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THE APPROACHES OF THE EUROPEAN COMMISSION AND THE U.S. ANTITRUST AGENCIES TOWARDS EXCLUSIVITY CLAUSES IN LICENSING AGREEMENTS

SERGIO BACHES OPI*

Abstract: This Article examines and compares the differing treatment of territorial restraints in licensing agreements under United States (U.S.) antitrust law and European Union (E.U.) competition law. While in the U.S. vertical territorial restraints are assessed under the Rule of Reason, in the E.U. they often are considered illegal per se, unless exempt under the E.U. Technology Transfer Regulation or by an express decision of the Commission addressed to the parties to the licensing agreement. Yet, even if a licensing agreement is exempt under the E.U. Regulation, the Regulation imposes severe time limitations on exclusivity clauses. These different approaches in the U.S. and the E.U. may be explained by the fact that, unlike U.S. antitrust agencies, the Commission still perceives competition rules as an instrument to attain a wider objective: i.e. market integration. This Article concludes that, in view of the achievements of the market integration process in the E.U., it is time for the Commission to adopt a more liberal approach towards these types of clauses.

INTRODUCTION

This article contrasts the approaches taken by the U.S. courts and antitrust agencies and the Commission of the European Communities (the Commission) on clauses granting sole and exclusive licenses. A

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licensing agreement may involve exclusivity in different respects. The licensor may grant one or more sole licenses, which prohibit the licensor from granting others licenses to use the licensed technology, or one or more exclusive licenses, which restrain the licensor itself from using the technology, or a combination of both.

Agreements involving sole and exclusive licenses may raise antitrust issues in myriad situations. Sometimes, a licensor grants absolute territorial protection to a licensee because the licensee otherwise may not be willing to make the necessary investments to set up a production line and a distribution network for the licensed product or service. In addition, a licensor may want to obtain from the licensee an exclusive license or the assignment of future improvements to or new applications of the licensed technology, thereby preventing the licensee from using its new improvements (exclusive grant-back clause).

A license agreement also may contain a non-compete clause (exclusive dealing). A non-compete clause prevents the licensee from licensing, using, or distributing goods produced under competing technologies.

Finally, an exclusivity clause may be found in a license agreement between the parties in a horizontal relationship. Two parties to a horizontal relationship may agree to issue licenses for their respective technologies to each other on an exclusive basis (cross-licensing). This Article focuses its analysis on sole and exclusive licenses.

This Article first analyzes the frameworks for evaluating antitrust restraints in the E.U. and the U.S. Next, it considers whether the U.S. Antitrust Guidelines for the Licensing of Intellectual Property\(^\text{1}\) and the E.U. Technology Transfer Block Exemption\(^\text{2}\) narrow the existing differences between the two enforcement systems' policies on exclusivity clauses in license agreements or, rather, perpetuate the traditionally inconsistent approaches pursued by the E.U. and the U.S. 

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I. FRAMEWORK FOR EVALUATING ANTITRUST RESTRATNS IN THE E.U. AND THE U.S.

In order to understand why a licensing agreement may be subject to different substantive legal standards in the E.U. and the U.S., it is necessary to compare the frameworks for evaluating antitrust restraints applied by the Commission and the U.S. agencies. First, the Commission applies a restrictive approach towards restraints of conduct, whereas U.S. antitrust law employs a Rule of Reason analysis. Second, the Commission tends to consider as "horizontal agreements" those licensing agreements which U.S. agencies consider "vertical agreements." U.S. agencies analyze license agreements ex ante while the Commission often analyzes them ex post. Thus, the Commission often deems a license horizontal even if the licensee is not able to compete with the licensor but for the license. The underlying reasoning of the ex post analysis is that once the licensor has innovated and the licensee has established a production line and developed a market, it is more competitive to have more firms in the market.

A. The Restrictive Approach Adopted by Commission Towards Restraints of Conduct

1. The E.U. Block Exemption System

The application of E.U. competition law is based on a dual enforcement system. The Commission, the national courts (NCs), and the administrative authorities (NAs) all have jurisdiction to apply Article 81 (1) of the EC Treaty. The drawback of this system is the risk of a lack of uniformity in the interpretation and application of the competition rules of the EC Treaty.

3 Reg. Monograph, supra note 2, at 19-25.
4 Id. at 12-13.
5 Id. at 242.
7 See R. Joliet, RULE OF REASON IN ANTITRUST LAW 174 (1967); see also M. Waelbroek, Antitrust Analysis Under Article 85(1) and Article 85(3), in 1987 FORDHAM CORP. L. INST. 693, 697 (Barry Hawk ed., 1988).
In the early 1960s, there was a risk that the application of EC competition law by NCs and NAs with diverse legal traditions was a danger to the uniform application of EC competition law in all Member States.\(^8\) Perhaps the Commission reasoned that the most effective way to limit the discretion of national competition authorities was to interpret the prohibition of Article 81 (1) as broadly as possible.\(^9\) The exclusive power vested in the Commission to grant individual exemptions under Article 81 (3) allowed this broad interpretation.\(^10\) This broad interpretation of Article 81 (1) led the Commission to apply Article 81 (1) to agreements regardless of whether the restraints of conduct contained therein had pro-competitive effects or had few or no anti-competitive effects.\(^11\)

As a result of the broad application of Article 81 (1), the Commission began to experience a backlog in the notifications,\(^12\) and its officials feared that the Commission would receive a flood of notifications of agreements that did not raise significant competition concerns.\(^13\) In order to reduce the Commission’s workload, to accelerate the review of individual notifications and other antitrust files, and ostensibly to promote legal certainty,\(^14\) the Commission decided to rely on block exemptions to exempt automatically certain categories of agreements.\(^15\)

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\(^8\) See V. Korah, EC COMPETITION LAW AND PRACTICE 125 (6th ed. 1997) [hereinafter Introductory Guide].


\(^11\) Barry E. Hawk, System Failure: Vertical Restraints and the EC Competition Law, 32 C.M.L.R. 973, 974-75 (1995); JOLIET, supra note 7, at 174.

\(^12\) Regulation 17/62 introduced a notification system and granted the Commission the exclusive power to grant individual exemptions under Article 81 (3) of the EC Treaty, 1959–1962 O.J. SPEC. ED. 87.


Under Article 81(3) of the EC Treaty, however, it was unclear whether the Commission had the power to issue block exemptions.\(^\text{16}\) Thus, the Commission obtained that power from the Council of the European Communities through Regulation 19/65.\(^\text{17}\) The group exemption method is, to a certain extent, a self-regulatory mechanism. If parties construct their agreements so that they fit within block exemptions, they can be certain that the agreements do not violate Article 81(1).\(^\text{18}\)

2. The Relationship Between Article 81(3) of the EC Treaty and the Rule of Reason

The block exemption system has been criticized for being too formalistic and incapable of curing the main shortcoming of the EC competition system—the lack of efficient substantive analysis to assess the likely competitive harm of an agreement.\(^\text{19}\) Agreements that do not fit into one of the block exemptions or that do not yield the benefits described in Article 81(3) violate Article 81(1), even if they do not significantly impair competition.\(^\text{20}\) Consequently, some scholars advocated for the Commission’s employment of a less legalistic approach that would place greater emphasis on factual economic considerations.\(^\text{21}\)

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\(^{16}\) Introductory Guide, \textit{supra} note 8, at 71.

\(^{17}\) Regulation 19/65, on Application of Article 85(3) of the Treaty to Certain Categories of Agreements and Concerted Practices, 1965 O.J. 36/533.

\(^{18}\) The Commission has withdrawn the exemption only in one case. \textit{See} Case T-7/93, Langnese-Iglo, 1995 E.C.R. II-1533, ¶ 209-10. The Commission is more likely to threaten the parties to withdraw an exemption than to persuade them to amend the agreement in accordance with its views. This approach was taken in Tetra Pak I, 88/501/EEC, 4 C.M.L.R. 479 (1990). The Commission’s decision was upheld on appeal by the C.F.I. Case T-51/89, Tetra Pak Rausing SA v. Commission, 1990 E.C.R. II-309; \textit{see} D.G. GOYDER, \textsc{EC Competition Law} 287 (3d ed. 1998).

\(^{19}\) Hawk, \textit{infra} note 11, at 986.

\(^{20}\) \textit{Id.} at 115. The leading case to understand how both the E.C.J. and the Commission have applied this rigid and formalistic approach towards vertical restraints is Cases 56 & 58/64, Etablissements Consten SA and Grundig-Verkaufs-GmbH v. EEC Commission, 1966 E.C.R. 299 [hereinafter Consten and Grundig]. In this case, the E.C.J. upheld a decision by the Commission prohibiting an exclusive distribution agreement without even inquiring into its possible pro-competitive effects in the market.

Nonetheless, the Commission frequently has refused to adopt a more flexible approach in its application of Article 81(1).\textsuperscript{22} The Commission has stressed that its analysis under Article 81(3) takes into account economic considerations because that analysis takes place at the stage of the Rule of Reason analysis.\textsuperscript{23} Moreover, the Commission opines that the introduction of a full-blown Rule of Reason in its application of Article 81(1) would lead to the setting aside of competition rules on the grounds of political or non-economic considerations.\textsuperscript{24} The Commission seems to rely on a simplistic view of the Rule of Reason and also appears to misunderstand the nature of this rule. Article 81(3) of the EC Treaty is not the equivalent of the Rule of Reason.\textsuperscript{25}

First, Article 81(3) exhaustively lists the factors the Commission must consider in order to decide whether to grant an exemption. The Rule of Reason analysis, in contrast, entails a more flexible inquiry that varies in focus and detail depending on the nature of the agreement and on market circumstances.\textsuperscript{26} The U.S. agencies may consider factors in their overall analysis such as those listed in Article 81(3) but, unlike in the E.U. exemption system, the U.S. Rule of Reason analysis is less rigid because no factor is dispositive in that analysis.\textsuperscript{27}

The requirements that an agreement must fulfill under Article 81(3) are more extensive than those of the U.S. Rule of Reason. Arti-

\textsuperscript{22} In its "White Paper on Modernization of the Rules Implementing Articles 85 and 86 of the EC Treaty," 1999 O.J. (C 132) 1 [hereinafter "White Paper"], the Commission explicitly refused to adopt a Rule of Reason approach. The Commission's refusal was based on four arguments: (i) it would require a reform of the EC Treaty; (ii) Article 81(3) of the EC Treaty already contains the elements of a Rule of Reason; (iii) the modernization of the application of EC Competition law cannot be made dependant upon developments in decision-making practice; and (iv) a Rule of Reason approach could lead to the setting aside of competition rules because of political considerations. Id. at § 57.

\textsuperscript{23} See Gutusso, supra note 14, at 235–36.

\textsuperscript{24} See White Paper, supra note 22, point (iv).

\textsuperscript{25} Account must be taken of the fact that, even in the U.S., the Rule of Reason concept remains vague, despite being the dominant form of analysis for Section 1 Sherman Act cases. Thomas A. Piraino, Jr., Making Sense of the Rule of Reason: A New Standard for Section 1 of the Sherman Act, 47 Vand. L. Rev. 1753, 1764 (1994).


\textsuperscript{27} In Continental T.V., Inc. v. GTE Sylvania, Inc., the Court held that, "[u]nder this rule the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition." 493 U.S. 36, 49 (1977); see also Antitrust Guidelines, supra note 26, ¶ 1.2.
Article 81(3) requires the Commission to determine whether the agreement improves distribution or production or promotes technical or economic progress, and whether consumers are being allowed a fair share of the benefits resulting from such improvements. Moreover, the claimed restriction must be "indispensable" for the attainment of these objectives and must not afford firms the possibility of eliminating competition in respect to a substantial part of the products in question.\footnote{See Consten and Grundig, 1966 E.C.R. at 348; Case 258/78, Nungesser v. Commission, 1982 E.C.R. 2073, ¶ 77.}

The initial inquiry under a Rule of Reason analysis is whether the challenged agreement is likely to harm competition and deprive consumers of the advantages of a freely competitive system.\footnote{The Guidelines for Collaborations Among Competitors seem to indicate that, for the U.S. agencies, the ultimate aim of antitrust laws is to protect consumer welfare. See §§ 2.1., 3.2., and 3.36. In light of its judgment in the State Oil Co. v. Khan case, the Supreme Court also appears to consider consumer welfare as the ultimate goal of antitrust laws. 522 U.S. 3, 15 (1997).} Only when this initial inquiry is answered in the affirmative will U.S. authorities engage in a full market analysis.\footnote{See IP Guidelines, supra note 1, ¶ 3.4; see also NCAA, 468 U.S. at 103–04.} This full market analysis weighs the anti-competitive effects of the restrictive agreement with its pro-competitive effects. Under the Rule of Reason, however, the essential question is not whether the claimed restrictions are "indispensable" to improve production or distribution, or to promote technical progress, but rather whether the anti-competitive effects of the restrictive agreement outweigh its pro-competitive effects.\footnote{Eleanor Fox, Maize Seed: A Comparative Comment, in 1982 FORDHAM CORP. L. INST. 151, 157, 159 (Barry Hawk ed., 1983); V. Korah, The Effect of EEC Competition Rules on Distribution of Goods and Services in Europe, in 1 1996 INT'L INTELL. PROP. LAW & POL'Y 395, 398–99 (Hugh C. Hansen ed., 1996).} In the field of vertical restraints, this inquiry requires the decision-maker to balance the fact that the protection granted under the agreement may be necessary to induce the dealer to invest in advertising, promotion, and providing information and service to customers with the potential harms to competition that may arise from the agreement by increasing the ability or incentive to raise prices or reduce output, quality, service, or innovation below what it likely would be in the absence of the agreement.\footnote{Fox, supra note 31, at 157.} Thus, the difference between the two systems is apparent: in the U.S., an agreement in principle may escape the prohibition of Section 1 of the Sherman Act without being indispensable to improving distribution or production and without giving consumers a fair
share of the benefits, or simply without improving distribution or production, provided it is not likely to harm competition.\textsuperscript{33}

Second, contrary to the Commission’s understanding of the Rule of Reason, the Rule of Reason does not induce antitrust authorities to consider non-economic factors in the antitrust analysis. The Rule of Reason analysis is based exclusively on competitive considerations.\textsuperscript{34} U.S. Supreme Court jurisprudence shows that courts may take into account policy or social considerations only to decide whether a specific restrictive practice is given “per se” treatment, “quick look” treatment, or “full-blown” Rule of Reason treatment.\textsuperscript{35}

3. The U.S. Approach: the Creation of the Rule of Reason to Limit the Prohibition of Section 1 of the Sherman Act

Unlike the Commission, the U.S. agencies and courts distinguish between restraints that are per se illegal and those that merit a Rule of Reason analysis.\textsuperscript{36} Unlike Article 81, Section 1 of the Sherman Act does not provide for the granting of exemptions. Therefore, in principle, all restraints of trade are prohibited. The absurdity of this solution led to the development of the ancillary restraints doctrine and, soon thereafter, the doctrine of the Rule of Reason to narrow the general prohibition of Section 1 of the Sherman Act.\textsuperscript{37}

In the ground-breaking case of \textit{Addyston Pipe and Steel Co.}, Judge Taft, writing for the circuit court, distinguished between ancillary re-

\textsuperscript{33} This difference was highlighted by René Joliet in 1967. \textit{See Joliet, supra} note 7, at 115.

