In the agreement entered into between INRA and Eisele there were clearly clauses by which the parties were trying to restrain parallel trade. According to the agreement INRA promised it would do everything in its power to prevent the export of seeds to Germany. In the beginning of the 1970's a parallel importer who tried to import the seed variety into Germany was challenged by Eisele, who threatened to sue him if he did not stop importing. The agreement thus contained restrictions on third parties and therefore infringed Article 81.1, according to the Court. In this part of the judgement the Court was sharing the view of the Commission and did not exempt it under Article 81.3.

⁷⁹ *Maize Seed*, para. 57.

⁸⁰ *Ibid.*

⁸¹ *Ibid.*, para. 56.

The absolute territorial protection enjoyed in practice by Eisele in the German market was not supported by Community law. As described above, the Court of Justice introduced in *Centrafarm v Sterling Drug* a principle of community-wide exhaustion.⁸² Once a protected product has been marketed by the owner or with his consent in another Member State, the intellectual property right cannot be used to prevent imports of the product. In this case INRA had marketed the seeds and traders were free to buy the seeds from traders in France and sell them in Germany. Consequently, neither INRA nor Eisele would be able to stop the imports by using their intellectual property rights. The British government intervened before the Court and put forward the argument that the agreement could not, because of the case law of the Court, create an absolute territorial protection and was therefore not an agreement prohibited by Article 81.1. The Court held that even though the parties of the agreement were in the position to escape from their restrictions by relating to the rules on free movement of goods, this did not affect the analysis under competition rules.⁸³ Furthermore, in the years following after *Centrafarm v Sterling Drug* Community law was undeveloped and Eisele had in fact managed to restrain two traders from importing the seed from France by using his intellectual property right during these years. The Court was concerned that the parties should not seek to retrieve by contract what was prohibited under Articles 28 and 30.⁸⁴

7.3 Importance of Maize Seed

Although the Court somewhat complicated the way of approaching exclusive licensing agreements under EC competition law, it showed a greater sensitivity to the commercial reality underpinning these agreements. The need for inducing investments made the Court modify the formalistic view of the Commission that every exclusive licensing agreement infringed Article 81.1.

When assessing the competitive effects of an agreement the analysis was earlier performed *ex-post*, i.e. not at the time when the agreement had been entered into but instead afterwards when examined by the Commission.⁸⁵ The prime example of this is the view of the Commission that an exclusive licence restricts competition since the licensor is hereby deprived the freedom of granting other licences in the same territory. This argument, also used by the Commission in its Maize Seed decision, is not entirely convincing since without exclusivity no licence would be granted at all. The freedom of the licensor to grant non-exclusive licenses is sometimes only theoretical. As explained above the exclusivity can often be a precondition for entering into the licensing agreement for the licensee. The Court, on the other hand, focused more on the commercial conditions in its judgement. It was in this case necessary to allow exclusivity between the licensor and

⁸² 15/74 *Centrafarm BV and de Peijper v Sterling Drug Inc.* [1974] ECR 1147.

⁸³ *Maize Seed*, para. 63.

⁸⁴ Bellamy, C., and Child, G.D., *Common Market Law of Competition*, para. 7-072.

⁸⁵ Korah, V., *Technology Transfer Agreements and the EC Competition Rules*, p.12.

licensee in order to induce investments. The focus was here clearly at the time when the agreement was entered into and not as in the decision of the Commission at the time when examining it. Viewed from this perspective the restriction on the licensor's freedom was not equal to a restriction of competition.

Due to the fact that this case concerned plant breeders' rights doubts have arisen whether the reasoning is also applicable to intellectual property rights in general. The Court has not expressed its view on this point, but the most common view is that the reasoning is generally applicable. The Commission has for example, as will be shown below, adopted much of the reasoning used by the Court in its following block exemptions.

Although the reasoning as such is applicable, the conditions for clearing an open exclusive licence agreement are still limited. The reason for the acceptance of the open exclusive licence in this case was the fact that the product was new and had been developed after years of research.⁸⁶ These criteria are rather vague and different interpretations can be made from the text of the judgement. First of all the product had to be new. According to the text of the judgement the product has to be new in the territory of the licensee.⁸⁷ But how new must it be? Is the novelty required the same as when applying for a patent? This is probably not the case but no straight answers can be given.⁸⁸ Secondly, the new technology had to be developed after years of research.⁸⁹ Moreover, the exclusivity had to be an indispensable part of the agreement.⁹⁰ In conclusion it can be said that the judgement left open a fair deal of uncertainty for practitioners giving advice on how to shape an exclusive agreement without violating Article 81.1.

This uncertainty also left the Commission a considerable discretion when dealing with exclusivity in their decisions following *Maize Seed*. Not surprisingly it interpreted the Courts' reasoning narrowly. In *Velcro/Alpix*⁹¹ the Commission gave its view on novelty as a relevant factor to take an exclusive licence agreement out of Article 81.1. The Commission held that although the technique licensed was new at the time of licensing, this was no longer the case when the Commission a couple of years later was examining the licence agreement. The agreement therefore infringed Article 81.1. In *Rich Products/Jus-Rol*⁹² the Commission found that an exclusive manufacturing licence infringed Article 81.1 since the process was not new enough. The Commission stated that there already existed other similar

⁸⁶ *Maize Seed*, para. 56.

⁸⁷ *Ibid.*, para. 55.

⁸⁸ Anderman, S., *EC Competition Law and Intellectual Property Rights – The Regulation of Innovation*, p. 66.

⁸⁹ *Maize Seed*, para. 56.

⁹⁰ *Ibid.*, para. 57.

⁹¹ 85/410 *Velcro/Alpix* [1985] OJ L233/22.

⁹² 88/143 *Rich Products/Jus-Rol* [1988] OJ L69/21.

processes that could be used and the reasoning in *Maize Seed* was consequently not applicable.

