

# Exclusive Territorial Rights in Patent Licenses and Article 85 of the EEC Treaty: An Evaluation of Recent Developments in the Law

by *Brian Cheffins*\*

## I. INTRODUCTION

In the European Economic Community (EEC, Common Market),<sup>1</sup> during recent years, the law relating to territorial restrictions in patent licenses has developed significantly. In 1982 the European Court of Justice (European Court),<sup>2</sup> in *Maize Seeds*,<sup>3</sup> made some important pronouncements regarding territorial restrictions in intellectual property licensing agreements. Territorial restriction also played an important part in the Block Exemption for Patent Licenses (Block Exemption).<sup>4</sup> This Regulation was issued by the European Commission (Commission)<sup>5</sup> in 1984. Overall, the EEC may have wholly worked

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\* Assistant Professor, Faculty of Law, University of British Columbia. This article is based on a thesis submitted in partial satisfaction of the LL.M. degree at Cambridge. My thanks to Elizabeth Freeman, Clare College, Cambridge, for her help in supervising my LL.M. thesis.

<sup>1</sup> The European Economic Community [hereinafter EEC] was created by a treaty signed on March 25, 1957 and came into force on January 1, 1958. With the addition of Spain and Portugal to the EEC on January 1, 1986, it now consists of twelve Member States. The six original Member States were Germany, Belgium, France, Italy, Luxembourg, and the Netherlands. On January 1, 1973, the United Kingdom, Ireland, and Denmark joined the EEC. Greece, which signed a Treaty of Accession in 1979, joined the EEC on January 1, 1981.

The EEC, in principle, is general in scope and covers all sectors of the economy not specifically covered by the other Communities. T. HARTLEY, *THE FOUNDATIONS OF EUROPEAN COMMUNITY LAW* 3 (1981). Consequently, the EEC can be distinguished from the European Coal and Steel Community [hereinafter ECSC] and the European Atomic Energy Community [hereinafter Euratom], which, as their names indicate, are limited to particular sectors of the economy.

<sup>2</sup> The Court of Justice of the European Communities [hereinafter European Court] acts as a referee between the Member States and the three Communities, and among Community institutions. The European Court also acts to protect the rights guaranteed to individuals under the Treaties.

<sup>3</sup> *Nungesser and Eisele v. Commission*, 1982 E. Comm. Ct. J. Rep. 2015, 36 Common Mkt. L.R. 278 (1983).

<sup>4</sup> Regulation 2349/84, 27 O.J. EUR. COMM. (No. L 219) 15 (1984), [1982-1985 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 10,610 (1984).

<sup>5</sup> The European Commission, which is the most supra-national of the EEC institutions, formulates proposals for new Community policies and administers existing policies. Though Commissioners are appointed by the governments of the Member States, they are required to be above national loyalties and in no sense represent their countries. T. HARTLEY, *supra* note 1, at 9.

out the relevant principles in this area.<sup>6</sup> This is significant, as the topic of territorial restrictions in patent licenses has been controversial for more than twenty years.<sup>7</sup> Given this, it is not surprising that the impact of *Maize Seeds* and the Block Exemption on EEC law has been examined extensively.<sup>8</sup>

Despite such an extensive examination, a further analysis of how *Maize Seeds* and the Block Exemption deal with territorial restrictions can still provide insights into other areas of EEC law. These include the economic costs and benefits of territorial restrictions in patent licenses, the relationship between market integration and competition law in the EEC, and the difficulties involved in administering and enforcing the EEC's competition law. This Article will examine these areas in the context of *Maize Seeds* and the Block Exemption. At the same time *Maize Seeds* and the Block Exemption will be critically evaluated. It will be argued that even though complicated issues are undoubtedly involved, the European Commission's and the European Court's approaches to territorial restrictions have flaws. Primarily, the Commission and the Court have not dealt satisfactorily with some of the economic and market integration concerns involved with territorial restrictions. It will be seen that in the case of the Commission, this has occurred in part because of lobbying and administrative pressures.