\textsuperscript{34} For instance, in \textit{NCAA}, the Supreme Court rejected the promotion of amateurism in college football as a valid justification for a television plan adopted by the National Collegiate Athletic Association which limited the number of games that any one team could televise and the price for the particular telecasts. 468 U.S. at 100-01; \textit{see also} Jan Peeters, \textit{The Rule of Reason Revisited: Prohibition on Restraints of Competition in the Sherman Act and the EEC Treaty}, 37 \textit{Am. J. Comp. L.} 521, 530-31 (1989).

\textsuperscript{35} \textit{See California Dental Ass'n.}, 526 U.S. at 771 (the lower court should have used a “less quick look” Rule of Reason analysis because the restraints on advertising may have had pro-competitive effects by preventing misleading or false quality claims); \textit{United States v. Brown Univ.}, 5 F.3d 658, 669 (3rd Cir. 1993) (inappropriate use of the “quick look” Rule of Reason because lower court did not take into account the nature of higher education and pro-consumer features of the agreement); \textit{NCAA}, 468 U.S. at 101 (inappropriate use of the per se analysis because restraints of competition are essential if the product—college football—is to be available at all).

\textsuperscript{36} For a detailed analysis of the development of the Rule of Reason by the Supreme Court and lower courts see \textit{Areeda & Hovenkamp, Antitrust Law Ch. 15} (1999 Supp.), and \textit{Daniel J. Gifford & Leo J. Raskind, Federal Antitrust Law Cases and Materials} 37-97 (1998).

\textsuperscript{37} \textit{Forrester & Norall, supra} note 9, at 20-1.
According to Judge Taft, an agreement is a reasonable restraint of trade only if it is incidental or ancillary to another agreement whose main objective is pro-competitive. The rationale for this distinction is found in the need to introduce a judicially manageable standard in the courts' reasoning for assessing restraints of trade. The ancillary restraint doctrine allows judges to determine when a restraint is necessary to make viable a pro-competitive transaction. In contrast, using this analysis for naked restraints, such as the price-fixing practices scrutinized in this case, would force a judge to perform an inappropriate function, determining whether the fixed prices are reasonable. To justify a cartel on the grounds that the prices fixed are reasonable is, as Judge Taft indicated, to "set sail on a sea of doubt."

In 1911, the Supreme Court endorsed the Rule of Reason approach in Standard Oil Co. of New Jersey v. United States and in United States v. American Tobacco Co. Under the Rule of Reason analysis, Section 1 of the Sherman Act applies only to restraints that are unreasonable (those whose anti-competitive effects outweigh their pro-competitive effects). Only naked restraints (for instance, those which have no purpose other than restricting output and raising prices, such as price fixing, horizontal territorial or customer allocation, minimum resale price maintenance, and certain tying arrangements) are per se illegal. Restrictive agreements are presumed valid until challenged.

B. The Application of the Rule of Reason Analysis to Vertical Restraints: The Conflicting Approaches of the Commission and the U.S. Agencies Regarding the Characterization of License Agreements as Horizontal or Vertical

1. The Economics of Vertical Restraints

The compatibility of an agreement with antitrust law may depend substantially upon whether the agreement qualifies as vertical or hori-
zontal. Both the Commission and the U.S. agencies consider vertical restraints less harmful to competition than horizontal restraints. There is an assumption that the advantages of vertical restraints in promoting interbrand competition outweigh their anti-competitive effects on intrabrand competition. In a vertical agreement, each of the parties has an interest in having the other produce more, because that is the rational way to maximize their respective profits; in a horizontal agreement, each party has an interest in having the other produce less.

The Commission has taken a less flexible position towards vertical restraints than the U.S. agencies. There are two connected factors driving these two approaches towards vertical restraints: (i) the strong influence which the economic model proposed by the Chicago School has exerted upon the U.S. agencies and courts, and (ii) the E.U.'s objective of achieving an integrated market.

a. The Chicago School Approach

U.S. agencies and courts have been strongly influenced by the economists of the Chicago School. According to this school of thought, vertical restraints almost never restrict competition, unless one of the parties enjoys significant market power in the relevant market. Instead, vertical restraints foster interbrand competition by increasing output and diminishing distribution costs.

The Chicago School stresses that, in a vertical relationship, both the manufacturer and the dealer want production to increase in order to maximize their returns, whereas parties to a horizontal agreement generally want to cut down on production for the sake of monopolistic gains. With a vertical restraint, both manufacturer and consumer want distribution to occur at the lowest possible cost in order to distribute as much product as possible. Therefore, Chicago School economists conclude that when a manufacturer chooses to impose a

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47 See Gifford & Raskind, supra note 36, at 147–59.
48 In the U.S., the leading cases in this respect are Sylvania, 433 U.S. 36 (non-price vertical restraints) and State Oil Co., 522 U.S. 3 (maximum vertical price fixing).
51 Bork, supra note 49, at 290.
52 Id. at 289.
vertical restraint upon its dealers, it chooses based upon criteria that also control consumer welfare. Because lower distribution costs are one aspect of the overall efficiency of a firm, as a manufacturer becomes more effective in selling its brand, competition among manufacturers intensifies and output increases.\textsuperscript{53} Since the manufacturer that imposes vertical restraints cannot intend to restrict output, according to the Chicago School, it instead must create efficiencies. The underlying thought is that a manufacturer does not have any incentive to protect one dealer from other dealers unless that protection is necessary to induce one dealer to make investments in advertising, promotion, or services for the benefit of the brand as a whole or for the benefit of consumers.\textsuperscript{54} Since vertical restraints are unlikely to harm competition because interbrand competition always provides a check on intrabrand restraints, some Chicago School economists have advocated for the per se legality of vertical restraints.\textsuperscript{55}

This approach has been contested by other economists because it is premised on the assumption that the manufacturer always makes rational choices as to the amount of protection that its dealers need to make the necessary amount of investments to promote the brand.\textsuperscript{56} Chicago School economists do not take into account the fact that a manufacturer may want to attract certain marginal consumers (for instance, high income consumers) by encouraging its dealers to offer further and better services. In order to comply with the manufacturer's plan, the dealers might request a level of protection higher than the level they need to promote the brand, leading to higher dealer margins and profits.\textsuperscript{57} The result is that the higher price ostensibly needed to support new services worsens the welfare of those non-marginal consumers by forcing them to pay for services they do not desire or by inducing them to purchase a substitute good or service that they otherwise would regard as inferior.\textsuperscript{58} It is the presence of the non-marginal purchasers that breaks the link, claimed to exist by Chi-

\textsuperscript{53} \textit{Id.} at 290.
\textsuperscript{54} \textit{Id.} at 295–97.
\textsuperscript{57} \textit{Id.} at 164, 166.
\textsuperscript{58} \textit{Id.} at 166.
Chicago School economists, between manufacturer choice and consumer welfare.59

The Chicago School would counter that consumer welfare is affected negatively only when consumers who do not want particular services cannot turn to other brands. However, even if a manufacturer does not have market power, vertical restraints still can harm competition when several manufacturers collectively dominate a large market share and they adopt a strategy of extensive services.60

U.S. agencies and courts have not fully upheld the extreme approach of the Chicago School because of the possible mistakes which the manufacturer could make regarding the protection needed to induce dealers' investments. Nonetheless, the Chicago School has had a strong influence on the development of Supreme Court case law regarding vertical restraints. In Sylvania,61 the Supreme Court overruled its previous ruling in the Schwinn case62 and endorsed the Rule of Reason analysis as the appropriate method to evaluate the compatibility of non-price vertical restraints.63 Before Sylvania, vertical restraints were presumed to be unreasonable and, therefore, per se illegal.64 The Schwinn rule is the approach often followed by the Commission.

In contrast with its Schwinn reasoning, the Supreme Court reasoned in Sylvania that vertical restrictions may promote interbrand competition by allowing a manufacturer to achieve certain efficiencies in the distribution of its products. The Supreme Court endorsed the Chicago School's view that interbrand competition provides a significant check on the exploitation of intrabrand market power because of consumers' ability to substitute a different branch of the same prod-

59 Id. at 167; see also S. Comanor, Vertical Price-Fixing, Vertical Restrictions and the New Antitrust Policy, 98 Harv. L. Rev. 983, 990, 999, 1001 (1985). According to Comanor, "[e]conomic theory alone cannot predict whether the imposition of vertical restraints—and dealer's provision of additional services—will benefit and enhance efficiency. Whether consumers benefit depends on whether gains to . . . [service seeking] consumers outweigh losses to . . . [price-seeking consumers]." In the E.U., some economists also have endorsed the idea that both non-price and price vertical restraints may either promote or reduce economic efficiency. David Deacon, Vertical Restraints Under EU Competition Law: New Directions, in 1995 Fordham Corp. L. Inst. 307, 317-18 (Barry Hawk ed., 1996).

60 Areeda, supra note 56, at 167-68.
61 Sylvania, 433 U.S. at 58.
63 Sylvania, 433 U.S. at 59.
64 Id. at 52.
uct. The view of the Chicago School is far from being widely accepted among economists and regulators. Some commentators have argued that there is no a priori basis to assume that sacrificing intra-brand competition to invigorate interbrand competition is a welfare-enhancing trade-off. For this reason, I believe the approach taken by the U.S. courts towards vertical restraints is much more realistic than the approach proposed by the Chicago School. There are reasons to support the view that market analysis under the Rule of Reason is required before concluding that a vertical restraint escapes the prohibition of Section 1 of the Sherman Act on the grounds that it promotes interbrand competition.

Although vertical restraints may jumpstart interbrand competition, they also may produce an increase in retail gross margins, leading to higher retail prices, a fall in non-marginal consumer surplus and, eventually, a decrease in industry surplus. Moreover, vertical restraints may help shield an inefficient group of distributors from market entry by more efficient distributors. This situation may arise when a horizontal cartel of dealers representing a large market share is able to force a manufacturer to grant it protection against other more efficient dealers.

Furthermore, empirical evidence shows that intrabrand vertical restraints do not always promote interbrand competition. In the U.S., there are industries where vertical restraints do not seem to have any significant pro-competitive effects on interbrand competition. For instance, a study of the blue jean industry demonstrated that, as intrabrand competition increases, there are higher margins at the manufacturer level, as well as reduced distribution costs that are passed along to consumers. The dominant manufacturer in the U.S. blue jean market, Levi Strauss, operated under a resale price maintenance (RPM) scheme, but as a result of a complaint issued by the FTC

65 Id. On remand, the district court held that the territorial location clause that was in dispute was reasonable because the restraint was more likely to promote than suppress interbrand competition. The Court of Appeals affirmed and, despite recognizing that Sylvania did check intrabrand competition, it considered that this was an "inevitable incident to Sylvania's attempt to promote and maintain interbrand competition . . . [I]t is important to emphasize that . . . in a market dominated by a single company (RCA), Sylvania possessed only a minor fraction of the total market, that many other brands were available to the consumer . . . [and] that Sylvania dealers could and did carry competing brands." GTE Sylvania Inc. v. Continental T.V. Inc., 537 F.2d 980, 1000-01 (9th Cir. 1976).
67 Id. at 177.
68 Id. at 179.
against Levi Strauss’s pricing policies, Levi Strauss abandoned its RPM scheme. This change led to more intrabrand competition which subsequently had the effect of reducing Levi Strauss dealers’ markups and consumer prices on Levi jeans. The price reduction of the leading brand forced down the retail prices of rival brands, thereby increasing interbrand competition. The Levi example confirms that, in certain industries, the onset of intrabrand competition first forces down margins and prices of well-known brands. Then interbrand competition is stimulated because the price of competing goods is also depressed. 69

b. Market Integration

In contrast to U.S. antitrust law, EC competition law underscores the goal of market integration as embedded in the EC Treaty. 70 In the E.U., the integration of different geographic markets is an independent objective of antitrust law. 71 The goal of single market integration has played a significant role in the jurisprudence of the European Court of Justice (E.C.J.) and the Court of First Instance (C.F.I.) in their applications of the provisions of the EC Treaty ranging from free movement of goods 72 to the use of intellectual property rights. 73 The E.C.J. and the C.F.I. also have taken into account the need to avoid market division when deciding on the compatibility of agreements with EC competition law. This jurisprudence endorses the Commission’s concern that vertical agreements are partitioning devices of the common market. 74

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70 See Deacon, *supra* note 59, at 308. In explaining the Commission’s approach to vertical restraints, Deacon states: “territorial exclusivity in particular was considered as contrary to one of the fundamental aims of the Community—the creation of a real internal/single market. Such restrictions appeared to contribute both to the continued division of the market along national lines and the maintenance of price differences between Member States.”
72 See Articles 28, 29, 30 of the EC Treaty as amended by the Treaty of Amsterdam (ex Articles 30, 34, 36), *supra* note 6.
73 See Case 15/74, Centrafarm BV v. Sterling Drug, Inc., 1974 E.C.R. 1147. In this case, the E.C.J. enunciated the so-called exhaustion doctrine. The E.C.J. held that it was contrary to Articles 28 and 30 of the Treaty for a patentee to assert its patent rights in one Member State to prevent parallel imports of patented products placed in the market of another Member State by the patentee or with its consent.
74 Gutusso, *supra* note 14, at 237. The goal of market integration explains the restrictive approach towards vertical restraints and the fact that the leading case in this field, *Consten and Grundig*, has not been overruled. In *Consten and Grundig*, the E.C.J. reasoned
2. The U.S. Agencies’ Application of the Rule of Reason to License Agreements

The U.S. agencies note in the Intellectual Property Guidelines that they will apply the general framework of the Rule of Reason analysis to evaluate vertical restraints and also to assess the legality of licensing agreements.\(^{75}\) This approach is consistent with the economic efficiencies attributed to license agreements.\(^{76}\) The U.S. agencies note, however, that licensing agreements may contain restraints that are unlawful per se, such as price fixing, output restraints, boycotts, and market allocations.\(^{77}\)

The application of the Rule of Reason analysis to license agreements by the U.S. agencies and courts contrasts with the more formalistic approach adopted by the Commission, partially because the Commission and the U.S. agencies differ in their characterization of licensing agreements.\(^{78}\) In the U.S., a licensing agreement is vertical if, at the time it was negotiated, the licensee could not have entered the market without assistance from the licensor.\(^{79}\) This analysis is an \textit{ex ante} analysis. The Commission, in contrast, often relies on an \textit{ex post} analysis of the license agreement in question. As a result, the Commission tends to consider most patent licenses as horizontal agreements even if the licensees would not have been able to compete with the licensors but for the licenses.\(^{80}\) This \textit{ex post} analysis explains why the Commission included some restrictions in the black list of the Technology Transfer Regulation, adopted pursuant to Article 81(3) of the

\[^{75}\] IP Guidelines, supra note 1, § 3.4.

\[^{76}\] Id. § 2.3.

\[^{77}\] Id.

\[^{78}\] Reg. Monograph, supra note 2, at 19–25.

\[^{79}\] IP Guidelines, supra note 1, § 3.3.

\[^{80}\] James Venit, \textit{In the Wake of Windsurfing: Patent Licensing in the Common Market}, in 1986 \textit{Fordham Corp. L. Inst.} 517, 529 (Barry Hawk ed., 1987). Venit points out that “in \textit{Maize Seeds}, the European Court appears to have implicitly rejected the Commission’s assumptions concerning the importance to be attached to the fact that both licensor and licensee are manufacturers . . . .” \textit{Id.}
EC Treaty, such as quantity restrictions, customers' restrictions, and exclusive dealing (non-competition) clauses.\(^8\)

The IP Guidelines follow a more economic approach than the Technology Transfer Regulation in determining whether a particular restraint in a licensing agreement is compatible with Section 1 of the Sherman Act. A Rule of Reason analysis requires a comprehensive economic inquiry into the market conditions (such as the market power of the parties to the licensing agreement, the level of concentration in the market, and the barriers to entry).\(^8\)

The significant weight that the U.S. agencies place on market analysis contrasts with the absence of a similar concern regarding market power in the European group exemptions. Market analysis plays a limited role in the application of the Technology Transfer Regulation. However, market power may be relevant in two situations: (i) to trigger a decision of the Commission withdrawing the benefit of the exemption when the licensed products do not have real competition in the licensed territory,\(^8\) and (ii) to benefit from the block exemption when a parent undertaking grants the joint venture a patent or know-how license, since the Regulation conditions its application to these agreements to those licensed products not exceeding certain market share thresholds.\(^8\)

Some practitioners and scholars consider the formalistic approach of the Technology Transfer Regulation to be an advantage of the E.U. system. They argue that, because of the Regulation, it is easier under EC competition law than under U.S. antitrust law to determine whether a licensing agreement is legally enforceable.\(^8\) On the

\(^8\) Reg. Monograph, \textit{supra} note 2, at 23.