The closed exclusive licence was seen by the Court as not only being incompatible with Article 81.1 but also not possible to exempt under Article 81.3. This was defined by the Court as an agreement where the parties proposed to eliminate all competition from third parties, such as parallel traders and other licensees. This means that an exclusive licence joined with territorial sales restrictions and intellectual property rights to create an absolute territorial protection will not be accepted. This far-reaching protection of the licensee “*manifestly goes beyond what is indispensable for the improvement of production or distribution or the promotion of technical progress*”.⁹³ The protection allowed for a licensee, without infringing Article 81.1, was thus after this judgement the protection against the licensor as well as against other licensees manufacturing in his territory provided that the conditions set up by the Court were fulfilled. The Court did not express its view on how far territorial protection was possible. It however expressly held that an exclusive licence agreement not automatically infringes Article 81.1 and that an exclusive licence agreement combined with contractual restrictions where the parties proposed to eliminate all competition from third parties violated Article 81.1 and could not be exempted under Article 81.3.

The Court once again had to deal with plant breeders’ rights in *Erauw-Jaquery*. This time the Court went as far as finding an export ban indispensable for the exclusive agreement and not infringing Article 81.1. However, the circumstances of the case were rather unusual and the Commission has later stated that the reasoning is not generally applicable to intellectual property licensing agreements.⁹⁴ The export bans were justified in this case since a strict control of quality was necessary in order for the plant variety to remain valid. The Court referred to the financial commitments made by the licensor, which justified the quality control. This control could not be made in other ways and was thus cleared.⁹⁵

7.4 The Windsurfing Judgement

The Court has since delivering the *Maize Seed* judgement only dealt directly with patent licensing agreements once. This was in *Windsurfing*⁹⁶, which was delivered in 1986. In the case the American firm Windsurfing International tried to impose restrictions on its German licensees going beyond the scope of the patent. Most of the disputed clauses of the agreement were not referring to territorial restrictions or exclusivity and the

⁹³ *Maize Seed*, para. 77.

⁹⁴ *Eighteenth Report on Competition Policy*, 1989, para. 103.

⁹⁵ *27/87 Erauw-Jaquery Sprl v La Hesbignonne Société Co-opérative* [1988] ECR 1919, para. 10.

⁹⁶ *193/83 Windsurfing International Inc. v Commission* [1986] ECR 611.

case will not be dealt with in detail here. However, the contested agreement contained one aspect of these issues. Windsurfing had set up a clause imposing a ban on manufacture in territories in which no parallel patent existed. According to the block exemptions, both the Patent Licensing Regulation that was in force at the time and the present regulation, such restrictions were white-listed only as long as parallel patents existed. This was not the case in the present situation.

Windsurfing was of the opinion that this restriction on the licensee was within the specific subject matter of its patent. The ban on manufacturing in other territories than provided for in the agreement was according to Windsurfing necessary in order to guarantee the quality of the products. The Commission however disregarded this argument and pointed out the possibilities for the licensees to enter into subcontracts to manufacture in Germany. This clause in the agreement was used by the licensees and Windsurfing had no control over these. The Court agreed in its judgement and held that this restriction preventing licensees from manufacturing in Member States where Windsurfing did not enjoy patent protection went beyond the scope of the patent. It thus restricted competition since it would prevent manufacturing and selling in these Member States.

8 Block exemptions issued by the Commission

8.1 Introduction

As shown in chapter 6, the Commission applies Article 81.1 widely. There is consequently a great need for exemptions. We shall now turn to look at how the Commission has tackled this issue.

The Commission has the exclusive power to exempt agreements under Article 81.3. This can be done either through the grant of an individual exemption or by the use of block exemptions granted by the Commission. In order for an agreement to be individually exempted, the parties must notify their agreement to the Commission. In some cases such a notification is dealt with formally. This however only occurs in a few cases every year. Normally the Commission sends a comfort letter to the parties of the agreement indicating that when looking at the information available in its view the agreement would benefit from an exemption, but no formal decision will be taken. Such a comfort letter is not enforceable in national courts. Because of the great number of agreements being notified to the Commission, it has also issued block exemptions for certain categories of agreements. Agreements that come within the terms of a block exemption do not need to be notified to the Commission, they are valid without its authorisation.

This automatic exemption has two major advantages. It increases the legal certainty for firms at the same time as the workload of the Commission is diminished. Certainly, there are also some disadvantages to the current system. Since there is such a difference from the complicated process of getting an agreement individually exempted the parties of the agreement are generally very interested in fitting their agreement under a block exemption. However, these are detailed and moreover only cover certain kinds of agreements. For instance, the Technological Transfer block exemption does not apply to agreements concerning other intellectual property rights unless these are ancillary to the patent licensed.⁹⁷

The Technology Transfer Regulation is made by the Commission under Regulation 19/65⁹⁸, which gives it the competence to declare Article 81.1 inapplicable to certain categories of agreements. The same basis was used when issuing the two block exemptions preceding the Technology Transfer

⁹⁷ Article 5.1.4 Technology Transfer Regulation.

⁹⁸ Council Regulation 19/65 On Application of Article 85(3) [now Art 81(3)] of the Treaty to Certain Categories of Agreements and Concerted Practices.

Regulation, the Patent Licensing Regulation⁹⁹ and the Know-How Licensing Regulation¹⁰⁰. The main reason for unifying these was the fact that most licensing agreements contain a mix of both patents and know-how.¹⁰¹ Because of this artificial division uncertainties arose as to which of the two block exemptions were applicable in such agreements. Before looking at the block exemption on Technological Transfer a quick look will be taken on its predecessors.