The Article is divided into three parts. In the first, the nature of territorial restriction in patent licenses will be described. Next, the current law relating to this area will be summarized. Finally, the law will be evaluated, with primary focus on *Maize Seeds* and the Block Exemption.

## II. THE NATURE OF TERRITORIAL RESTRICTIONS IN PATENT LICENSES

When a patentee grants a license to manufacture and sell a patented product or to utilize a patented process in manufacturing and selling a product, the licensee, when he markets the product in his country, can face competition from a number of sources.<sup>9</sup> These include the patentee, other licensees, whether based in the licensee's territory or outside it, and resellers supplied by the patentee or other licensees. A patentee, like a licensee, also faces potential

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<sup>6</sup> R. MERKIN & K. WILLIAMS, *COMPETITION LAW: ANTITRUST POLICY IN THE UNITED KINGDOM AND THE E.E.C.* 294 (1984).

<sup>7</sup> For a useful summary of the history involved, see Stone, *The E.E.C. Block Exemption for Patent Licences—Part 1*, 7 EUR. INTELL. PROP. REV. 173 (1985); D. GUY & G. LEIGH, *THE EEC AND INTELLECTUAL PROPERTY* 163–69, 174–81.

<sup>8</sup> On *Maize Seeds*, see Hoffmann & O'Farrell, *The Open Exclusive Licence—Scope and Consequences*, 6 EUR. INTELL. PROP. REV. 104 (1984) and sources cited therein at note 2. On the Block Exemption, see Stone, *supra* note 7; Hearn, *More on Patent Licensing in the E.E.C.—I*, 1985 SOL. J. 325; Lewin & Martin, *Patent Licensing in the E.E.C.*, 6 COMPANY LAW. 62 (1985); V. KORAH, *PATENT LICENSING AND E.E.C. COMPETITION RULES REGULATION 2349/84* (1985).

<sup>9</sup> Van der Esch, *Industrial Property Rights Under E.E.C. Law*, in *ANNUAL PROCEEDINGS OF THE FORDHAM CORPORATE LAW INSTITUTE—ANTITRUST AND TRADE POLICIES OF THE E.E.C.*, 539, 541 (B. Hawk ed. 1983).

competition from several sources. These sources of competition include all of his licensees and resellers supplied by the licensees.

A patent license can include terms meant to give a degree of protection from competition.<sup>10</sup> As a start, a patentee can promise not to grant any other licenses in a licensee's territory. The licensee will then have what is referred to as a sole license to manufacture and sell the patent-based product in his territory. Further, the patentee can promise not to manufacture and sell in the licensee's territory. The licensee will then have an exclusive license in such territory. The patentee can give himself the same degree of territorial protection by refraining from granting licenses in his own territory.

The patentee can give a licensee further protection by providing for an export ban on sales into the licensee's territory. The patentee can achieve this by promising not to sell the patent-based product in the licensee's territory and by promising to oblige other licensees to refrain from doing the same. A patentee can help to secure similar protection for himself and other licensees by getting the licensee to agree to an export ban. The licensee will thus agree not to export the patent-based product to the patentee's territory or any territory where the patentee has granted a license.

There is one other way in which patent licenses can protect patentees and licensees from competition. This is by imposing export bans on resales. To achieve this, the licensee will agree to sell only to customers who agree not to resell in the patentee's territory or any territory where the patentee has granted a license. Further, the patentee will agree to only sell to customers who agree not to sell in the licensee's territory. Finally, the patentee will get his other licensees to make the same promise as the first licensee regarding resales.

When placed together in patent licenses, the provisions discussed above give a patentee and his licensees extensive territorial protection. The patentee and the licensee not only have the exclusive right to manufacture and sell in their respective territories, they also are protected from competition with each other. In addition, all parties are protected from competition with their respective customers.