\(^8\) This comprehensive analysis of the market is somehow mitigated when courts rely on the so-called "Quick Look" Rule of Reason. See \textit{California Dental Ass'n}, 526 U.S. at 778-81; see also Fox, \textit{supra} note 31, at 156; Korah, \textit{supra} note 31, at 396.

\(^8\) Article 7(1) of the Technology Transfer Regulation empowers the Commission to withdraw the exemption where it finds that an exempted agreement nevertheless has certain effects which are incompatible with the conditions laid down in Article 81(3) of the EC Treaty and, in particular, when the effect of the agreement is to prevent the licensed products from being exposed to competition in the licensed territory from identical or interchangeable goods or services "which may in particular occur where the licensee's market share exceeds 40%." It is not clear, however, whether one has to assess the licensee's market share at the date of the license or at the time the Commission is deciding whether to withdraw the exemption. See Reg. Monograph, \textit{supra} note 2, at 242.

\(^8\) The licensed products must not exceed 20% or 10% in the market for the licensed products depending on whether the license covers production or distribution and production respectively, Commission Regulation 240/96, art. 5(2), 1996 O.J. (L 31) 2.

other hand, block exemptions may constrain companies and cause them to structure their agreements in the way contemplated by the group exemption, despite the fact that more efficient structures exist. 86

The existence of different frameworks in the E.U. and the U.S. influences the way both competition authorities analyze specific restrictions of conduct in licensing agreements. In the E.U., Article 81 of the EC Treaty prohibits (and nullifies under Article 81 (2)) all restrictive license agreements, regardless of whether those agreements are pro-competitive, unless the agreements have been formally exempted pursuant to an individual decision under Article 81 (3) or fall under the Technology Transfer Regulation. 87 In contrast, in the U.S., restrictions in licensing agreements are deemed to be valid and enforceable without the need for individual approval by the U.S. agencies until they are challenged. 88

3. The E.C.J.’s Attempts to Develop a Rule of Reason-Oriented Approach: Conflict Between the E.C.J. and the Commission

The E.C.J. has applied a more flexible approach to vertical restraints than the Commission, 89 although the Commission has at times

86 See Forrester & Norall, supra note 9, at 25.
87 Guttuso, supra note 14, at 235. The Commission has, however, mitigated the broad prohibition of Article 81(1) by introducing a “de minimis” rule, see the last version of the “de minimis” rule in Commission Notice on Agreements of Minor Importance, 1997 O.J. (C 372) 13, and by deciding some cases under the ancillary restraints doctrine. See Commission Decision No. 90/410 EEC, 1990 O.J. (L209) 15 (Elopak/Metal Box-Odin).
88 Davis & Johnston, supra note 85, at 16.
89 See Case 234/89, Stergios Delimitis v. Henninger Bräu, 1991 E.C.R. 935. In Delimitis, the E.C.J. ruled that an agreement has to be analyzed within its “legal and economic context” in order to show whether it has the effect of restricting competition. Id. Therefore, the Court in Delimitis stressed the importance of looking in a realistic way at the anticompetitive effect of an agreement as opposed to the formalistic approach often followed by the Commission in many of its decisions. Id.; see also Langnese, 1995 E.C.R. II-1533; Case T-9/93, Schöller Lebensmittel v. Commission, 1995 E.C.R. II-1611. In Langnese and Schöller, two ice-cream manufacturers operated in the German market through a substantial number of exclusive purchase agreements concluded with their retail outlets. The Commission denied an individual exemption for the agreements on the grounds that, given the substantial percentage of the market controlled by Langnese and Schöller through their tied outlets and the length of the exclusive purchase obligations imposed upon retailers, the agreements had the effect of foreclosing a third competitor, Mars, from access to the German market of “impulse” ice-creams. Both producers appealed the Commission’s decisions before the C.F.I. The C.F.I. upheld the position of the Commission not to grant the exemptions. What it is interesting is that, unlike the Commission which only began to analyze the market under Article 81 (3), the C.F.I. applied Delimitis and analyzed the effect of the agreements on the market under Article 81(1). See Langnese, E.C.R. II-1572-1573, ¶ 99-101. See the latest application of the Delimitis doctrine in Case 214/99, Neste, Judgment of
applied a flexible approach in some of its decisions. This tension between the two Community institutions also is reflected in the field of licensing agreements itself. In Nungesser (also known as the Maize Seed case), the E.C.J. held that a grant of an open exclusive license (a license whereby the owner agrees not to grant other licenses in respect to the same territory and not to compete with the licensee in the licensed territory) was not contrary to Article 81(1). In this case, INRA, a research institute financed by the French Minister of Agriculture, developed a special hybrid maize seed that could be grown in the colder climate of Northern Europe. The INRA assigned its plant breeders’ rights to Nungesser in order to overcome the prohibition under German law that prevented the owner of plant breeders’ rights to exploit the parents’ know-how. The Commission considered this exclusivity necessary to guarantee that each parent company would devote its full efforts to the project. See Christopher Bellamy & Graham D. Child, Common Market Law of Competition 88 (1993). See also Commission Decision No. 98/531 (EC), 1998 O.J. (L 246) 1 (Van den Bergh Foods) as an example that the Commission is moving towards a more economic approach.


Nungesser, 1982 E.C.R. 2068, ¶ 53. An open exclusive license also can be defined as a license that does not affect the position of third parties such as parallel importers and licensees in other territories. Id. at 2069, ¶ 58. In other words, it is a license that does not confer absolute territorial protection to the licensee. Id. at 2070, ¶ 61.
outside Germany from registering those rights in Germany. In addition, INRA granted Nungesser exclusive rights to cultivate and sell in the German market four varieties of the hybrid maize seeds developed by INRA. The INRA agreed that it would not grant further licenses in the German territory and that it would try to prevent the seeds grown in France from being exported to Germany, except to Nungesser. Eventually, other seed varieties superceded the INRA seed, and at least two dealers in Germany imported the improved seeds from dealers in France. Nungesser invoked its license rights and successfully restrained parallel imports by these two dealers.

Following a strict interpretation of the prohibition contained in Article 81(1), the Commission found that the exclusive license agreement infringed the EC Treaty. The E.C.J. quashed in part the Commission’s reasoning and upheld Nungesser’s position that the Commission had incorrectly taken the view that an exclusive license for breeders’ rights must, by its very nature, be treated as an agreement prohibited by Article 81(1). The E.C.J. ruled that a total prohibition of every exclusive license, even an open one, prejudices the dissemination of knowledge and new technology in the common market and prejudices competition in the common market between the new product and similar existing products. The E.C.J. reasoned that the open exclusive license was not incompatible with Article 81(1) because, without such an exclusive license ensuring that other licensees would not be appointed for the granted territory, a licensee established in another Member State would be deterred from assuming the risk of cultivating and marketing the INRA’s new varieties of hybrid maize seed.

The E.C.J.’s judgment does not comment on the relevance of novelty when assessing the compatibility of an open exclusive license with Article 81(1). Korah has pointed out that novelty was only one of the factors that influenced the E.C.J.’s ruling. Thus, novelty should not be viewed as a requirement for an open exclusive license to escape the prohibition of Article 81(1). Instead, whether the open ex-

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93 Id. at 2057, ¶ 11.
94 Id.
95 Id. at 2071, ¶ 64.
96 Nungesser, 1982 E.C.R. 2070, ¶ 60.
97 Id. at 2069, ¶ 52-58.
98 Id. at 2069, ¶ 45.
99 Id. at 2069, ¶ 57.
100 Id. at 2069, ¶¶ 56-57.
exclusive license is necessary to encourage investment, even if the product is not new, is crucial to the E.C.J.\textsuperscript{101}

The E.C.J. ruled that a license granting absolute territorial protection to the licensee (most notably prohibiting other licensees from importing the maize seeds into Germany, from selling the product to parallel importers, and from meeting uncontested demand from the protected licensee’s territory) remains contrary to Article 81(1).\textsuperscript{102} Furthermore, the E.C.J. upheld the Commission’s decision in part by concluding that these types of licenses cannot benefit from Article 81(3) because a license granting absolute territorial protection goes beyond what is “indispensable” for inducing the dealer to cultivate and market the maize seed.\textsuperscript{103}

In subsequent cases, the E.C.J. has gone so far as to hold that restrictions that are ancillary to a license agreement may not violate Article 81(1) even when they lead to absolute territorial protection. In \textit{Coditel II},\textsuperscript{104} the E.C.J. held that an exclusive copyright license to exhibit films granting absolute territorial protection to the licensee did not infringe Article 81(1). The E.C.J. reasoned that absolute territorial protection was indispensable for the copyright owner and the licensee to obtain fair rewards for creating the film.\textsuperscript{105} The E.C.J., however, also held that there are specific circumstances when exclusive licenses may fall under the prohibition of Article 81(1), namely, when the exercise of the exclusive right creates barriers which are unjustifiable in terms of the needs of the cinematographic industry, when there is a possibility of charging fees which exceed a fair return on investment, and when the period of exclusivity is unreasonable.\textsuperscript{106}

\begin{thebibliography}{10}
\bibitem{101} Reg. Monograph, \textit{supra} note 2, at 88. Not all the authors share this view. Sebastiano Gutusso of the EC Commission believes that dissemination of a new technology is an essential factor if an open exclusive license is to be considered compatible with Article 81(1). \textit{See} Gutusso, \textit{supra} note 14, at 237.
\bibitem{102} Nungesser, 1982 E.C.R. 2070, ¶ 61. Korah has pointed out that the reasoning of the E.C.J. in \textit{Nungesser} seems to be inconsistent in certain points. In ¶ 53, the E.C.J. seems to extend the concept of open exclusive licenses to those clauses which prevent a licensee from selling in another territory, whereas ¶ 77 holds that this clause is contrary to Article 81. According to Korah, the inconsistency and vagueness of the judgment “indicates that there must have been profound disagreement between the judges.” \textit{Reg. Monograph, supra} note 2, at 49–50. Thereafter, in \textit{Bossois/Interpane}, [1988] 4 C.M.L.R, ¶ 16a, the Commission held that a license containing a clause which prevents a licensee from selling in another territory does not qualify as open exclusive license. \textit{Introductory Guide, supra} note 8, at 244.
\bibitem{103} \textit{See} Nungesser, 1982 E.C.R. 2073–74, ¶ 77.
\bibitem{105} \textit{Id.} ¶ 16.
\bibitem{106} \textit{See} id. ¶¶ 16, 19.
\end{thebibliography}
E.C.J. did not elaborate on the circumstances under which an exclusive copyright license still may be contrary to Article 81(1) and left to the national court the task of ascertaining whether the exercise of the exclusive right had the objective or effect of restricting competition. The criteria set out in Coditel II, however, are difficult to apply in practice. The E.C.J. entrusted the national court with the difficult task of determining whether an absolute territorial protection clause gives the licensee the possibility of charging fees exceeding a fair return on investment. Curiously enough, this activity is of the kind that Judge Taft indicated in Addyston Pipe and Steel Co. that a judge should avoid.

In Erauw-Jacquéry, the E.C.J. upheld an exclusive license over plant breeders’ rights granting absolute territorial protection to the licensee. In this case, absolute territorial protection was necessary to allow the holder of the right to control propagators of the basic seed. The E.C.J.’s holding can be reconciled with its Nungesser holding because, in Nungesser, the absolute territorial protection clause related both to basic and certified seeds while, in the Erauw-Jacquéry case, the absolute territorial protection clause related to basic seeds.

The E.C.J.’s reasoning rests upon the fact that basic seeds need a more specialized handling than certified seeds. Basic seeds have been produced under the responsibility of the breeder according to accepted practices for the maintenance of the variety. Unlike patents, for the rights over basic seeds to remain valid, the variety must remain distinct, uniform, stable, and useful. Therefore, in order to maintain the distinct character of the variety and allow the owner to retain its intellectual property rights, it is necessary for the owner to control the destination and use of the basic seed.

The foregoing cases shed light on the EC competition law’s approach toward exclusive licenses. As some commentators have pointed out, it is not entirely clear to what extent Coditel II and Erauw-Jacquéry

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107 Id.
108 85 F. 271.
110 Id. at 1938–39, ¶ 10.
Jacqu"emy apply to technology licensing generally.\textsuperscript{114} The language of the E.C.J. in Coditel II and Erauw-Jacqu"emy appears to be limited to performing rights and plant breeders' rights respectively. Unlike Nungesser, Erauw-Jacqu"emy specifically referred to rights over basic seeds and not to exclusive licenses in general. Thus, it is difficult to extend Erauw-Jacqu"emy to other exclusive licenses, a position also adopted by the Commission in its traditionally restrictive interpretation of the above-mentioned E.C.J rulings.\textsuperscript{115}

A broad interpretation of Coditel II and especially of Erauw-Jacqu"emy (that an exclusive license granting absolute territorial protection to the licensee is not contrary to Article 81(1) whenever it is necessary to market products which need careful handling) would allow one to argue that a pure exclusive software license, which is not covered by any of the block exemptions,\textsuperscript{116} escapes the prohibition of Article 81(1).\textsuperscript{117} Nevertheless, the Commission includes pure exclusive software licenses in the prohibition of Article 81(1).\textsuperscript{118}

The Commission also has narrowly interpreted the E.C.J.'s holding in Nungesser. Unlike the E.C.J., the Commission presupposes that an open exclusive license is prohibited under Article 81(1).\textsuperscript{119} Furthermore, despite Nungesser's reference to exclusive licenses in general, the Commission has limited Nungesser's ruling to plant breeders' rights.\textsuperscript{120} The Commission never has employed the Nungesser holding.