8.2 Earlier Block Exemptions

8.2.1 Patent Licensing Block Exemption

The need for a block exemption on patent licensing grew stronger with the more restrictive view of the Commission towards patent licensing generally and exclusivity and territorial restraints in particular. The need for a block exemption on patent licensing was therefore well known from the early years of the 1970's and preliminary drafts were made already in 1976. The final regulation was however not adopted until 1984. The long delay was a consequence of the complex and controversial nature of the matters involved. There was a fundamental disagreement concerning the objective of the block exemption.¹⁰² The Commission, on one hand, saw the block exemption as a way of extending the competition rules of the Community to patent licensing agreements in order to prevent circumvention. The representatives of the European industry, on the other hand, focused on the increased diffusion of technology and the enhanced welfare this would create. Until the last months before the final version was drafted the Commission was heavily criticised by industrial groups for being too hostile towards the patent rights. The Commission listened to some of this criticism and issued the regulation 2349/84 for the block exemption of patent licensing agreements, in which it expressed a more liberal view towards patent licensing than in the previous decisions.

8.2.2 Know-how Block Exemption

Know-how is formally not an intellectual property right. It does not confer a legal monopoly on the holder nor is it limited geographically or in time. However, it is of great economical value since it allows possession of or at least access to the most recent technology. The Patent Licensing Regulation was applicable to mixed agreements where the know-how was ancillary to the licensed patent. No regulation existed for pure know-how agreements or mixed agreements where the patent was ancillary to the know-how. This

⁹⁹ Commission Regulation 2348/84 on the application of Article 85.3 [now 81.3] to certain categories of patent licensing agreements [1984] OJ L219/15.

¹⁰⁰ Commission Regulation 556/89 on the application of Article 85.3 [now 81.3] to certain categories of know-how licensing agreements [1989] OJ L61/1.

¹⁰¹ Anderman S., *EC Competition Law and Intellectual Property Rights – The Regulation of Innovation*, p. 81.

¹⁰² Cawthra, B.I., *Patent Licensing in Europe*, p. 45.

created a legal uncertainty, which had detrimental effects on the diffusion of new technology in the Community.

Furthermore, in the *Bousois/Interpane*¹⁰³ decision the Commission indicated that the Patent Licensing Regulation was too inflexible to be applicable to various types of mixed technology licences. As an answer to this it later issued a second regulation for pure know-how licences and the mixed licences that did not qualify under the Patent Licensing Regulation, the Know-How Licensing Regulation. This block exemption contained an important definition of know-how. It was defined as “*a body of technical information that is secret, substantial and identified in any appropriate form*”.¹⁰⁴ By introducing this definition the Commission tried to avoid firms using the new block exemption as a way of getting anticompetitive agreements, without any innovative values, exempted.¹⁰⁵

8.3 Technology Transfer Regulation

The goal of the Technology Transfer Regulation is the harmonisation and simplification of the rules governing patent and know-how licensing agreements. The intention from the Commission when issuing it was that the regulation would encourage the dissemination of technical knowledge and the promotion of the manufacture of technically more sophisticated products.¹⁰⁶

8.3.1 Scope

The regulation applies to pure patent and pure know-how licensing agreements as well as to mixed licensing agreements containing both. Know-how is defined in Article 10.1 as technical knowledge that is secret, substantial and identified. It is applicable to agreements between two parties only.¹⁰⁷ Pure sales licences are not within the scope of the exemption since the aim is to facilitate the dissemination of technology and improve the manufacturing processes throughout the Community. In the case of a sales license, the licensee is not regarded to have done these kinds of investments deserving to be protected. Applicable in these cases is the block exemption for vertical agreements.¹⁰⁸

¹⁰³ 87/123 *Bousois/Interpane* [1987] OJ L50/30.

¹⁰⁴ Article 1.7.1 Know-How Regulation.

¹⁰⁵ Anderman, S., *EC Competition Law and Intellectual Property Rights – The Regulation of Innovation*, p. 79.

¹⁰⁶ Recital 3 Technology Transfer Regulation.

¹⁰⁷ Article 1 Technology Transfer Regulation.

¹⁰⁸ Commission Regulation 2790/99 on the application of Article 81.3 of the Treaty to categories of vertical agreements and concerted practices OJ L336. For the exact distinction between sale or distribution agreement and licensing agreement see Article 2.3 and 2.5 of this regulation and also the Guidelines on vertical restraints at para. 30.

After a brief overview of the provisions we will focus on how the Commission has solved the issues of exclusivity and territorial restraints in the regulation.

8.3.2 Structure

The structure of the new regulation is the same as that of its predecessors. Article 1 is the main provision and lists clauses that are in breach of Article 81.1 but merit exemption according to Article 81.3. Article 2 contains the white list. These are the clauses that usually do not infringe Article 81.1 but are exempted just in case they may do so in particular circumstances. The reason for including these is to increase the legal certainty for the parties forming their agreement. Articles 1 and 2 should however be read together with Article 7, according to which the Commission can withdraw the benefit of the block exemption where it finds in a particular case that an agreement falling within these first two Articles nevertheless has certain effects incompatible with Article 81.3.

Article 3 contains the black list. Inclusion of any of these terms means that the benefit of the block exemption is lost. Agreements containing such clauses can thus only be exempted by an individual exemption. Article 4 deals with the opposition procedure and states that obligations restrictive of competition not expressly exempted or white-listed in Articles 1 or 2 can be notified to the Commission. If the Commission does not oppose the application of the regulation on these “non-white” clauses within 4 months the agreement is exempted. The opposition procedure does not cover the black listed clauses in Article 3. Thus, an agreement containing blacklisted provisions cannot be exempted under this procedure.