### III. CURRENT LAW

In the EEC Treaty<sup>11</sup> the articles which are most relevant to territorial protection in patent licenses are 85 and 30 thru 36.<sup>12</sup> The majority of this Article will

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<sup>10</sup> The following is based on B. CAWTHRA, *PATENT LICENSING IN EUROPE* 46 (1978); B. FOWLSTON, *UNDERSTANDING COMMERCIAL AND INDUSTRIAL LICENSING* 4 (1984); R. MERKIN & K. WILLIAMS, *supra* note 6, at 32; R. WHISH, *COMPETITION LAW* 352 (1985).

<sup>11</sup> Treaty Establishing the European Economic Community, *done at Rome*, March 25, 1957, 298 U.N.T.S. 3.

<sup>12</sup> Article 85 provides that:

1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted prac-

focus upon the law arising from Article 85. Articles 30 thru 36 will also be discussed with respect to the extent to which provisions have to be placed in patent licenses in order to secure territorial protection for a patentee and his licensees.

Prior to the passage of the EEC Treaty, if parties to a patent license wanted to ensure that the patent-based product did not pass between their territories, it was not as necessary to include an export ban between themselves and to place restrictions on their customers. This was because national patent laws could be relied on to restrict sales between countries.<sup>13</sup> To illustrate, assume that a patentee held parallel patents in Belgium, France, the Netherlands, and the United Kingdom. Assume further he granted exclusive manufacturing and sales licenses in Belgium, France, and the Netherlands, and retained the U.K. market for himself. The patentee and licensees would have been able to prevent

tices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

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

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

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

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

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

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

Article 30 provides that "[q]uantitative restrictions on imports and all measures having equivalent effect shall, without prejudice to the following provisions, be prohibited between Member States."

Article 36 states that:

The provisions of Articles 30 to 34 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States.

<sup>13</sup> See Casati, *The "Exhaustion" of Industrial Property Rights in the EEC: Exclusive Manufacturing and Sales Provisions in Patent and Know-How Licensing Agreements*, 17 COLUM. J. OF TRANSNAT'L L. 313, 325 (1978); Turner, *Competition and the Common Market After Maize Seed*, 8 EUR. L. REV. 103, 108 (1983); P. DEMARET, PATENTS, TERRITORIAL RESTRICTIONS, AND EEC LAW: A LEGAL AND ECONOMIC ANALYSIS 59-62 (1978).

the importation of the patent-based product into each other's territories by bringing infringement actions. Thus, if the French licensee sold the patent-based product to a customer who tried to resell in the United Kingdom, or the French licensee himself tried to sell the product in the United Kingdom, the patentee could prevent the sale of the product in the United Kingdom. Specifically, the patentee could claim that his patent rights were being infringed.

National systems of patent law continue to exist in the EEC. Articles 30 to 36, which seek to establish the free movement of goods in the EEC, however, have distinctly reduced the extent to which national patent laws can be used to restrict the movement of patent-based products within the EEC. For example, it is clear that an infringement action cannot be used to prevent the customer of a licensee or a patentee from importing patented goods into a Member State where the good in question has patent protection.<sup>14</sup> This is because the European Court has held that once a patentee has obtained a monetary reward from selling, or consenting to the sale of, a patent-based product in the EEC, his patent rights cannot be relied on to prevent the importation of the patent-based product into any Member State.<sup>15</sup> This principle is clearly applicable to customers of patentees. Further, because by granting a license the patentee will have consented to the sale of the patent-based product in the EEC and will have received his reward in the form of a license fee or royalty, this principle also applies to customers of licensees.

It is not clear whether a patentee, or a licensee relying on patent rights, can prevent imports by a licensee from another Member State.<sup>16</sup> The European Court has clearly stated that patent rights cannot be used to prevent imports as soon as the patent-based product has been placed on the market in the country from which the product was being imported. This, however, does not apply to a situation where the licensee does the importing himself.<sup>17</sup>

The indications, however, are that the European Court would not allow patent rights to stop such importing. In recent cases the Court has been paying greater attention to the idea that a patent is a reward for inventive effort.<sup>18</sup> This reward is the exclusive right of being the first to market the patent-based product. Given this, it can be argued that when a patentee grants a license he receives his reward in the form of license fees and/or royalty fees. According to such

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<sup>14</sup> Casati, *supra* note 13, at 326.