\textsuperscript{114} See Reg. Monograph, \textit{supra} note 2, at 50.

\textsuperscript{115} Id. at 50. See, however, Article 2(3) of Commission Regulation (EC) No. 2790/99 on the Application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices, O.J. [1999] L 336/21. Article 2(3) states that Regulation 2790/99 applies to vertical agreements containing intellectual property provisions provided that those provisions do not constitute the "primary object" of the vertical agreement and are directly related to the use, sale, or resale of goods or services. Article 2(3) could be extended to exempt exclusive software licenses by arguing that the "primary object" of the license is the dissemination of the software rather than the license as such. This approach, however, is risky since, to date, Article 2(3) and its application to exclusive software licenses has not been subject to the analysis of EC Community Courts. See Valentine Korah, \textit{The New EC Vertical Restraint Block Exemption}, 8th Annual Conference on International Intellectual Property Law and Policy, Fordham University School of Law, Apr. 28, 2000, at 6 (on file with author).


\textsuperscript{117} Introductory Guide, \textit{supra} note 8, at 246.


\textsuperscript{120} Korah opines that the E.C.J. did not want to limit the scope of its holding to plant breeders' rights. Instead, the judgment has to be interpreted as applicable to all those...
to declare that open exclusive licenses are compatible with Article 81(1) because the Commission systematically has argued that the product in question is not sufficiently new and, indeed, in its decision in Nungesser, the Commission held that the INRA’s varieties of maize seed were not new products.

The reasoning of the E.C.J. in the above-mentioned cases cannot qualify as a Rule of Reason analysis. The E.C.J. does not weigh the pro-competitive effects of the claimed restrictions against their anti-competitive effects (for example, there is no inquiry into market power) as do the U.S. agencies and courts under the Rule of Reason. Rather, the E.C.J. applies the “ancillary restraints doctrine” to inquire whether the challenged restrictions are “necessary” to secure the implementation of a lawful agreement. Under a pure Rule of Reason approach, a restraint is justified once its pro-competitive effects outweigh its anti-competitive effects and, although the necessary or indispensable character of a restriction may be a factor to take into account, it is not crucial to the decision of whether a particular restraint escapes the prohibition of Section 1 of the Sherman Act.

II. Regulation of Exclusive Licenses in the E.U. Technology Transfer Regulation and the U.S. Intellectual Property Guidelines

The purpose of an intellectual property license is to allow third parties to use the technology of the licensor. The licensee may require the inclusion in the license agreement of an exclusive clause guaranteeing the licensee a certain degree of territorial protection. Without this protection, the licensee may not be willing to incur the costs required to set up a line of production and develop a market.

A licensee may enjoy different levels of territorial protection depending on the scope of the exclusive license as well as on other factors, such as transport costs or regulatory barriers. The licensor, for instance, may grant an open exclusive license. Licensees, however, often seek closed exclusive licenses that provide absolute territorial protection. In a closed exclusive license, the licensor agrees not to situations where open exclusivity is necessary to induce useful investment. See Reg. Monograph, supra note 2, at 48–49.

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121 Korah, supra note 118, at 46–2, n.4.
122 Nungesser, 1982 E.C.R. at 2071–72, ¶ 68.
123 Korah, supra note 31, at 398; see also Peeters, supra note 34, at 556, 560.
124 Korah, supra note 31, at 398.
125 Id.
compete in the licensee's territory and agrees to prevent other licensees from pursuing an active or a passive sales policy in the licensee's territory. 126

A. Regulation of Exclusive Licenses in the Technology Transfer Regulation

1. Agreements Covered by the Regulation

Article 1(1) of the Regulation exempts from the application of Article 81(1) pure patent licensing agreements, pure know-how licensing agreements, mixed patent and know-how agreements, and those agreements containing ancillary provisions relating to intellectual property rights other than patents. These agreements are defined in Recitals 4 to 10 and by the first four items of Article 10 of the Regulation. Ancillary provisions are defined in Article 10(15).

Article 5 provides that the Regulation does not apply to technology pools, licenses between competitors that hold interests in a joint venture, or a license by one competitor to the joint venture if the license relates to the activities of the joint venture,127 or to reciprocal rights between competitors under which there are territorial restrictions. Recital 8 excludes from the Regulation agreements relating to marketing know-how communicated in the context of franchising agreements. Franchising agreements, however, may be exempted under Regulation 2790/99,128 though it is unclear whether the Regulation covers industrial franchising.129 This issue is relevant because

126 Under the Technology Transfer Regulation, prohibition of passive sales is permitted for a period of five years. Commission Regulation 240/96, arts. 1(1)(6) and 1(2)(3), 1996 O.J. (L31) 2.

127 See, however, Article 5(2) which provides that the Regulation applies to agreements between a parent company and the joint venture that relate to the activities of the joint venture if certain thresholds are not exceeded. The licensed products must not exceed 20% or 10% of the market for the licensed products depending on whether the license covers production, distribution and production respectively.


129 Industrial Franchising describes an agreement whereby the franchisor communicates to the franchisee instructions on how to produce something (know-how) and licenses to it a trademark. Unlike a pure franchising agreement, in an industrial franchising agreement intellectual property rights are related to production rather than to marketing products or services.
there is no group exemption available for industrial franchising unless the Technology Transfer Regulation applies.

The former know-how block exemption regulation applied to agreements combining know-how and trademark licenses where the trademark license was ancillary to the know-how. The Commission appears to have interpreted this provision narrowly. In Moosehead/Whitebread, Moosehead granted to Whitebread an exclusive license to brew and sell beer within the United Kingdom under Moosehead's trademarks. Moosehead agreed to provide Whitebread with the yeast and with all the relevant know-how necessary to produce the product. The Commission found that the know-how regulation then in force did not apply to Moosehead's industrial franchising because the licensed trademark could not be considered ancillary to the know-how. The Commission concluded that, although the trademark was not very well-known in the United Kingdom, the parties viewed the Canadian origin of the mark as crucial to the success of the marketing campaign, which promoted the product as Canadian beer.

It is unclear whether the Commission would decide a case like Moosehead/Whitebread in the same way under the Technology Transfer Regulation. The Regulation may be subject to two conflicting interpretations regarding whether it applies to industrial franchising because of the lack of clarity of the wording of the two provisions under which industrial franchising could be evaluated.

In Recital 6 of the Regulation, the Commission declares that "it is appropriate to extend the Regulation to pure or mixed agreements containing the licensing of intellectual property rights other than patents (in particular, trademarks, design rights, and copyright, especially software protection), when such additional licensing contributes to the achievement of the objects of the licensed technology and contains only ancillary provisions." (Emphasis added). Recital 6 seems to incorporate in the Regulation the traditional notion of ancillary restraints which

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132 Id. at 394–95, ¶ 7–8.
133 Id. at 395, ¶ 9.
134 Id. at 398, ¶ 15(3).
135 See id. at 399, ¶ 15(4)(b).
136 Id. at 399, ¶ 16. The Commission, however, exempted the agreements notified by Moosehead and Whitebread pursuant to Article 81(3).
stresses the idea that ancillarity implies that the additional licensed technology must be of a lesser value than the licensed know-how or patent to which it is ancillary.

In contrast with Recital 6 and unlike the former know-how block exemption regulation, the Technology Transfer Regulation contains a broad, and also unusual, definition of "ancillary provisions." Article 10(15) defines ancillary provisions as those "relating to the exploitation of intellectual property rights other than patents, which contain no obligations restrictive of competition other than those also attached to the licensed know-how or patents and exempted under this Regulation." This definition does not require that the provisions related to other kinds of intellectual property be of a lesser value than the licensed know-how or patent.

Article 10(15) also is subject to two interpretations. Some authors argue that, in order to be ancillary under the Regulation, the alleged ancillary intellectual property rights must be "ancillary in the usual sense" of being less valuable than the licensed know-how or patent technology. According to this school of thought, if the Commission had intended to extend the Regulation to a license of any intellectual property other than patents, provided that it also contained a license of know-how or patent, one would have expected the structure and content of Article 1(1) of the Regulation to have been substantially different and the Commission's intention to have been more clearly articulated in the recitals of the Regulation. Despite the foregoing, this school of thought acknowledges that, as Recital 6 refers to the scope of the Regulation being extended "when such additional licensing 'contributes' to the achievement of the objects of the licensed technology," there might be more to the Regulation than first thought.

A second school of thought postulates that the broad definition of ancillary restraints under Article 10(15) clearly indicates that there are officials in the Commission who believe that industrial franchising can be brought within the Regulation as long as there is a qualifying know-how or a licensed patent. This school of thought attempts to overcome the apparent inconsistency between Article 10(15) and Re-

137 Reg. Monograph, supra note 2, at 117-18.
138 See id. at 118.
139 Christopher Kerse, Block Exemptions Under Article 85(3): The Technology Transfer Regulation—Procedural issues, 6 E.C.L.R. 331, 335 (1996).
140 Id. at 335.
141 Id.
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Under this approach, it is easier to conclude that the Regulation covers industrial franchising because, on one hand, the trademark must not be less valuable than the licensed technology and, on the other hand, the trademark often contributes to achieving the object of the licensed technology.

There are more arguments in favor of including industrial franchising in the Regulation than there are arguments against it. First, it may be inferred from Article 10(15)'s definition of ancillary provisions that the Commission was willing to introduce a change with respect to the former know-how block exemption. Second, Recital 6 introduces a double requirement for a license agreement containing ancillary rights other than patents to be included under the Regulation. On one hand, the additional license must contribute to the achievement of the object of the licensed technology and, on the other, it must contain only ancillary provisions. This wording implies that the contribution to the achievement of the object of the licensed technology is a requirement different from the requirement of ancillarity. This distinction between "contribution" and "ancillarity" supports the idea that Recital 6 is not inconsistent with the definition of "ancillary provisions" contained in Article 10(15), which permits industrial franchising to be covered more easily by the Regulation.

Despite the foregoing, it is unwise to assume that the Regulation now includes industrial franchising. The appropriate practical advice is to notify the Commission of the industrial franchising and to request an individual exemption or a comfort letter under Article 81(3). Yet, it is defensible not to notify the Commission on the

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142 Reg. Monograph, supra note 2, at 118–19. Also in favor of this second approach are Bos & Slotboom, supra note 2, at 23.
143 Korah, supra note 118, at 46–5, 46–6.
144 Form A/B requests the notifying party to indicate if it is willing to accept a comfort letter. A positive answer normally speeds up the process because, unlike a formal decision granting an individual exemption, a comfort letter does not require the approval of the "college" of Commissioners. However, a comfort letter technically is not binding either upon the Commission or the national courts and authorities. On the problems which arise from comfort letters, see C.S. Kerse, E.C. ANTITRUST PROC., 275–76 (1998); Introductory Guide, supra note 8, at 147–48.
grounds that there are provisions within the Regulation that support the argument that industrial franchising is automatically exempt.145

2. Only Agreements With Two Parties Are Covered

The Technology Transfer Regulation applies to licensing agreements to which there are only two parties.146 Organizations that constitute a single economic unit are regarded as one undertaking for these purposes.147

In Centrafarm v. Sterling Drug, the E.C.J held that an agreement between parties belonging to the same group and having the status of parent and subsidiary was not caught by Article 81(1) if the parties form an economic unit within which the subsidiary does not have real freedom to determine its conduct and "if the agreements or practices are concerned merely with the internal allocation of tasks as between [parties]."148 In Viho Europe, the E.C.J. qualified the Centrafarm test and held that Article 81(1) does not apply to agreements within the corporate group when a subsidiary does not freely determine its conduct in the market, whether or not the parties to the agreement allocate tasks between the different subsidiaries.149

Article 6(3) of the Regulation also provides that agreements where some of the rights or obligations are assumed by individuals or entities connected with the parties to the agreement also fall within the scope of the block exemption.150 Thus, for the purposes of the Regulation, connected parties are considered one party.

3. Extraterritorial Application

The Technology Transfer Regulation applies to territorial restrictions that extend beyond the territory of the common market.151 Territorial restrictions outside the common market can affect competi-

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148 Centrafarm, 1974 E.C.R. 1147, ¶ 16 (Ruling).
150 “Connected undertakings” are defined in Article 10(14) of Commission Regulation 240/96.
tion within the common market and do so, for instance, when imports into the common market are subject to restrictions imposed on external territories, or when a licensee in the common market is restricted from operating outside the common market.\textsuperscript{152} It is unclear, however, whether the Regulation automatically exempts agreements for territories wholly outside the common market. The Regulation may be interpreted in either of two ways.

First, it is arguable that, because Articles 1(1)(1) and 1(1)(2) of the Regulation refer to the "licensed territory," a concept defined in Article 10(11) as a "territory covering all or at least part of the common market," the Regulation does not apply to agreements covering territories wholly outside the common market.\textsuperscript{153} Under this approach, if there is a risk that these agreements infringe upon Article 81(1) then individual notification is required.

The opposite position may also be sustained because Recital 7 of the Regulation does not require that the licensee cover at least part of the common market before the Regulation applies.\textsuperscript{154} Moreover, the first paragraph of Article 1(1) does not require license agreements to cover at least part of the common market to exempt the territorial restrictions contained therein. Accordingly, it can be argued that, if the Commission had wanted to establish this important limitation to the territorial scope of the Regulation, it would have mentioned it expressly in the first paragraph of Article 1(1).

\textsuperscript{152} Kevin Coates & John Finnegan, \textit{Intellectual Property, in The EC Law of Competition,} 600–01 (Jonathan Faull & Ali Nikpay eds., 1999). \textit{See} Case C-306/96, Javico International and Javico v. Yves Saint Laurent Parfums, 1998 E.C.R. I-198, ¶ 38. In this case, the E.G.J. held that Article 81(1) precluded a supplier established in one Member State from imposing on a distributor established in another Member State to which the supplier entrusted the distribution of his products in a territory outside the EC a prohibition on making any sales outside the third country in question, including the EC, either by direct marketing or re-exportation from the contractual territory, if that prohibition had the effect of preventing, restricting, or distorting competition within the EC. This "might" be the case where the EC market in the products in question is characterized by an oligopolistic structure or by an appreciable difference between the prices charged for the contractual product within the common market and those charged outside the EC and where, in view of the supplier's market position for production and sales in the EC, the prohibition entails a risk that it "might" have an appreciable effect on the pattern of trade between Member States as to undermine the attainment of the objectives of the common market.