Article 5 excludes certain horizontal agreements, such as patent pools, from the scope of the regulation. These arrangements may have serious anti-competitive effects and can therefore only be individually exempted. Article 5 also excludes licences of other intellectual property rights from the scope of the regulation, unless these provisions are ancillary to the patent licence. Article 6 includes sub-licences and assignments within the scope of the exemption. Article 8 contains a list of rights similar to patent rights, which are included in the block exemption.

8.3.3 Exclusivity and Territorial Restrictions

The view of the Commission regarding exclusivity and territorial restraints expressed in the block exemption is strongly influenced by the case law of the Court, most notably the *Maize Seed* judgement. In Recital 10 of the Technology Transfer Regulation the Commission gives its interpretation of the judgement:

*“Exclusive licensing agreements, i.e. agreements in which the licensor undertakes not to exploit the licensed technology in the licensed territory himself or to grant further licenses there, may not be in themselves incompatible with Article [81.1] where they are concerned with the introduction and protection of a new technology in the licensed territory, by reason of the scale of the research which has been undertaken and of the increase in the level of competition, in particular inter-brand competition, and in the competitiveness of the undertakings concerned resulting from the dissemination of innovation within the Community.”*¹⁰⁹

This refers to the open exclusive licences, which under certain circumstances do not infringe Article 81.1. In such cases there is no need to rely on the regulation. However, as shown above the Commission has interpreted the judgement narrowly in its decisions. There is therefore often a need to fit the agreement under the regulation. Exemptible exclusivity is dealt with in the first article. We will first look at how far the Commission has allowed protection between the licensor and his licensee, which was the situation in *Maize Seed*. Further on, the protection between licensees will also be dealt with.

8.3.3.1 Permitted protection between licensor and licensee

Articles 1.1.1-3 exempt clauses used to protect the licensor and licensee from exploiting the technology in the territory of each other.¹¹⁰

Exploitation is defined in the regulation as any use of the licensed technology.¹¹¹ According to these provisions the absolute territorial protection is permitted, but only as between the licensor and licensee. The licensee can be prohibited from using the licensed technology in any way in the territory of the licensor. Also, the same restrictions can be placed on the licensor as regards exploitation in the territory of the licensee. This is the same issue as dealt with by the Court in *Maize Seed*. In the judgement it was held that an open exclusive licence did not infringe Article 81.1, where it concerned the introduction of a new technology developed after years of research. Under the regulation the open exclusive licence are viewed as infringing Article 81.1, but merit exemption under 81.3. There are in the regulation no requirements that the technology should be new or a result of large investments. However, as will be shown below, the time limits in Article 1.2-5 have to be considered. The Commission has thus incorporated the *Maize Seed* judgement concerning the open exclusive licence under

¹⁰⁹ Recital 10.

¹¹⁰ Article 1 states that pursuant to Article 81.3, Article 81.1 shall not apply to agreements containing the following obligations:

1.1.1 an obligation on the licensor not to license other undertakings to exploit the licensed technology in the licensed territory;

1.1.2 an obligation on the licensor not to exploit the licensed technology in the licensed territory himself;

1.1.3 an obligation on the licensee not to exploit the licensed technology in the territory of the licensor within the common market.

¹¹¹ Article 10.10.

Article 81.3 instead of under Article 81.1 but on the other hand widened the scope by leaving out the requirements of novelty and financial investments.

8.3.3.2 Permitted protection between licensees

Article 1.1.4-6 deals with the permitted territorial protection between licensees.¹¹² Articles 1.1.5-6 deal with clauses generally referred to as export bans. These bans on selling the licensed product outside the licensed territory is an efficient way of dividing a market. They are therefore in evident conflict with the objective of market integration. On the other hand, the export bans are often necessary to protect licensees from competition, especially when starting up its business. Therefore a ban on active sales, i.e. where the licensee is actively seeking customers in the territory of another licensee, is permitted.¹¹³ The examples in the paragraph of ban on advertising specifically aimed at the territories of other licensees are not totally up to date and it is unclear how it should be applied to advertising on the Internet and in international TV-channels.¹¹⁴ The Commission has however expressed the view that the use of Internet is not, as a main rule, considered a form of active sales.¹¹⁵

A licensee can even be prohibited from answering to unsolicited orders from customers in the territory of other licensees.¹¹⁶ This is referred to as bans on passive sales. The exemption of these bans opens up for strong territorial protection. However, as will be seen below, the ban on restricting passive sales are only exempted during a shorter time. The licensees are during the first years of their business very vulnerable to competition. The investments required in tooling up their manufacture and selling organisation justifies protection during this period.

Export bans are thus exempted, opening up for a certain level of market division. Absolute territorial protection is however still not possible to obtain since the customers of the licensees are still able to import the licensed product into the territory of another licensee and sell it there. This is so because the patent right is exhausted when the product is placed on the market and contractual restrictions on the customers of the licensees are

¹¹² 1.1.4 an obligation on the licensee not to manufacture or use the licensed product, or use the licensed process, in territories within the common market which are licensed to other licensees;

1.1.5 an obligation on the licensee not to pursue an active policy of putting the licensed product on the market in the territories within the common market which are licensed to other licensees, and in particular not to engage in advertising specifically aimed at those territories or to establish any branch or maintain any distribution depot there;

1.1.6 an obligation on the licensee not to put the licensed product on the market in the territories licensed to other licensees within the common market in response to unsolicited orders.

¹¹³ Article 1.1.5.

¹¹⁴ Lidgard H. H., *Licensavtal i EU*, p. 108.

¹¹⁵ Commission notice *Guidelines on Vertical Restraints* [2000] OJ C 291/1, para. 51.

¹¹⁶ Article 1.1.6.

black listed.¹¹⁷ Furthermore, bans on passive selling to parallel traders situated within the territory of the licensee himself are black listed.¹¹⁸ Thus the bans on passive selling is only exempted during a short period of time and only as regards passive selling to dealers located outside the territory of the parties to the licensing agreement. The licensee cannot be restricted from meeting orders from customers in his own territory, even if he knows the customer will engage in parallel trade.