<sup>15</sup> *Centrafarm v. Sterling Drug, Inc.*, 1974 E. Comm. Ct. J. Rep. 1147, 2 Common Mkt. L.R. 480 (1974); P. OLIVER, *FREE MOVEMENT OF GOODS IN THE E.E.C.* 156-61 (1982).

<sup>16</sup> Lang, *Patent Rights and Licensing in E.E.C. Law*, in *CONTRIBUTIONS TO COMMUNITY COMPETITION LAW* 59, 65 (G. Sundstrom ed. 1978).

<sup>17</sup> Casati, *supra* note 13, at 326.

<sup>18</sup> *Pharmon B.V. v. Hoechst A/b*, 3 Common Mkt. L.R. 755, 791 (1985); *Merck v. Stephar*, 1981 E. Comm. Ct. J. Rep. 2063, 2081, [1979-1981 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 8707 (1981).

reasoning, his patent rights should not be able to be relied on to retard the movement of the patent-based product between Member States, including movement arising from direct sales by licensees.<sup>19</sup> Thus, so long as the Court continues to focus its inquiry on the reward to the patentee, it is likely that the Court will hold that direct sales by licensees from one Member State into another are not prohibited under national patent laws.

The foregoing indicates that if a patentee and his licensees want to establish territorial protection within the EEC, they will not be able to rely effectively on the patent laws of the Member States. Instead, territorial protection and exclusive territorial rights will have to be established through the use of the terms of the patent licenses at issue. This may, however, cause the licenses to run afoul of Article 85. It is well established that patent licenses which grant exclusive rights and/or contain territorial restrictions can fall within Article 85(1). Article 85(1) prohibits agreements between persons, companies, and other undertakings which may affect trade between Member States and which have as their object or effect the prevention, restriction, or distortion of competition within the EEC. Under Article 85(3), however, a patent license falling within Article 85(1) can be exempted from prohibition and invalidation in certain instances. A patent license is exempt if, while allowing consumers a fair share of the resulting benefit, it contributes to improving the production or distribution of goods or it promotes technical or economic progress.

During the 1970s the European Commission took the view that if an agreement was not too minor,<sup>20</sup> a patent license containing territorial protection would automatically fall within Article 85(1). Consequently, the patent license would have to be exempted by the Commission under Article 85(3) in order to remain valid.<sup>21</sup> In the early 1980s the European Court, in two cases dealing with other types of intellectual property, overturned the Commission's view. In *Maize Seeds*,<sup>22</sup> which involved plant breeders rights, and *Coditel v. Cine Vog Films (No. 2)*,<sup>23</sup> a copyright case, the Court held that territorial restrictions did not necessarily bring the agreements in question within Article 85(1). Rather, other

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<sup>19</sup> Hoffmann & O'Farrell, *supra* note 8, at 108; Casati, *supra* note 13, at 328-29. In *Pharmon v. Hoechst*, *supra* note 18, the Court held that a patentee could rely on patent law to restrict direct sales by a licensee from another country. The basis of the Court's reasoning was that the patentee had not received his full reward because the license had been compulsorily granted. If the license had been granted voluntarily, the Court likely would have held that he had received his full reward and thus could not rely on patent law to prevent imports by a licensee.

<sup>20</sup> As was the case in *Re Burroughs/Delplanque*, 11 Common Mkt. L.R. 67 (1972).

<sup>21</sup> R. MERKIN & K. WILLIAMS, *supra* note 6, at 333; Hawk, *Patents Under EEC Competition Law*, 53 ANTITRUST L.J. 737, 750-51 (1984).

<sup>22</sup> See *supra* note 3.