\textsuperscript{153} Coates & Finnegan, \textit{supra} note 152, at 601.

\textsuperscript{154} Recital 7 provides, "[w]here licensing agreements for non-member countries or for territories which extend beyond the frontiers of the Community have effects within the common market which may fall within the scope of Article 81(1), such agreements should be covered by this Regulation to the same extent as would agreements for territories within the common market." \textit{See} Commission Regulation, \textit{supra} note 151.
According to some Commission officials, the Commission’s position as to the application of the Regulation to license agreements wholly outside the common market is “unclear.”\textsuperscript{155} Thus, there may be a contradiction between Recital 7 and the fact that the Regulation’s definition of “licensed territory” requires that at least part of the common market be covered by the license. The approach that relies on Recital 7 is stronger than the approach that relies on the fact that the Regulation’s definition of “licensed territory” requires at least part of the common market to be covered by the licensee. First, Recital 7 is the provision in the Regulation which deals specifically with the extraterritorial application of the Regulation, and its wording allows the application of the Regulation to agreements for territories wholly outside the common market. Thus, Articles 1(1)(1) and 1(1)(2) should be read in light of Recital 7. Second, there exists no policy reason justifying the exclusion of license agreements from the scope of the Regulation solely on the grounds that those agreements do not cover at least part of the common market. If the prohibition of Article 81(1) applies to agreements, including license agreements, for territories wholly outside the common market that are implemented within the common market,\textsuperscript{156} there is no reason why these agreements should not benefit from the block exemption to the same extent as do agreements for territories within the common market.

4. Territorial Restrictions

a. \textit{Open Exclusive Licenses}

i. Exempted Provisions

The Technology Transfer Regulation exempts agreements whereby the licensor agrees not to license anyone else in the licensee’s territory (Article 1(1)(1)) and not to exploit the technology in the licensed territory himself (Article 1(1)(2)). The Regulation also exempts a restriction imposed upon the licensee not to exploit the technology in the licensor’s territory (Article 1(1)(3)). In addition, a licensee may agree not to exploit the licensed technology in the territories of the common market that are licensed to other licensees (Article 1(1)(4)). The Regulation exempts a restriction preventing a li-

\textsuperscript{155} Coates & Finnegan, supra note 152, at 600.

licensee from engaging in an active sales policy, in particular from advertising, in the territory of other licensees, and also exempts a prohibition on passive sales\(^{157}\) in other licensed territories for five years from the date the product is first placed in the common market by any licensee.\(^{158}\)

According to the E.C.J.'s ruling in \textit{Nungesser}, the obligations exempted under Articles 1(1)(1) and 1(1)(2) amount to open exclusivity and may be compatible with Article 81(1). However, the obligations imposed on the licensee, that are exempted under Articles 1(1)(3), (4), (5), and (6), allow greater territorial protection than the E.C.J. \textit{Nungesser} holding indicated may be compatible with Article 81(1). The obligations exempted in Articles 1(1)(3), (4), (5), and (6) go beyond those imposed on the licensee and licensor by an open exclusive license because they have the effect of conferring absolute territorial protection between licensor and licensee and between the licensees.\(^{159}\)

Because Article 1(1) of the Technology Transfer Regulation exempts pure patent licenses, pure know-how licenses, and mixed licenses, including those licenses containing ancillary provisions relating to intellectual property rights other than patents, from the prohibition of Article 81(1), the exemption also covers \textit{open exclusive licenses}. Thus, contrary to the E.C.J.'s ruling in \textit{Nungesser}, the Commission presupposes that an open exclusive license may infringe Article 81(1) and, therefore, that the license needs to be exempted.\(^{160}\)

Article 1(1) of the Technology Transfer Regulation must be interpreted in conjunction with Recital 9. Recital 9 declares that open exclusive licensing agreements "may not be in themselves" incompati-

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\(^{157}\) Passive sales are those made in the territories licensed to other licensees within the common market in response to unsolicited orders. Commission Regulation 240/96, art. 1(1)(6).


\(^{159}\) It must be noted, however, that although officials of the Commission refer to "absolute territorial protection" as between licensor and licensee, in fact, this protection is always limited. Under the rules of free movement of goods and, more specifically under the doctrine of exhaustion as developed by the E.C.J., those to whom either party sells the protected product cannot be restrained through the exercise of national intellectual property rights from selling it throughout the common market. See Introductory Guide, supra note 8, at 249.

\(^{160}\) The E.C.J. in \textit{Italy v. Council and Commission} held that an agreement that falls within an exempted category does not necessarily fall within the prohibition of Article 81(1). Case 32/65, 1966 E.C.R. 389, 406. According to the E.C.J., granting exemptions by categories cannot amount, even by implication, to passing a pre-conceived judgment on any agreement considered individually. \textit{Id.}
ble with Article 81(1) of the EC Treaty "where they are concerned with the introduction and protection of a new technology in the licensed technology, by reason of the scale of the research which has been undertaken, of the increase in the level of competition, in particular interbrand competition, and of the competitiveness of the undertakings concerned resulting from the dissemination of innovation within the Community."

Recital 9 shows that the Commission has narrowly interpreted *Nungesser* because it makes the exclusion of an open exclusive licensing agreement from the prohibition of Article 81(1) dependent on the introduction of a *new technology*. Recital 9 is not satisfactory because it introduces legal uncertainty as to when an open exclusive license falls outside the prohibition of Article 81(1). For instance, how new must this technology be in order for the license agreement to be covered under the Regulation?\(^\text{161}\) Note in particular that the Commission never has considered a product sufficiently new for the purpose of qualifying a license agreement as granting an open exclusive license.\(^\text{162}\)

The Commission missed an opportunity to enhance legal certainty in this area by endorsing, without qualification, the ruling of the E.C.J. in *Nungesser*. Contrary to Recital 9's suggestion, the E.C.J. did not condition such exclusion on novelty. Novelty was only mentioned as one of the elements to be taken into account when deciding if an open exclusive license is contrary to Article 81(1). Indeed, the need to encourage investment is the most important factor in the E.C.J.'s reasoning.\(^\text{163}\)

**ii. Duration of the Exemption**

* a. *basic provisions*

Articles 1(2), 1(3), and 1(4) of the Regulation impose time limitations on the grant of exemptions depending on whether the license is a pure patent license, a pure know-how license, or a mixed license. For pure patent licenses, Articles 1(1)(1) to 1(1)(5) apply to the extent that and for as long as the licensed product is protected by paral-

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161 Davis & Johnston, *supra* note 85, at 19.
163 *Id.* at 88.
lel patents\textsuperscript{164} in both the territory of the licensees and the territory of the licensor.\textsuperscript{165} For a pure know-how license, in contrast, the exemption period is limited to ten years from the date when the licensed product is first placed in the common market by one of the licensees.\textsuperscript{166}

For a mixed license, the duration of the exemption also is limited to ten years from the date when any of the licensees first places the licensed product in the common market. Potentially, however, the longer period available to pure patent licenses may be available to mixed licenses if there is a “necessary patent” both in the licensed territory and in the territory protected by a restriction on exploitation of the licensed technology outside the licensed territory.\textsuperscript{167} The requirement of necessity prevents application of the longer period to a know-how license where an irrelevant patent was added.\textsuperscript{168}

Finally, a prohibition on passive sales between licensees is limited to five years from the date the licensed product was placed in the common market by any of the licensees, whether the licenses is a pure patent, a pure know-how, or a mixed license.

b. different levels of territorial protection granted to licensors and licensees

Licensees are not given the same level of territorial protection \textit{vis-à-vis} each other with respect to passive sales as is permitted between licensor and licensee. The licensor may rely on his contractual rights against passive sales by any of its licensees in its territory for the duration of the patent license, or for ten years from the date of the first sale by any licensee in the common market for a know-how license. The licensee can rely only on its licensed rights against passive sales from other licensees into its territory. In addition to its contractual rights, the licensor also may rely on its patent rights to prevent

\textsuperscript{164} Article 10(13) of the Technology Transfer Regulation defines parallel patents as “patents which, in spite of the divergences which remain in the absence of any unification of national rules concerning industrial property, protect the same invention in various Member States.”

\textsuperscript{165} Commission Regulation 240/96, art. 1(2) 1996 O.J. (L 31) 2.

\textsuperscript{166} \textit{Id.} art. 1(3).

\textsuperscript{167} \textit{Id.} art. 1(4). Necessary patents are “patents where a license under the patent is necessary for the putting into effect of the licensed technology in so far as, in the absence of such a license, the realization of the licensed technology would not be possible or would be possible only to a lesser extent or in more difficult or costly conditions. Such patents must therefore be of technical, legal or economic interest to the licensee.” Commission Regulation 240/96, art. 10(5), 1996 O.J. (L 31) 2.

\textsuperscript{168} Reg. Monograph, \textit{supra} note 2, at 152.
any of its licensees from making direct sales in its territory or the ter-
ritory of any of the other licensees (Article 2(1)(14)).

The relationship between Article 1(2) and Article 2(1)(14) re-
quires clarification. Article 1(2) imposes a five-year limitation on pas-
sive sales outside the licensee’s territory while Article 2(1)(14) never-
theless allows the patent licensor to prevent passive sales after five
years. The explanation for the apparent contradiction is that Article
1(2) addresses the contract between licensor and licensee, while Arti-
icle 2(1)(14) addresses the licensor’s patent rights.

For the first five years, the licensor has a choice between two
causes of action that can prevent direct sales by a licensee outside the
licensee’s territory: one based on contractual provisions (Article 1(2))
and another based on patent rights (Article 2(10)(14)). After five
years, contractual bans on direct passive sales are unenforceable and
the licensor’s only recourse is patent litigation in the country of im-
portation. Contractual rights are significantly easier to enforce be-
cause there is no need to prove the ownership, existence, and validity
of the patent. It is regrettable that the Regulation does not state a
policy reason justifying the higher level of territorial protection in fa-
vor of licensors. There is, however, a plausible explanation and justifi-
cation for this distinction. The licensee frequently has to make sub-
stantial investments to set up a production line, develop the market
and, sometimes, to improve the licensed technology. Therefore, the
licensee needs some degree of territorial protection if it is to be in-
duced to invest. However, the licensor, unlike the licensee, usually
takes the initiative to engage in costly and risky research and devel-
opment. The Commission seems to have been persuaded by the idea
that the decision to invest in research and development undertaken
by the licensor often entails a financial risk additional to that borne by
the licensee. This risky and costly investment initiative would justify
granting to the licensors a level of territorial protection higher than
that granted to licensees.

170 Maurits Dolmans, Commentary: Territorial Restrictions and the EC Technology Transfer
1998).
171 Id. at 48–2.
c. technology transfer regulation and regulation 2790/99 distinguished

The Commission has taken a more flexible approach regarding the prohibition of passive sales in licensing agreements than it has taken regarding passive sales in vertical distribution agreements. Like repealed Regulation 1983/83, Regulation 2790/99 does not permit restrictions on passive competition. The Technology Transfer Regulation does not state the policy reason for allowing a restriction on passive sales on licensees. In my view, the Commission thought that a licensee deserves more protection during the start-up period than a common distributor, since a licensee frequently has not only to develop a market within the licensed territory, but also to invest in setting up a production line and, possibly, improving the technology.

iii. The Application of Regulation to Less Restrictive Clauses: Obligations Promised by the Licensor

The Technology Transfer Regulation does not expressly exempt an agreement between the licensor and its licensees that the territorial restrictions provided in Articles 1(1)(4), 1(1)(5), and 1(1)(6) will be imposed on other licensees. Some commentators have argued that, since the Commission considers in Recital 12 of the Regulation that territorial restraints encourage licensors to grant licenses and licensees to undertake the investments required to implement the license, a promise to impose the permissible restrictions to other licensees is exempted as well.

The Regulation also does not explicitly exempt a promise by the licensor not to grant additional licenses without the consent of the

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174 Both the E.U. Technology Transfer Regulation and the U.S. IP Guidelines share the same economic rationale to allow certain restraints in licensing agreements. The Technology Transfer Regulation states that technology transfer agreements encourage the dissemination of technical knowledge in the Community and [promote] the manufacture of technically more sophisticated products. Therefore, the obligations listed in Article 1 generally contribute to improving the production of goods and to promoting technical progress. They make holders of patents or know-how more willing to grant licenses and licensees more inclined to undertake the investment required to manufacture, use, and put on the market a new product or to use a new process.

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majority of licensees. The problem is that such an agreement is likely to have a horizontal element and well may be part of a patent or know-how pool excluded from the Technology Transfer Regulation by Article 5(1)(1) or (3). Before the adoption of the Regulation, in Bronbemaling v. Heidemaatschappij, the Commission disapproved an agreement to settle a patent dispute before the Dutch patent office between three competing building companies and a licensor because the agreement stated that the licensor would not grant additional licenses without the consent of the majority of the building companies.

b. Closed Exclusive Licenses

Without prejudice to Article 1(1)(6) (restrictions on passive sales for five years), the Technology Transfer Regulation does not exempt licenses granting absolute territorial protection between licensees. Therefore, a license agreement granting absolute territorial protection to the licensee can escape the prohibition of Article 81(1) only if the parties apply for and obtain an individual exemption pursuant to Article 81(3). Given the strict approach taken by the Commission towards agreements that may have the object or the effect of dividing the common market, the Commission is likely to reject such an exemption.

c. The Loopholes in the Territorial Protection Allowed Under the Regulation

Even when a licensor grants its licensees some territorial protection, a licensee is not totally insulated from competition. Where transportation costs are not an important element in the final price of the licensed product, there are several circumstances that may limit the amount of territorial protection granted by the licensor to the li-

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176 See Reg. Monograph, supra note 2, at 135 n.20.
178 Article 3 of the Technology Transfer Regulation states that the exemption does not apply if the agreement contains provisions preventing parallel imports, i.e., 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 placed in the common market by the licensor or with his consent.
licensee even in those cases in which a licensor grants absolute territorial protection to a licensee.

First, a licensee may face interbrand competition from licensees selling products made by competing technologies. If, for instance, the licensees of the competing technologies are not manufacturing the competing products in a geographic area close to the first licensee's territory, then interbrand competition can be mitigated if transportation costs are high. Interbrand competition also may be mitigated if there are significant regulatory or other barriers between various territories.

Second, the principle of exhaustion of rights as developed by the E.C.J. prevents the licensor or the licensee from relying on its intellectual property rights to impede parallel imports of products which have been brought into the country of origin by the licensor or by a third party with the licensor's consent. 179 Although the E.C.J. refers to marketing in the country of origin, and not to direct sales by the licensee into another Member State, the Commission traditionally had interpreted that the grant of a license exhausted the right of the licensor in the country of import. 180 However, the Commission changed its course in the Technology Transfer Regulation with Article 2(1)(14) 181 and returned to its view on limited licenses stated in its "Christmas Message" of 1962. 182

The Commission's changed approach is difficult to explain, especially in view of the strong language used in its press release regard-

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180 In the GEMA case, the Commission intervened to deter the German copyright protection society from requesting the payment of royalties to the manufacturers of sound recordings in Germany working to order and on account of sound recording suppliers licensed by one of the copyright protection societies of the various Member States. According to the Commission's Press Release announcing the settlement of the case, a license granted by a Community copyright protection society is valid throughout the Community and authorizes manufacture in any Member State. In other words, for the Commission the grant of a license exhausted the copyright right of the licensor in the country of import. See Commission's Press Release, February 6, 1985, [1985] 2 C.M.L.R. 1, 1.