The ban on exercising intellectual property rights in order to impede parallel trading in the regulation might be seen as somewhat unnecessary since it already follows from the case law of the Court regarding free movement of goods. The inclusion of this provision is however in line with the Court's view in *Maize Seed* where it was held that the rules on competition should be applied independently of the rules on free movement of goods.¹¹⁹

8.3.4 Duration permitted

Although the main reason for replacing the Patent Regulation and the Know-How Regulation with the Technology Transfer Regulation was to include the use of both patent and know-how licences into one block exemption, there are still distinctions made between these in the new regulation. Different time-limits apply concerning territorial restraints depending if it is a pure patent licence agreement, a pure know-how licence agreement or a mixed licence agreement.¹²⁰ The reason for this differentiation is to be found in the fundamental differences between the two kinds of intellectual property rights. As regards the pure patent licence agreements the restrictions in Article 1 are limited in time to the period of parallel patent protection in the respective territories.¹²¹ After one of these patents has expired the exemption is withdrawn. For pure know-how licensing agreements this duration has to be calculated in a different way

¹¹⁷ Article 3.3 states that the exemption in Article 1 shall not apply where one or both of the parties are required without any objectively justified reason:

a. to refuse to meet orders from users or resellers in their respective territories who would market products in other territories within the common market;

b. to make it difficult for users or resellers to obtain the products from other resellers within the common market, and in particular to exercise intellectual property rights or take measures so as to prevent users or resellers from obtaining outside, or from putting on the market in the licensed territory products which have been lawfully put on the market within the common market by the licensor or with his consent;
or do so as a result of a concerted practice between them.

This prohibition is not absolute. These actions are only prohibited where no objectively justified reasons exist. The recitals contain no explanation of what the Commission understands as an objectively justified reason, which could make these restrictions legitimate. This is undoubtedly meant to be applied restrictively since it an exception to the main rule of parallel trade, which plays a central part in fulfilling the objective of market integration, see Lidgard, H. H., p.121.

¹¹⁸ Article 3.3.a.

¹¹⁹ 258/78 *Nungesser KG and Kurt Eisele v EC Commission (Maize Seed)* [1982] ECR 2015 at para. 63.

¹²⁰ Article 1.2-5.

¹²¹ Article 1.2.

since there is no legal protection of the know-how as for patents. The time when the patent has expired and no longer is protected is as concerns know-how the time when the know-how no longer is secret. This point in time is of course not possible to determine, but has been set to 10 years from the first marketing of the product within the Community by a licensee.¹²² The time limits for the restrictions of passive sales in Article 1.1.6 are limited to five years for both pure patent and pure know-how agreements.¹²³

Regarding mixed licences the territorial restrictions, except the restriction on passive sales, may be permitted for either 10 years from the date the product is first placed on the Common Market by one of the licensees or for the duration of the licensed necessary¹²⁴ patents in each territory. The restrictions on passive sales are, just as for the other kind of licenses, set to 5 years.¹²⁵ By introducing the concept of necessary patents the Commission has tried to prevent parties from licensing a newer patent in order to prolong the exemptions for the territorial restraints. This way the parties can only prolong these restraints by licensing a relevant patent. Such patents must therefore be of technical, legal or economic interest to the licence. Difficulties may of course arise in deciding when, according to the definition in the regulation, a patent is “necessary” or not. Also the fact that technology is often continuously developed could make it hard to determine at what stage there has emerged a new product which would start another period of territorial protection.¹²⁶

The common starting point for all these time limits is the time from when the licensed product is first put on the market within the Community by one of the licensees. This means that the protection permitted for the different territories dates from the same time. Consequently, a licensee who is granted a licence at a later stage than the other licensees will enjoy territorial protection during a shorter period of time. This could have a negative effect on licensors who do not have the resources needed in order to set up a network of licenses covering the entire Community. Such a company might want to gradually license out to a couple of countries at a time. The later licences enjoying a shorter time of protection would then be less valuable.¹²⁷

¹²² Recital 13 and Article 1.3.

¹²³ Articles 1.2 and 1.3.

¹²⁴ Necessary patents are defined in Article 10.5 as: *patents where a licence under the patent is necessary for the putting into effect of the licensed technology in so far as, in the absence of such a licence, the realisation of the licensed technology would not be possible or would be possible only to a lesser extent or in more costly conditions.*

¹²⁵ Article 1.4.

¹²⁶ Robertson, A., *Technology Transfer Agreements: An Overview of how Regulation 240/96 Changes the Law*, 3 ECLR [1996] p. 160.

¹²⁷ Anderman, S., *EC Competition Law and Intellectual Property Rights – The Regulation of Innovation*, p. 96.

Territorial restrictions extending beyond the time-limits are black listed.¹²⁸ These longer territorial restrictions can only be exempted through an individual decision.¹²⁹ If improvements result in innovations that are distinct from the licensed technology the parties can always enter into a new agreement and this way benefit from the exemptions in the regulation.

8.3.5 Differences from earlier Block Exemptions

The new block exemption is different from the two earlier ones in a couple of aspects. Generally it can be said that the Technology Transfer Regulation is more liberal towards licensing than its predecessors. In the years before adopting the regulation, the Commission acknowledged in a White Paper the importance of licensing to the diffusion of new technology and the resulting increased competitiveness of Europe vis-à-vis US and Japan.¹³⁰ A conclusion drawn in this report was that in order to improve the conditions for the diffusion of new technologies the rules on competition had to be less stringently applied. An expression of this approach can be seen in the fact that the time periods for territorial exclusivity have been extended in many cases. This way the possibilities of protecting the licensee against intra-brand competition are increased. Furthermore, the white list has been extended at the same time as the black list has been shortened. Also, the opposition procedure has been simplified in order to facilitate the examination of grey clauses.