182 See Notice on Patent Licensing Agreements, 2922/62, 1962 O.J. (commonly known as the "Christmas Message," partly because of its date and partly because of the good news that many exclusive licenses would not infringe Article 81(1) and need not be brought to the attention of the Commission); see also Reg. Monograph, supra note 2, at 72–73 n.46. Notice that in none of its formal decisions on patent licenses did the Commission accept the view announced in its "Christmas Message." Reg. Monograph, supra note 2, at 72–73.
ing the settlement of proceedings against GEMA. The Commission may have decided to include Article 2(1)(14) in the Regulation in order to strengthen the defense of its position in the Ladbroke case. At the time the Technology Transfer Regulation was being drafted, the Legal Service of the Commission was defending the Commission’s rejection of a complaint submitted to it by a Belgium betting agency (Tiercé Ladbroke) against the grant of an exclusive license in the films of French horse-races limited to Germany and Austria.

Contrary to its position in the GEMA case, the Commission rejected the complaint by Tiercé Ladbroke because the challenged restrictions formed part of the inherent right granted to a copyright holder to choose its licensees and the size of the territories that it grants to them; therefore, the restrictions did not infringe Article 81(1).

183 "[1] The Commission took the view in this case that, within the Community, freedom to choose where to manufacture records and other sound recordings (pre-recorded cassettes, tapes and compact discs) should not be restricted by the application of national copyrights laws. [ ... ] [3] A separate requirement to pay royalties to the national copyright protection society having 'jurisdiction' over the place of manufacture according to the rates applicable there would in practice mean the re-erection of national barriers by contractual means between Member-States. [ ... ] [9] This action is part of the Commission’s efforts to ensure the complete freedom of competition and eliminate national barriers in this sector." Commission’s Press Release, supra note 180, [1985] 2 C.M.L.R. at 2, 3.

184 This Commission decision rejecting the complaint related to Belgium and was never published. The Commission, however, published a decision regarding a similar complaint but related to Germany. [1996] 5 C.M.L.R. 320, PMI-DSV. The Belgian complaint related both to a refusal of PMU (Pari Mutuel Urbain) and PMI (Pari Mutuel International) to grant the Belgian subsidiary of the Ladbroke Group (Tiercé Ladbroke) a license for the Belgian market, and also to a refusal by DSV (PMI’s German licensee) of a sub-license also for the Belgian market. The German decision related both to the refusal of PMI to grant the German subsidiary of the Ladbroke Group (Ladbroke Deutschland) a sub-license for use in the horse races betting market for Germany on the ground that it was not allowed by its agreement with PMU, and also to the refusal of DSV to grant a sub-license for the same market also on the ground that it was banned to do so by its agreement with PMI. The Commission’s decision related to Belgium was appealed by Ladbroke before the C.F.I., and the C.F.I. upheld the rejection of the complaint by the Commission. Case T-504/93, Tiercé Ladbroke v. Commission, 1997 ECR II-927, ¶¶ 146 151, 152, 153. The C.F.I. ruled that “the mere fact that the owner of the copyright has granted to a sole licensee an exclusive right over the territory of a Member State, while prohibiting the grant of sub-licenses for a specific period, is not sufficient to justify a finding that such a contract must be regarded, as the purpose, the means or the result of an agreement prohibited by the Treaty.” ¶ 149. See a critical commentary on the Ladbroke case in V. Korah, The Ladbroke Saga, 3 E.C.L.R. 169 (1998).


186 Ladbroke, 1997 ECR II-927, ¶ 34. In its decision related to Germany, the Commission held that the provision limiting the exclusive operating license to Germany was not caught by Article 81. The holders of the copyright to the pictures of French races, the rac-
Article 2(1)(14) presupposes that direct sales by a patent licensee outside its territory do not exhaust the right of the licensor in the country of import. The licensor may reserve its right to rely on its patent to impede the sale of the patented goods by one licensee directly in the territory of another or in the licensor's own territory. This provision, however, is not likely to significantly increase the protection of licensees vis-à-vis other licensees. Once a licensee has sold the goods to a dealer, the licensor no longer can rely on its patent to prevent the imports of the patented product from entering into its territory or the other licensees' territories. Goods are likely to be imported if prices in the country of import are higher than those prevailing in the country of export (this is the situation, for instance, with regard to the sale of pharmaceutical products within the E.U.). Article 2(1)(14), however, may be useful to protect other licensees and the licensor itself if the licensees sell the patented products only to final customers and not to dealers.

Finally, a further limitation in the licensee's territorial protection arises from Commission Regulation 2790/99. Regulation 2790/99, which is applicable to vertical distribution agreements, does not permit the licensor to protect its licensees from active sales made by distributors appointed by the licensor in other territories. On this point, Regulation 2790/99 is more restrictive than the repealed Regulation 1983/83 on exclusive distribution agreements. Article 2(2) of Regulation 1983/83 exempted an obligation imposed on the exclusive distributor "to refrain, outside the contract territory and in relation to the contract goods, from seeking customers, from establishing associations, were entitled in granting [its subsidiary] PMI the right to use such pictures and commentaries to require it to seek their approval whenever PMI wished to exercise those rights abroad. Likewise, the Commission found that an obligation imposed on DSV to refrain from sublicensing the licensed pictures outside the licensed territory was not caught by Article 81(1) because "it forms part of the rights granted to copyright holders under present Community rules." According to the Commission, if such a clause were not included, the license would become a European license under which the licensor would no longer be free, in particular, to choose his sub-licensees for the other Member States.

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188 Reg. Monograph, supra note 2, at 206.
190 Id., art. 4(b), 1999 O.J. (L 336) 21. Article 4(b) §1 exempts only "the restriction of active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer, where such a restriction does not limit sales by the customers of the buyer."
any branch and from maintaining any distribution depot." Thus, Regulation 1983/83 did not limit the exemption, as Regulation 2790/99 does, to the "buyers" to whom the supplier has allocated the territories. Hence, the exemption of Article 2(2) of Regulation 1983/83 appeared to cover those situations in which a licensor imposed on its distributors an obligation not to pursue an active sales policy in its licensees' territories.

The following example shows the inadequacy of the current territorial protection provisions under Regulation 2970/99 in addressing the needs of licensors. If a licensor wants to establish a network combining exclusive licensees for some territories and exclusive distributors for others, the amount of protection received by each of them may be inappropriate. For instance, imagine that a licensor appoints an exclusive distributor for Spain and an exclusive licensee for the UK. For the purposes of the Technology Transfer Regulation, the Spanish territory is the "licensor's territory" because the licensor has reserved Spain as the licensor's territory within the meaning the definition of Article 10(12) of the Regulation.192 Thus, the licensor's distributor can be protected from the active and passive sales of the UK licensee subject to the time limits under the Regulation. The distributor then is receiving an amount of protection that may exceed that necessary to induce it to market the product. In contrast, the UK licensee, who will have to set up a production line and develop a market, is granted less protection than the licensor's distributor. The licensee probably will not be protected from the active sales of the distributor because Regulation 2970/99 does not exempt such a provision.

There is no economic rationale justifying the licensor's inability under Regulation 2790/99 to protect its licensees from its distributors. Instead, there are meritorious economic and policy reasons to permit suppliers to protect its licensees against active sales made by the licensor's distributors in the licensed territories.

The competitive benefits of territorial restraints as acknowledged in Regulation 2790/99,193 the improvement of economic efficiency within the chain of distribution of goods, and in the Technology Transfer Regulation, the dissemination of technology and the im-

192 Article 10(12) defines the "territory of the licensor" as the "territories in which the licensor has not granted any licenses for patents and/or know-how covered by the licensed technology."

provement of manufacturing processes, also are present for territorial restraints between a licensee and a distributor. A licensee may be unwilling to undertake necessary investments if the licensor does not assure it a certain level of territorial protection against the sales made by the licensor’s distributors in the licensed territory. This lack of protection of the licensee may have a negative impact on the dissemination of technology and on the improvement of manufacturing processes, which are the main objectives of the Technology Transfer Regulation. The current situation raises the question of under which circumstances, if any, an agreement between a licensor and a licensee whereby the licensee is territorially protected from the licensor’s distributors falls outside the scope of Article 81(1).

A clause prohibiting the licensor’s distributors from making active sales in the territory of the licensee could escape the prohibition of Article 81(1) if the clause is interpreted as ancillary to the license agreement because ancillary restraints fall outside of Article 81(1). In the E.U., the term “ancillary restraints” may be used in two situations. One school of thought reasons that the term describes those restraints that are reasonably necessary for the performance of a contract that is not itself anti-competitive. A second school of thought reasons that the term is used to describe any restriction in an agreement that it is not appreciable and which, for that reason, falls outside of Article 81(1). This second interpretation is based on the wording of Article 81(1) as it has been interpreted by the E.C.J. In Völk v. Verwaeye, the E.C.J. held that an agreement does not infringe Article 81(1) if it does not appreciably restrict competition in the common market. A clause restricting distributors from making active sales in the licensed territories could qualify as an ancillary restraint, whether the term “ancillary restraints” is given one meaning or the other.

Without being able to impose an obligation on its distributors not to make active sales in the licensed territories, the licensor may not be able to find any licensee to develop the market and set up a production line. This negative obligation then could be an ancillary

196 For a more elaborated analysis on the different schools of thought regarding ancillary restraints see González Díaz, supra note 90.
197 Id. at 327.
restraint within the first use of the term "ancillary restraints" because it is a provision "necessary" to make the license agreement viable. It is also possible that a clause imposing on distributors the obligation not to make active sales in the licensed territories is ancillary because it is not likely to have an appreciable effect on competition.

The above analysis shows that there is an important regulatory gap in EC competition law regarding the protection of licensees from sales made by the distributors of the licensor. First, it is incompatible with Article 81(1) for a licensor to grant territorial protection to its licensees from the active sales made by its distributors in the licensee's territories. Second, such a clause is not covered by any block exemption. Third, it is unlikely that the Commission will grant an individual exemption for such a clause under Article 81(3). Thus, a prompt reform of Regulation 2790/99 is needed to fill the existing gap in the territorial protection of licensees.

d. *Time Limits Set Forth in the Technology Transfer Regulation: A Critical View*

One of the major differences between the regulation of territorial restraints in licensing agreements in the E.U. and U.S. is the time limitations of the exemptions for the territorial protection obligations referred to in points (1) to (5) of Article 1(1) of the Technology Transfer Regulation.

One of the consequences and major drawbacks of having a system of block exemptions instead of a Rule of Reason approach is that block exemptions must be limited in time. It is regrettable that the Technology Transfer Regulation does not state any convincing justification for these time limits. At the risk of oversimplification, these time limits appear to be a manifestation of the Commission's traditional sensitivity to schemes or agreements that have the potential of dividing national markets in the E.U.

i. The Ten Years in Know-how Limitation and Mixed Agreements

The Commission unconvincingly tries to justify the ten year time limitation with the difficulty in determining the point at which the

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know-how ceases to be secret.\textsuperscript{202} Although it may be difficult to determine the time at which the know-how ceases to be secret, it also is arguable that the duration of the territorial restraints in know-how agreements should have been determined on the basis of the precarious nature of the know-how's secrecy.\textsuperscript{203} In other words, the Commission relies on the difficulty in determining when the know-how ceases to be secret without taking into account as much as it should the fact that, given the swift development of technological changes, the duration of the agreement may be foreshadowed when the know-how enters the public domain.\textsuperscript{204} The ten year limit seems to be the consequence of a compromise between the seven years suggested by the Commission and the recommendation made by the European Parliament that it was inappropriate to stipulate a maximum time.\textsuperscript{205}

An explanation, but not a justification, for the ten year time limit set out by the Regulation may be found in the tension between the \textit{ex ante} and the \textit{ex post} analysis of licensing agreements which often characterizes the approach of the Commission towards exclusive licenses. Behind the ten year limitation, one can see the shadow of an \textit{ex post} analysis of the restrictive clauses that may be included in exclusive license agreements. In my view, when the Commission decided to introduce the ten year time limit, it had in mind the idea that the licensee and the licensor are in a horizontal relationship once the licensee begins manufacturing the products under the licensed technology. If the Commission considers a license agreement as horizontal, it is easier to justify more restrictive time limits because then the territorial limitations exempted under Article 1(1) (1) of the Regulation are likely to be perceived as a partitioning device to divide the common market and, therefore, worthy of being strictly limited in time.

Should the Commission have had an \textit{ex ante} approach in mind when the introduction of this time limitation was being discussed, it probably would have exempted the prohibition of active sales in know-how agreements for a longer period. An \textit{ex ante} analysis of a license agreement requires the Commission to determine whether a licensee would have not entered the market but for the license

\begin{footnotesize}
\begin{enumerate}
\item Commission Regulation 240/96, Recital 13, 1996 O.J. (L 31) 2.
\item Id. at 660.
\item Id.
\end{enumerate}
\end{footnotesize}
agreement. If the answer to this question is affirmative, then the license agreement should qualify as a vertical arrangement. It is easier to justify a longer period for an exemption if the license agreement is vertical because pro-competitive efficiencies are more easily attached to vertical agreements than to horizontal agreements. A horizontal agreement is more likely to cause a reduction of output and an increase in prices than a vertical one.

The development and subsequent marketing of a product manufactured under a know-how technology may be as costly and risky as the development and marketing of a product manufactured under a patented technology. For this reason, the licensor and licensees should be entitled under a know-how license agreement to impose upon each other territorial restraints for a longer or unlimited period.  

The ten year time limit may cause a reduction in the value of the know-how, thereby discouraging innovation. Under the Technology Transfer Regulation, if the parties to a know-how licensing agreement believe that a longer period will be necessary to implement their agreement, they must apply for an individual exemption under Article 81(3) and must justify the necessity of a longer period on the grounds of the expensive and risky investment required under the agreement or on the grounds that the parties are not competitors at the date of the grant of the license.

In a highly competitive market where innovation evolves rapidly, applying for an individual exemption after the expiration of the ten year period may damage the competitiveness of a firm in the relevant market. This limitation may be especially damaging in sectors where research and development are costly and risky and are only undertaken if parties are able to generate the necessary cash flow during a period longer than ten years or even during the period in which the know-how remains secret.

The ten year limit works poorly when technology is being constantly developed. Recital 14 of the Regulation provides that an individual exemption under Article 81(3) is required when the parties want to agree on further periods of territorial protection to exploit

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206 Reg. Monograph, supra note 2, at 154. Korah "would have preferred horizontal agreements to have been more fully excluded from the regulation and the periods of territorial protection to have been unlimited [because] [t]he innovator has no incentive to share any market power it may have with his licensees and if it restrains them from competing with each other it must be because of the need to induce investments by them." Id.

any subsequent improvements to the licensed technology. Only when the research for improvements results in "innovations" that are distinct from the licensed technology may the parties enter a new agreement benefiting from the exemption under the Regulation.

The problem with Recital 14 is that it is not easy to distinguish "improvements" from "innovations" that are distinct from the licensed technology. The prospect of costly and time-consuming litigation, which may arise due to conflicting views on the nature of the new inventions may in some situations discourage licensors and licensees from committing resources to develop and eventually exploit the improvements.

The ten year period also limits the licensor's know-how rights to the period when the time limit starts running on the date the product is first placed in the common market by one of the licensees. Thus, subsequent licensees are granted territorial protection for shorter periods. Licensees will not commit to developing a market and setting up a line of production if there is not sufficient time left to take advantage of them, because the cost in building a plant and developing a market may be the same as that borne by the previous licensees who are enjoying longer periods of territorial protection. The Commission never has been persuaded by this argument and has opined that the difficulty in persuading subsequent licensees to invest will encourage licensors to license more rapidly.\(^{208}\)

The Commission's view overlooks two main disadvantages. First, it discriminates between small and large innovators. A large firm with a manufacturing capacity can develop its technology itself and still be able to grant protection to each licensee from active sales by the others for ten years after the introduction of the licensed product into the common market. However, a small firm may have serious problems in developing its technology and may decide to merge with the initial licensee in order to avoid the time limits and the other constraints of the Regulation. Second, a licensor may decide to grant the first license outside the common market in order to avoid the ten year limit. Thus, the current Regulation may, in certain situations, encourage development outside the E.U.\(^{209}\) The European industry, as a whole, would suffer.\(^{210}\)

\(^{208}\) See Reg. Monograph, supra note 2, at 153; Commission’s Press Release, supra note 180, IP(84) 270.

\(^{209}\) See Reg. Monograph, supra note 2, at 154; see also Bright, supra note 15, at 33–1.

\(^{210}\) See Bright, supra note 15, at 33–1.
Whatever the duration of the time limit for the prohibition of active sales in know-how and mixed agreements, the time limit should run from the date of its own license so that there will be sufficient time left to take advantage of it when the licensee starts to sell. This approach was suggested by the Social and Economic Committee in its comments on the draft of the previous know-how regulation.211

ii. The Passive Sales Time Limit

Protection between licensees from passive sales is permitted under the Technology Transfer Regulation for a period of five years from the date the product is first placed in the common market. Like the former patent and know-how block exemption regulations, the Technology Transfer Regulation does not contain any explanation on why the Commission chose this five-year limit.

During the drafting of the former patent block exemption regulation,212 the Commission initially was opposed to passive sales protection but seems to have accepted the five-year solution in response to the criticism of the Economic and Social Committee. The Commission, however, did not follow the view of the Economic and Social Committee that the protection from passive sales should be as long as the protection from active sales.213

The same argument that justifies a longer exemption for the active sales prohibition also is valid with regard to passive sales. The pro-competitive efficiencies that stem from territorial protection clauses inserted in license agreements may justify, at least, an extension of the passive sales’ prohibition to a period as long as that allowed for active sales prohibitions.214

iii. Conclusion: Proposal for Reform

Great progress has been made in the achievement of an integrated market in the E.U., and further efforts certainly will be neces-

213 Additional Opinion on the Draft Commission Regulation on the Application of Article 85(3) of the Treaty to Certain Categories of Know-how Licensing Agreements, supra note 211.
sary if the full economic advantages of integration are to be realized. However, I wonder if a stage of maturity already has been reached in the creation of the single market in which a thorough analysis and debate within the Commission, and between the Commission and the industry, is required regarding whether it is economically sensible to maintain these time limits. The Technology Transfer Regulation seems to be at odds with the vital importance of technology to economic growth and to the ability of firms to compete in an increasingly globalized market.

In 1996, the Commission realized that innovation was vital for the success of a modern economy and that the two former block exemption regulations for patent and know-how licenses respectively could not properly meet the needs of innovators. This was one of the reasons why it adopted the Transfer Technology Regulation as a step towards the creation of a legal environment that would promote technical innovation and its dissemination within the E.U. In this regard, one of the most welcome developments in the Transfer Technology Regulation was the adoption by the Commission of a more relaxed approach towards certain clauses that were black-listed in the repealed block exemption regulations.

217 The black list of the Technology Transfer Regulation (Article 3) is shorter than those of its predecessors. The following obligations on the licensee which were formerly contained in the black list of the Patent Regulation and the Know-how regulations were excluded from the current black list: (i) an obligation not to contest the secrecy of the licensed know-how or to challenge the validity of licensed patents within the common market (a “no-challenge” clause); (ii) a tying clause which is not necessary for a technically proper exploitation of the licensed technology or to ensure that the product meets accepted minimum specifications; (iii) an obligation not to continue to use the licensed know-how after the termination of the agreement where the know-how has meanwhile become publicly known other than by action of the licensee; (iv) an obligation to pay royalties on goods or services which are not entirely or partially produced by means of the licensed technology or for the use of know-how which has become publicly known by the action of the licensor; (v) an obligation to accept automatic prolongation of the initial duration of the licensing agreement by the inclusion in it of any new improvements communicated by the licensor; (vi) an obligation to grant the licensor the exclusive right for improvements to or new applications of the licensed technology which would prevent the licensee during the currency of the licensing agreement and/or thereafter from using his own improvements in so far as these are severable from the licensor’s own know-how or from licensing them to third parties, where such licensing would not disclose the licensor’s know-how that is still secret (an “exclusive grant-back clause”); and (vii) customer allocation restrictions where the parties were not competitors before the license was granted.
As in 1996, the Commission now should be prepared to again revise its policy on license agreements and adopt a more lenient approach towards territorial restraints by amending or repealing the time constraints to which territorial clauses in licensing arrangements are subject to under the Technology Transfer Regulation. In addition to the arguments in favor of this reform that relate to the dissemination of technology and improvement of manufacturing processes, a more specific pro-European economic integration argument also may be made in favor of extending or repealing these time limits. The more integrated the economies of the Member States become, the more damaging the maintenance of a system which may discourage the use of innovation and deter licensors from engaging in license agreements in different Member States will be.

Deepening economic integration at the interbrand level eventually may be prevented or delayed, *inter alia*, by the time limits established under the Technology Transfer Regulation for territorial restraints as long as more innovators may be discouraged from investing in research and development and eventually licensing its technology in different Member States. 218

B. The U.S. Agencies and Courts' Approach Towards Exclusive Licenses

1. The Application of the Rule of Reason to Territorial Restraints

The U.S. already had an integrated economy when the Sherman Act was enacted in 1890. 219 For that reason, market integration has not been an objective of U.S. antitrust law. 220 Thus, U.S. agencies and courts have not been as concerned as the Commission with the anti-competitive effects of vertical restraints and have judged them, since

218 Mastromanolis, *supra* note 21, at 614. This author makes the same criticism with regard to territorial restrictions in exclusive distribution agreements. The argument is not new, though. In 1966, Advocate General Roemer, in his Opinion in Cases 56 & 58/64, Etablissements Consten SA and Grundig-Verkaufs-GmbH v. EEC Commission, 1966 E.C.R. 352, 359, argued that prohibiting an exclusive distribution agreement which grants absolute territorial protection, making possible imports of the product in question in the territory of the appointed distributor, may lead to the abolition of the sole distributorship and that suppression of the distributor may stand in the way of the integration of the various national markets. The E.C.J., however, did not follow the Opinion of the Advocate General.


1977, under the Rule of Reason.221 Despite having an integrated economy, before *Sylvania* (1977) vertical restraints were per se illegal under U.S. antitrust law. Nonetheless, license agreements traditionally had been subject to a more lenient approach even at the time when vertical restraints were considered per se illegal under *Schwinn* (1967).222

U.S. courts consistently have upheld the validity of territorial restrictions in patent license agreements against complaints that an exclusive license agreement is per se illegal because it imposes territorial restrictions on licensors and/or licensees.223 Section 261 of the Patent Act specifically authorizes the assignment of an exclusive right under a patent to the whole or part of the United States.224 One of the aims of this provision is to provide the patentee with a reasonable means to secure the reward granted to him under the Patent Act.225

In view of Section 261, it has not been difficult for U.S. courts to rule that it not necessary to analyze the reasonableness of territorial divisions226 because, as a matter of law, a patent licensor’s use of geographic restrictions in a licensing agreement constitutes a lawful application of the rights derived from a patent grant.227 Thus, Section 261 immunizes an allocation of territories created by a patentee’s use of exclusive licenses from antitrust liability.228 In this respect, there is

221 *See* Paddock v. Chicago Tribune, 103 F.3d 42 (7th Cir. 1996) (upholding a series of contracts under which various sellers of news and other services supplied one newspaper exclusively in a given area).

222 *Schwinn*, 388 U.S. at 373. *See* Dunlop Co. Ltd. v. Kelsey-Hayes Co., 484 F.2d 407, 417 (6th Cir. 1973). In Dunlop, the court of appeals held that the territorial division of world markets through patent licenses did not violate U.S. antitrust law. *Id.*


224 “The applicant patentee, or his assigns or legal representatives may in like manner grant and convey an exclusive right under his application for patent, or patents, to the whole or any specified part of the United States.” 35 U.S.C. § 261 (1982).


228 Dunlop, 484 F.2d at 417; Miller Insituform, 605 F. Supp. at 1131.
similarity between the approaches of the U.S. Congress and the Commission towards exclusive licenses.

The Commission considers compatible with Article 81(1) the right to limit the grant of a copyright license to a specific territory on the grounds that it forms part of the intellectual property right of the holder. In the PMI/DSV case,\(^{229}\) the Commission held that the grant of a territorially limited copyright license for performing rights does not infringe Article 81(1). Thus, the holders of a copyright to pictures and commentaries of French races were entitled, in granting PMU the right to use such pictures and sounds, to require it to seek approval whenever PMI wished to exercise those rights abroad. Likewise, the Commission held that the grant of a copyright license to DSV by PMI limited to Germany, prohibiting DSV from sub-licensing the pictures and sounds of the French horse races outside Germany without PMI's approval, was part of the rights granted to copyright holders under E.U. law.\(^{230}\)

The introduction of Article 2(1)(14) in the Technology Transfer Regulation indicates that the position held by the Commission in the Ladbroke decisions with regard to limited exclusive copyright licenses over performing rights is applicable also to patent licenses.\(^{231}\) Moreover, it is arguable that the reasoning of the Commission in PMI/DSV also applies to intellectual property rights other than patents and copyrights.\(^{232}\) The PMI/DSV decision, as well as the introduction of Article 2(1)(14) in the Technology Transfer Regulation, must be interpreted as a return by the Commission to the narrower definition of the exhaustion doctrine given by the E.C.J. in Centrafarm\(^ {233}\) and which the Commission had interpreted broadly in cases such as GEMA.\(^ {234}\) The judgment of the E.C.J. in Centrafarm related to patents, but the initial reasoning of the E.C.J. before considering the specific facts of the case does not seem to be limited only to patents. Instead, it appears applicable to all intellectual property rights.

Given that in the U.S., territorial restrictions in patent licenses are considered permissible under Section 261 of the Patent Act, what

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\(^{230}\) The Commission reached the same conclusion in a previous decision of the "Ladbroke saga" rejecting a complaint by Tiercé Ladbroke (a Belgian betting agency) against the principal French horse racing associations (Pari Mutuel Urbain and Pari Mutuel International). Ladbroke, 1997 ECR II-927, ¶ 146.

\(^{231}\) See Commission Regulation 240/96, Recital 18, 1996 O.J. (L 31) 2.

\(^{232}\) Korah, supra note 184, at 175.

\(^{233}\) Centrafarm, 1974 E.C.R. 1147, Grounds ¶ 5.

is relevant is which restrictions the patentee may impose once its rights are exhausted by the first authorized sale. At this point, the patentee’s ability to impose territorial restraints would be like that of a licensor of other kinds of intellectual property. U.S. courts analyze the territorial restraints under the general framework for evaluating vertical restraints,\(^{235}\) the Rule of Reason.\(^{236}\) Thus, U.S. agencies and courts apply a Rule of Reason analysis to all territorial restraints regarding intellectual property rights other than patents, for which an equivalent to Section 261 does not exist.

In the E.U., after the decisions of the Commission on the Ladbroke complaints and the introduction of Article 2(1)(14) in the Technology Transfer Regulation, a patentee or a copyright holder can grant an exclusive territory to its licensee. However, unlike in the U.S., the territorial restrictions that a licensor imposes on a licensee beyond what is entitled under its intellectual property rights are considered a per se violation of Article 81(1). Exclusive licenses for intellectual property rights other than copyrights or patents are per se illegal pursuant to EC competition law and, therefore, must be exempted to be enforceable.\(^ {237}\)

For instance, a case like Nungesser would have been analyzed by the U.S. agencies and courts under the Rule of Reason; most likely, they would have reached a different conclusion with regard to the absolute territorial protection from that of the E.C.J. A U.S. court would have accepted such a clause unless it tended to reduce production and elevate the prices in the German market. Instead of holding that an airtight territorial protection restricts intrabrand competition and automatically violates Article 81(1), even if it promotes interbrand competition, a U.S. court first would have defined the relevant market in order to determine Nungesser’s market share, the market shares of other actual or potential competitors, and the possible existence of barriers to entry into the market. If the analysis of the relevant market

\(^{235}\) See Sylvania, 433 U.S. at 49. Notice though that minimum resale maintenance still is per se illegal. Khan, 522 U.S. at 3.

\(^{236}\) Fox, supra note 31, at 156.