Still, the more profound problems remain. Because of the wide application of Article 81.1, almost all exclusive licences fall within Article 81.3. This creates an uncertainty for firms entering into licensing agreements. Because of the time-consuming process of getting an individual exemption, the parties to the agreement are under strong pressure to fit the agreement under the regulation. This system does not allow a great deal of flexibility, which in turn could have detrimental effects on the willingness to invest and the possibilities of getting a product onto the market.

¹²⁸ Article 3.7.

¹²⁹ Recital 14.

¹³⁰ See European Commission's White Paper on Growth, Competitiveness, Employment: *The Challenges and Ways Forward into the 21st Century*, COM (93) 700, December 1993.

9 Licensing and the principle of exhaustion

9.1 Introduction

In this chapter we will further explore the boundaries of the permitted territorial limitations in patent licensing agreements under EC law, focusing on the possibility of the licensor to protect its licensees from each other. This is an area, which is to a large extent left unclear and the Court and the Commission seem to have different views. When looking at this some more underlying, principal questions will also be dealt with. This includes the question of how to apply the doctrine of exhaustion to licensing agreements. When exactly does the exhaustion occur and in what ways does this affect the licensing agreements?

9.2 View of the Commission on principle of exhaustion

As held above in chapter 4, Community law cannot affect the existence of national intellectual property rights. Nor can the proper exercise of these rights be affected. This exercise is the exercise needed to safeguard the rights, which constitute the specific subject matter of the intellectual property right in question. These demarcations have been elaborated by the Court in its case law, which the Commission is obliged to follow.¹³¹ Since the Commission has not directly adopted the terminology of the Court, one is left with interpreting the block exemption issued and the decisions taken.

In the block exemption the Commission indirectly expresses its view on the effect of the principle of exhaustion on licensing agreements. In Article 1 of the Technology Transfer Regulation it considers territorial limitations as infringing Article 81.1 and requiring exemption under Article 81.3. Thus, these limitations are not within the specific subject matter of the licensed intellectual property right. If this were the case these limitations would not be seen as an improper exercise of the right but instead belonging to its existence and not being subject to Community law. As described in chapter 6 above, the Commission originally indicated in its Christmas Message that it would not consider a patent licence agreement where the licensor limited the rights of the licensee as violating Article 81.1. These limited licensing agreements were only seen as an expression of the licensor subdividing his exclusive right. In the following years this view changed and in its

¹³¹ The Court has the monopoly in interpreting the Treaty according to Article 220. See also Recital 11 Technology Transfer Regulation.

decisions, the Commission held that territorially limited licences were in fact restricting competition.

The approach of the Commission is based on the view that the granting of a licence exhausts the intellectual property right. Since this right is exhausted when granting a licence, any limitations in the agreement are contractual and therefore subject to competition law. According to this view a sales license granted for only a part of the Common Market amounted to a licence to sell throughout the Common Market combined with contractual restrictions. This view followed from the Commission's interpretation of the case law of the Court under the free movement of goods. But this interpretation is not undisputed and we will now look at the basis for the Commission's standpoint.

9.3 Case law of the Court

The Court held in *Centrafarm v Sterling Drug*¹³² that the patentee had no right under his intellectual property right to prevent the import of protected products into one Member State if it had been marketed by the patentee, or with his consent, in another Member State.

In the judgement the Court referred to marketing in the territory of export by or with the consent of the holder as the criteria for exhaustion of the patent right.¹³³ It is not clear from the judgement, however, if the grant of the licence in itself exhausts these rights. This was nonetheless the interpretation made by the Commission. By extending the scope of the doctrine of exhaustion this way, the Commission limited the scope of national intellectual property rights and consequently also the possibilities of circumventing the rules on competition.

The question is thus if it is the granting of the licence as such that exhausts the intellectual property right or if this occurs only after the licensed product is actually put on the market, either by the patentee or with his consent. The granting of a sales licence can be seen as consenting, although indirectly, to the licensee putting the product on the market. This indicates that the right is exhausted. Moreover, a fundamental reason for the principle of exhaustion to apply when marketing the product is the fact that the patentee thereby is rewarded for his creative effort. A reward is however also received when the patentee decides to licence out his innovation. On the other hand, the products are not put on the market as a direct consequence of the grant. The marketing requires additional action from the licensee. In conclusion, the question of when the principle of exhaustion applies is not finally decided. On a literal interpretation it seems that it requires the marketing of patent protected goods in another Member State. By applying a more contextual approach, as the Court has done in several judgements before, one can

¹³² 15/74 *Centrafarm B.V. v Sterling Drug Inc.* [1974] ECR 1147.

¹³³ *Ibid.*, para. 12.

clearly argue that the intellectual property rights are exhausted when granting a licence for another Member State.

We will now turn to an aspect of licensing where this question has important practical implications, namely the use of intellectual property rights to prevent direct sales from one licensee into the territory of the licensor or other licensees.

9.4 Direct sales

By direct sales is meant that products are exported for the purpose of sale by a licensor or a licensee who holds the right in one Member State directly to a person in another Member State, without having marketed the product in the first country. The key question in this context arises whether or not the patentee can use his patent right to prevent direct sales from one of his licensees into the territory of another. The possibility of isolating the licensees this way without having to rely on contractual restrictions is important to the value of licensing. This in turn depends on at what time the right of the patentee is exhausted and the rules on free movement applies.