\(^{237}\) The Commission, however, is likely to clear an exclusive license when (i) the licensor and the licensees are permitted to sell in the whole of the common market and they are likely to do so given that the licensed products can be transported relatively easily and inexpensively, and (ii) the combined market shares of the parties in the relevant market is not noticeable. See Commission Decision No. 72/25/EEC, [1972] 4 C.M.L.R. D67, ¶6 (Burroughs/Delplanque); Commission Decision No. 72/26/EEC, 4 C.M.L.R. D 72, ¶6 (Burroughs/Geha-Werke). The combined market share of the parties at the date of the decision of the relevant product was under 10%. Reg. Monograph, supra note 2, at 44 n.36.
had shown that interbrand competition was vigorous enough to counterbalance the presumed negative impact of the airtight territorial restraint, a sustainable reduction in output and increase in prices, then the court would have found that the challenged clause was not in violation of Section 1 of the Sherman Act.\textsuperscript{238} Even if a closer substitute would not exert an immediate constraint over Nungesser’s ability to achieve supracompetitive profits, as long as absolute territorial protection were necessary for Nungesser to make available a new product in the German market, the restraint probably would be justified.\textsuperscript{239}

Attempted pretext or sham license schemes to disguise a naked horizontal market division scheme have been declared violations of Section 1 of the Sherman Act. In \textit{U.S. v. Crown Zellerbach Corp.},\textsuperscript{240} two already competing companies (ALSCO and Crown) in the business of manufacturing and distributing cabinets for dispensing linen and paper towels, used a patent license to divide the territory of the relevant market and to allocate customers among themselves.\textsuperscript{241} Cabinets were distributed through linen and towel supply businesses and paper jobbers.\textsuperscript{242}

Under the terms of their agreement, ALSCO granted an exclusive license to Crown to use and distribute ALSCO’s patented paper towel cabinets in the territory of the east of the Mississippi, while ALSCO reserved for itself the territory west of the Mississippi. Crown also agreed to deal exclusively with ALSCO and not to distribute cabinets of other producers.\textsuperscript{243} ALSCO reserved the right to distribute on an exclusive basis to customers in the linen and cloth towel supply business.\textsuperscript{244} The effect of the agreement was to give Crown the sole right to sell the cabinets to paper jobbers in the eastern United States and to reserve to ALSCO the linen supply company customers in that area. All customers west of the Mississippi were also reserved to ALSCO.\textsuperscript{245}

\textsuperscript{238} After \textit{Nungesser}, the E.C.J., despite not judging absolute territorial protection clauses under the Rule of Reason but under the ancillary restraints doctrine, has ruled that, in some situations, absolute territorial protection clauses are compatible with Article 81(1). \textit{Erauw-Jacquéry}, 1988 E.C.R. 1919, Grounds \textsuperscript{120}; \textit{Coditel SA}, 1982 E.C.R. 3381 Grounds \textsuperscript{120}.

\textsuperscript{239} Fox, \textit{supra} note 31, at 159.

\textsuperscript{240} \textit{Crown Zellerbach Corp.}, 141 F. Supp. 118.

\textsuperscript{241} \textit{Id.} at 123.

\textsuperscript{242} \textit{Id.}

\textsuperscript{243} \textit{Id.} at 123–24.

\textsuperscript{244} \textit{Id.} at 124.

\textsuperscript{245} \textit{Crown Zellerbach Corp.}, 141 F. Supp. at 124.
Competition between the respective distributors of Crown and ALSCO was foreclosed by Crown's agreement that it would not sell or lease any cabinets to replace cloth or paper towel cabinets installed by any of ALSCO's distributors, and by ALSCO's agreement that any of its linen supply company distributors who replaced cabinets installed by one of Crown's distributors would lose the right to protection from competition from Crown's distributors.246

On the basis of Section 261 of the Patent Act, the court held that a territorial protection granted under a license agreement was a valid exercise of ALCO's patent rights.247 However, the court rejected Crown's argument that the patent license justified the allocation of customers.248 The court ruled that customers' allocations are not immunized by the patent laws and therefore, according to the controlling precedents249 constituted a per se violation of the Sherman Act.250

2. The U.S. Agencies' Intellectual Property Guidelines

The IP Guidelines are consistent with the jurisprudence of the U.S. courts regarding territorial restraints. The first difference with the approach of the Commission towards exclusive licenses is that the U.S. agencies do not differentiate between open exclusive licenses and licenses granting absolute territorial protection. This distinction reflects the concern of the Commission and European Community Courts about the market divisions that may be originated within the common market by the organization of a distribution system with exclusive distributors.251

Unlike in the E.U., where an exclusive license agreement is per se illegal unless exempted,252 the IP Guidelines state that an exclusive license agreement raises antitrust concerns only if the licensees themselves, or the licensor and the licensees, are in a horizontal relationship.253 A horizontal relationship is defined in Section 3.3 of the IP Guidelines as a relationship between the licensor and its licensees, or
between licensees, in which the parties would have been actual or potential competitors in the relevant market in the absence of a license. On this point, the Commission’s analysis differs from that of the U.S. agencies. According to the IP Guidelines, territorial restraints may raise problems in arrangements between parties who are competitors already, such as cross-licensing by parties collectively possessing market power,\textsuperscript{254} grantbacks,\textsuperscript{255} and acquisitions of intellectual property rights.\textsuperscript{256}

Unlike the Technology Transfer Regulation, the IP Guidelines do not contain time limitations on territorial exclusivity. This is perhaps one of the pivotal differences from the E.U. approach. The lack of time constraints on territorial protection clauses in U.S. antitrust law stems from the fact that, unlike in the E.U., the principal form of analysis in U.S. antitrust law is the Rule of Reason, rather than a formalistic system based on the idea that any restriction of conduct amounts to a restriction of competition and, therefore, must be prohibited.

The U.S. agencies’ more flexible approach towards territorial restrictions in license agreements and other restraints in technology transfer agreements in general also is reflected by the adoption within the IP Guidelines of a market share safe harbor.\textsuperscript{257} The IP Guidelines indicate that “absent extraordinary circumstances,” the U.S. agencies will not challenge a restraint in an intellectual property agreement if the restraint is not facially anticompetitive and if the licensor and the licensees collectively account for no more than twenty percent of each relevant market significantly affected by the restraint. This safety zone does not apply to those transfers of intellectual property rights to which the merger analysis is applied.

Determination of whether a license agreement falls within the safety zone is decided by reference only to goods markets unless the analysis of goods markets alone will not adequately address the effects of the licensing agreement on competition among technologies or in research and development. If an examination of the effects on competition among technologies is required and market shares cannot be ascertained, the U.S. agencies will not challenge a restraint in a li-

\textsuperscript{254} Id. § 5.5; see Article 5 of Commission Regulation 240/96.

\textsuperscript{255} IP Guidelines, supra note 1, § 5.6; see Articles 2(1) (4) and 3(6) of Commission Regulation 240/96.

\textsuperscript{256} IP Guidelines, supra note 1, § 5.7.

\textsuperscript{257} Id. § 4.3.
license agreement if the restraint is not facially anticompetitive and there are four or more independent sources of technology.

The Technology Transfer Regulation does not contain a safety zone similar to that contained in the IP Guidelines. Given the nature of a block exemption, it is not necessary to have one because agreements covered by the block exemption are not caught by Article 81(1). The only safety zone available to parties to a license agreement that falls within the jurisdiction of the Commission is that established in the Commission Notice on Agreements of Minor Importance.258 However, there is a basic difference between the “de minimis” rule of the Notice and the safe harbor of the IP Guidelines. A restrictive agreement falling outside the Notice is automatically void under Article 81(2), while a restraint falling outside the IP Guidelines' safe harbor still is subject to a Rule of Reason analysis and could be exonerated.259

Finally, the IP Guidelines note that certain transfers of intellectual property rights are most appropriately analyzed under the merger control provisions. The U.S. agencies will apply the merger analysis to an outright sale by an intellectual property owner of all of its rights to that intellectual property and to a transaction in which a person obtains an exclusive license for intellectual property through a grant, sale, or other transfer. An exclusive license in this context is a license that precludes all other persons, including the licensor, from using the licensed intellectual property. These transactions are assessed mainly under Section 7 of the Clayton Act and the principles set out in the U.S. agencies Merger Guidelines of 1992.260

CONCLUSION

The transfer of intellectual property rights traditionally has played and still plays an important role in the domestic economies of the E.U. and the U.S. Until roughly twenty-five years ago, few transactions were likely to have significant anticompetitive impacts on foreign jurisdictions.261 Indeed, it was not until 1972 that the Commission issued its first two decisions on the compatibility of exclusive manufacturing licenses with Article 81 (1).262 Thus, businesses engag-

258 1997 O.J. (C 372) 13, ¶¶ 9–11; see Bright, supra note 15, at 33–11.
260 IP Guidelines, supra note 1, § 5.7.
262 Burroughs/Delplanque, supra note 237; Burroughs/Geha-Werke, supra note 237.
ing in international business transactions in the Community prior to the 1970s had no reason to be concerned about having their license agreements declared void pursuant to EC competition law.\textsuperscript{263}

There certainly were exceptions, and one could speculate that the Commission was notified of many license agreements in which at least one of the parties was a non-EC company since the early 1970s and during the subsequent years. Most industries were only beginning to internationalize and their operations and ventures in other countries were often limited or fledgling.

Since the early 1970s, the situation has evolved primarily due to three factors: (i) the growth of new technologies which made necessary the use of technology transfer agreements, (ii) the steady globalization of production and marketing processes, and (iii) the growing concern among industrialized nations about the need to improve intellectual property protection. These factors are likely to have fostered a steady increase in technology transfers in international business transactions throughout the last two decades. Since the mid-1980s, the new advances in information and communication technologies, in biotechnology, and in the development of new materials have demonstrated how vital intellectual property can be in the promotion of economic growth.\textsuperscript{264}

The growth of new technologies in the E.U. and the U.S., along with the increasing globalization of the economy which took place throughout the 1990s has made transactions involving the transfer and use of technology more likely than ever to raise antitrust issues.\textsuperscript{265} This phenomenon underlies the need to have a coherent set of antitrust rules for license agreements in the E.U. and the U.S.

\textsuperscript{263} This lack of concern was partially supported by the Commission Notice of 1962 (the "Christmas Message") in which the Commission took the view that limited patent licenses did not infringe Article 81(1) because some of the restrictions upon the licensee, such as territorial restrictions, field-of-use restrictions, or limitations in time, were inherent to the patent rights of the licensor. Notice on Patent Licensing Agreements, 1962 O.J. 2922/62.

\textsuperscript{264} OECD COMPETITION POLICY AND INTELLECTUAL PROPERTY RIGHTS 7 (1989).

\textsuperscript{265} See Commissioner Roscoe B. Starek, III, International Cooperation in Antitrust Enforcement, Address at the Illinois State Bar Association International Trade Program, at http://www.ftc.gov/speeches/starek/illbar.htm (May 10, 1996). ("Antitrust is becoming increasingly important to American firms because they are engaging in more and more international transactions. A firm must be carefully attuned not only to the antitrust laws of the United States but also to the competition policies and antitrust enforcement regimes of the other nations in which it operates."). See also Kobak, supra note 261, at 341; Sara M. Biggers, Richard A. Mann, & Barry S. Roberts, Intellectual Property and Antitrust: A Comparison of Evolution in the European Union and United States, 22 HASTINGS INT'L. & COMP. L. REV. 209, 209 (1999).
The new Technology Transfer Regulation is one step forward in the convergence of EC competition law and U.S. antitrust law in the area of exclusive licensing agreements. There are many provisions that the Commission now perceives *ex ante* rather than *ex post.* However, there still are significant differences between the systems.

Territorial restrictions in license agreements are more or less presumptively lawful in the U.S. since the demise of the *Schwinn* case and are regarded with favor by the IP Guidelines. However, the Commission is likely to consider a territorial protection clause in a license agreement contrary to Article 81(1) but exemptable either under the Technology Transfer Regulation or under an individual exemption granted by the Commission pursuant to Article 81(3) of the EC Treaty. Clauses granting absolute territorial protection to the licensee are prohibited under Article 81(1) (and therefore null and void under Article 81(2)), and it is highly unlikely that the Commission will grant an individual exemption to one of those clauses under Article 81(3).

This pivotal difference regarding territorial restraints is rooted in the disparate attitudes towards market integration in U.S. agencies and the Commission. The objective of single market integration explains the reluctance of the Commission to accept the Chicago School's line of thought that if a transaction is vertical, it is unlikely to be anticompetitive because the licensor has no incentive to give more protection than is necessary to induce its licensees' investment. Under this reasoning, as it has been understood by U.S. agencies and courts, the test is whether territorial restraints unreasonably restrain trade, not whether they have a market partitioning effect. This test is *prima facie* incompatible with the objective of market integration as understood by the Commission, as a process in which intrabrand competition plays a crucial integrating function.

The acceptance in the E.U. of the approach proposed by the Chicago School would require the Commission to analyze the economic conditions of the relevant market before condemning a restraint of conduct under Article 81(1) and would deprive the Commission of its power to grant exemptions. The Commission and the E.C.J. have endorsed the practice of treating restrictions of conduct as infringing article 81(1) unless they are exempted. This formalistic

266 Reg. Monograph, supra note 2, at 251.
267 IP Guidelines, supra note 1, § 4.1.2.
268 An example of the Commission's zeal on monitoring exclusive license agreements can be found in the Commission decision in the *Davidson Rubber* case. [1972] C.M.L.R. D
approach ensures, according to the Commission’s view, progress in the attainment of the single market because it enables the Commission to act in a regulatory fashion to require parties to modify their agreements before it grants an exemption or sends a comfort letter.269

Finally, the Commission should revise its restrictive approach towards territorial restraints in license agreements in recognition of the achievements that have been made in moving towards a single market. A restrictive policy towards vertical restraints, and towards territorial restraints in license agreements in particular, hinders single market integration by discouraging the use of innovation and deterring licensors from engaging in license agreements in different Member States. This may encourage development outside the E.U.

Ideally, further convergence on the legality of license agreements under the antitrust laws of the E.U. and the U.S. should take the form of a change in the E.U. from a formalistic system based on the per se rule to a more flexible system for evaluating restraints of conduct based on a Rule of Reason. Some of the E.C.J.’s judgments have made significant inroads in this regard,270 although the Commission often has treated them as irrelevant.271

The “White Paper on Modernization of the Rules Implementing Articles 85 and 86 of the EC Treaty” has made clear that the Commission is not planning to adopt a Rule of Reason.272 The maintenance of a modified formula (i.e., the Commission is planning to abolish the compulsory notification system) of the traditional approach towards the application of Article 81(1) does not mean that a reform of the

52. In this case, a U.S. company, Davidson, granted exclusive patent and know-how licenses to several European licensees over a new technology to make elbow rests and seat cushions. Davidson agreed not to appoint other licensees in the granted territories. The Commission held that the exclusive licenses violated Article 81(1) on the grounds that they prevented Davidson from giving third parties, through the grant of further licenses, the possibility of also exploiting its patents. The Commission, however, granted an exemption under Article 81(3) because (i) the exclusive territories were “indispensable” if the technology was to be made available in Europe, (ii) there were other competing processes, and (iii) the licensees were not prevented from selling the licensed products outside its territories. ¶ 47-48. The question that arises from this case is whether the Commission should have cleared directly Davidson’s license agreements, given that ex ante no competition was restricted in the common market, instead of granting an exemption.

269 See Deacon, supra note 59, at 308.


271 Korah, supra note 31, at 399.

272 White Paper, supra note 22, at 17.
Technology Transfer Regulation, in particular in the area of territorial restraints, is no longer necessary.

Instead, the time limits to territorial restrictions in license agreements laid down by the Regulation appear to be no longer justified on the grounds of the objective of single market integration. Accordingly, the Commission should engage in a thorough analysis as to the need to amend the Regulation in favor of an extension or repeal of the ten year limit for exclusive know-how agreements and sometimes mixed agreements, as well as the extension of the five year limitation to the prohibition of passive sales between licensees in license agreements to at least ten years. In addition, time limits should only start to run from the date of the license concerned and not from the date a licensee first placed the product in the common market.