The Court has never clarified this. In *Pharmon v Hoechst*¹³⁴ the Court dealt with direct sales by a licensee into the territory of the licensor, although under a compulsory licence. The Advocate General Mancini in his opinion suggested that exhaustion should apply to direct sales generally.¹³⁵ In his view, the decisive factor for exhausting the patent rights and consequently upholding the rules on free movement was the consent of the patent holder. Thus, the licensor would not be able to prevent his contractual licensee from exporting directly into his territory by using his patent. The opinion delivered by Advocate General Mancini thus supported the view of the Commission. The Court chose not to address the question of the effects under a voluntary licence but limited its judgement to compulsory licences. The Court held that the patentee could not be seen to have consented to putting the product on the market in such a case. The question of exhaustion of his rights was therefore not relevant.

The *Maize Seed* case did not deal with direct sales as such but instead more generally with the level of protection allowed between licensor and licensee. In the judgement the Court held that open exclusive license was one where “*the exclusivity of the licence relates solely to the contractual relationship between the owner of the right and the licensee*”¹³⁶ This was put in contrast to the closed exclusive licence where the exclusivity is joined with territorial sales restrictions and intellectual property rights in order to create an absolute territorial protection where the parties are trying to “*eliminate all*

¹³⁴ 19/84 *Pharmon v Hoechst* [1985] ECR 2281.

¹³⁵ *Ibid.*, p. 2285.

¹³⁶ 258/78 *Nungesser KG and Kurt Eisele v EC Commission (Maize Seed)* [1982] ECR 2015 at para. 53.

competition from third parties, such as parallel importers or licensees for other territories."¹³⁷

The Court thus cleared as an open exclusive licence the obligation on the licensor not to compete with the licensee in his territory and not to grant other licences in the area. An obligation on the licensee not to sell in the territory of the licensor ought therefore also be regarded as falling outside the scope of Article 81.1, since it relates solely to the contractual relationship between licensor and licensee and has no direct implications on parallel traders or licensees in other territories. But an obligation on the licensee not to sell in the territory of another licensee certainly has such direct implications. This would indicate that such obligations do infringe Article 81.1 and are not within the specific subject matter of the property right. The Court did not in the judgement refer to the specific matter of plant breeder's rights nor the distinction between the existence and exercise of national intellectual property rights, but instead focused on the need for protection against competition in order to induce investment.

The distinction made between the protection allowed between licensor and licensee and the protection allowed between licensees seems questionable. Why should a licensee only deserve protection from his licensor and not from other licensees? The licensee is faced with the same problem of parallel imports regardless of whether these origins from the licensor or the licensee. The judgement does not provide any answers to this. The Court perhaps found it reasonable to protect a licensee from the licensor, since the latter may have had a competitive advantage, compared to a licensee, due to its prior experience of the licensed technology.¹³⁸ However, as long as the licensee is not sheltered from competition from all directions, the investments made cannot be protected and the underlying objective is failed.¹³⁹

The *Maize Seed* judgement does not provide any straight answers whether restrictions on selling into the territories of other licensees amounts to an open exclusive license or conferring absolute territorial protection. On a literal interpretation of the judgement, the Court held that absolute territorial protection is allowed as between licensee and licensor, but if the competition from other licensees is also eliminated the licence is regarded as a closed exclusive licence, which is not exemptable under Article 81.3. This part is in line with the approach of the Commission. In the reasoning of the Court, however, there seems to be an acceptance of the need to protect licensees from each other in order to increase the diffusion of new

¹³⁷ Ibid.

¹³⁸ Anderman, S., *EC Competition Law and Intellectual Property Rights – The Regulation of Innovation*, p. 67.

¹³⁹ Korah, V., *Technology Transfer Agreements and the EC Competition Rules*, n. 52 at p. 74.

technology throughout the Community.¹⁴⁰ The fact that the Court held the protection of licensees against the competition of each other as a criterion automatically transforming an open exclusive licence into a closed, which could not be exempted, is surprising.

Turning to the Technology Transfer Regulation, we can first of all notice, as described above in chapter 8.3.3.2, that the Commission in Article 1.1.6 exempts for a period of five years from the first putting on the market by a licensee in the Community of the licensed product a ban on a licensee selling into the territory of another licensee. According to Article 1.1.5 a ban on active selling into the same territory can be prohibited for a longer time. These export bans are thus seen as falling outside the specific subject matter of the patent and violating Article 81.1, but meriting exemption for a limited time under Article 81.3.

In the Technology Transfer Regulation there is however a new provision that did not exist in neither the Patent Regulation nor the Know-How Regulation. According to Article 2.1.14 the Commission white-lists the reservation by the licensor a right to exercise his patent right to oppose the exploitation of the technology by the licensee outside the licensed territory. The insertion of this provision implies that the patent right of the licensor is not exhausted when granting the licence to the licensee.¹⁴¹ The patent right of the licensor cannot be exhausted when granting a licence and at the same time be used to prevent sales by licensees outside his licensed territory. Consequently, the new block exemption contains two different approaches regarding the principle of exhaustion, which are mutually inconsistent. This would imply that direct sales from a licensee outside his territory exhausts the patent right.

The question whether or not direct sales from one licensee into the territory of another can be prevented by a patent right has practical implications and show clearly the interaction of competition law and the rules on free movement of goods. If the prevention of these sales is seen as being within the specific subject matter of the patent, and thus not exhausting the patent, then the holder of the patent is capable of prohibiting these sales. This prevention can then be achieved without having to rely on contractual obligations, thus falling outside Article 81. As a result of this the block exemption is not applicable and its time limits do not come into play. If, on the other hand, the direct sales from one licensee into the territory of another is seen as exhausting the patent then the only way of preventing these is by contract. These restrictions would then consequently fall within the scope of competition law. The main problem connected with this are the time-limits, which start running from when the licensed product is first put on the market within the Community. If a licensee is granted a licence some time after this

¹⁴⁰ 258/78 *Nungesser KG and Kurt Eisele v EC Commission (Maize Seed)* [1982] ECR 2015 at para. 58.

¹⁴¹ *Korah, V.*, p. 205.

first was done, the protection possible for him is considerably reduced. The right under Article 2.1.14 to prevent direct sales from a licensee into the territory of another licensee only exists during the lifetime of the patent. The duration of all national patents in the Community today is 20 years. The time when this provision can come into play is consequently the time after the time limits have expired and before the patent right has. In the recitals of the new block exemption the Commission underlines that the view taken in this matter does not prejudice any developments in the case law of the Court.¹⁴²

It should be noted that even in the case that direct sales could be prevented by the use of the patent right, an absolute territorial protection is under no circumstances possible to create. Restrictions cannot be put on the customers of the licensees. These are always allowed to engage in parallel trade. Consequently the issue of direct sales is of greatest importance when doing business in products not suitable for parallel trade, such as individually suited goods.

¹⁴² Recital 11 Technology Transfer Regulation.

10 Conclusions

The approach of the Commission taken towards exclusive licence agreements must be seen in the light of the development of the Community as a whole. The active role played by the Commission, striking down on almost all exclusive agreements in the 1970's, was perhaps necessary in order to speed up the market integration process. This had a negative impact on the diffusion of new technologies throughout the Community. After the new input from the Court in the *Maize Seed* judgement focus moved away from the objective of market integration. In the future, as the economic integration proceeds, a less interventionist approach can be expected and more focus will be placed on the diffusion of new technologies. Economic efficiency will gain power on behalf of the market integration objective.

In practical terms, the balancing has been made between allowing co-operation needed in the diffusion of new technology on the one hand and the need to guarantee the right of third parties, in the form of parallel trade, on the other. The role of the parallel trader is crucial to the objective of market integration. The Court has repeatedly taken the position of a parallel trader as a point of reference when delivering judgements on territorial limitations. The work of the parallel trader levels out price differences in the Community and this way contributes to the market integration. One problem with this approach is the fact that a true Common Market does not exist as of today. The national intellectual property laws are still not harmonised and differences in scope remain. As a result, the value of intellectual property differs from one Member State to another and consequently also the prices for the protected goods. The difference in protection is a result of the lack of political activity in the area. The Court pointed at the problems arising out of this in the early years of the work of the Community, but the laws are still mainly national. The price for this inactivity is however today paid by the holders of the intellectual property rights, who are exposed to competition from the entire Community without having a possibility of taking advantage of the existing price differences in the same. These differences in price are today in the hands of parallel traders, who are free riding on the innovations made by the patent holders. Focus should in the first place be focused on integration through a unification of the intellectual property laws of the Member States of the Community. Until this has been realised a heavier burden of the inactivity should be borne by the Member States themselves rather than the right holders.

What then is the effect of focusing too much on parallel traders instead of allowing stronger territorial protection between the parties of the licensing agreement? Whatever approach is taken by the Commission it will have direct implications on market structure, especially in sectors where the manufactured goods is trader exposed, i.e. where the transport costs are

small compared to the value of the goods. Industries manufacturing these kinds of products, such as pharmaceuticals, might consider other ways of exploiting their intellectual property rights than licensing. These firms have in many occasions chosen to integrate vertically in order to keep the technology within the company as close to the end consumer as possible and this way avoid the coming into play of Article 81 of the Treaty, which presupposes an agreement between two independent undertakings.¹⁴³ This decreased diffusion of technologies would probably have a negative impact on the general level technology in the Community and consequently also be detrimental to the competitiveness of the Union. To small- and medium-sized companies these effects can be even more detrimental since these companies often lack the capital resources needed to integrate vertically.

The distinction between the existence and the exercise of an intellectual property right is fundamental to the understanding of the Community law in this area. This distinction was first elaborated under the rules on competition but was later transposed also to the rules of free movement of goods. This is significant for the way in which different parts of Community law have interacted when dealing with trade in goods protected by intellectual property rights. Another example is the fact that the exception in Article 30, permitting some exercise of the rights, has been transposed to the rules on competition, which originally seemed to be fully applicable to the exercise of these rights. This interaction is present also in the field of licensing of intellectual property rights. The Commission has when tackled the questions of patent licensing also been forced to deal with general principles regarding the relationship between national intellectual property laws and the EC law concerning free movement of goods. Generally, the Commission has limited the scope of national intellectual property rights by interpreting the Community law widely. However, by inserting Article 2.1.14 in the new block exemption the Commission has taken on a new approach, which might indicate a future change in coming decisions and regulations.

This area of law is heavily influenced by the judgement of the Court in *Maize Seed*. In this judgement the Court opened up for a more economical rule of reason approach in contrast to the formalistic approach earlier used by the Commission. This was clearly a step forward making the analysis of the exclusive licences more sophisticated. However, the case left many questions open. It is for instance not clear whether an open exclusive licence will only be held not to violate Article 81.1 under the conditions given in the case or if these only were given as examples. Furthermore, the judgement gives contradicting indications as regards direct sales. It is still unclear whether the insertion of a restriction of such sales into the licensing agreement will transform it into a closed exclusive licence.

¹⁴³ See *Centrafarm v Sterling*, where an agreement between a parent and a subsidiary was seen as an internal allocation of functions and therefore falling outside the scope of Article 81.

Although a clarification by the Court on these issues would be most welcomed, these theoretical uncertainties are not evident to parties entering into a licensing agreement. Because of the use of block exemptions the parties are provided with detailed provisions limiting their freedom. The Technology Transfer Regulation is an expression of an increased priority given to the diffusion of technologies over the objective of market integration. The regulation clearly has, by unifying the two earlier regulations, made the treatment of mixed patent and know-how agreements less artificial. The regulation has proven to be successful, which not least can be seen in the lack of decisions taken by the Commission in the area since it entered into force.

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