<sup>23</sup> 1982 E. Comm. Ct. J. Rep. 3381, 36 Common Mkt. L.R. 49 (1983). The case is discussed in O'Farrell, *Recent Developments in Copyright in the E.E.C.*, 7 EUR. INTEL. PROP. REV. 102, 105 (1985).

circumstances had to be considered in order to determine the applicability of Article 85(1).

The European Court's holding in *Maize Seeds* is of particular interest because the Court discussed the types of territorial protection which do not bring an agreement within the ambit of Article 85(1). Though the case did not involve patent rights, the Court's reasoning is probably applicable to patent licenses.<sup>24</sup> *Maize Seeds* suggests that a patent license containing territorial restrictions will not fall into Article 85(1) in certain circumstances.<sup>25</sup> First, the patent must involve a new technology. Second, the risk and development costs involved must have had to have deterred the licensee from taking the license if there had been no territorial protection. Finally, the license must have been an open rather than a closed exclusive license.<sup>26</sup> A license is considered open if it gives the licensee exclusive rights in his territory and prevents the patentee from making direct sales into the licensee's territory.<sup>27</sup> A license is considered closed if it obliges the patentee to get other licensees and third parties to promise not to sell a product in the licensee's territory. The distinction between these two situations is that open exclusivity relates only to the contractual relationship between the patentee and the licensee.<sup>28</sup> It is unclear if a license becomes closed when a licensee agrees not to export into the patentee's territory.<sup>29</sup>

As discussed previously, the European Commission, prior to *Maize Seeds*, considered patent licenses containing territorial restrictions to automatically fall within Article 85(1). Since the validity of such patent licenses turned on whether they were exempted, the Commission encountered the administrative difficulty of processing a large number of exemption applications.<sup>30</sup> Due to this difficulty, the Commission, in the mid-1970s, proposed a Regulation which granted automatic exemptions.<sup>31</sup> Under the proposed regulation a patent license would automatically be exempted if it did not contain certain prohibited terms. Furthermore, under the Regulation, certain terms were to be expressly permitted.

Initially, the European Commission, in its proposals, was hostile towards territorial restrictions. This was manifested in a Commission draft, which be-

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<sup>24</sup> Hoffmann & O'Farrell, *supra* note 8, at 104.

<sup>25</sup> Stone, *supra* note 7, at 174; Hawk, *supra* note 21, at 751, 755.

<sup>26</sup> Commentators' views on this point vary somewhat. See Hoffmann & O'Farrell, *supra* note 8, at 104-06; Van der Esch, *supra* note 9, at 546-47; Turner, *supra* note 13, at 106-07, 113; O'Farrell, *supra* note 23, at 105; Hawk, *supra* note 21, at 752-54. V. KORAH, *supra* note 8, at 5, says that a product need not involve a new technology but should extend to where there is a new product for which there is no substitute.

<sup>27</sup> Hawk, *supra* note 21, at 752; Hoffmann & O'Farrell, *supra* note 8, at 107.

<sup>28</sup> Hawk, *supra* note 21, at 751-52; Hoffmann & O'Farrell, *supra* note 8, at 107.

<sup>29</sup> Hoffmann & O'Farrell, *supra* note 8, at 107-08.

<sup>30</sup> R. WHISH, *supra* note 10, at 364; Lewin & Martin, *supra* note 8, at 63.

<sup>31</sup> Brunsvold, *E.E.C. Commission Hearings on Draft Patent Licence Regulations*, in 1981 LICENSING LAW HANDBOOK 291, 292 (B. Brunsvold ed. 1981).

came public in 1977, which enumerated narrow grounds for exemption. The narrow allowance of territorial restrictions was extensively criticized.<sup>32</sup> As a result, each successive Commission draft became increasingly permissive.<sup>33</sup>

Finally, almost ten years after the Regulation was first proposed, Regulation 2349/84<sup>34</sup> was issued by the European Commission. This Regulation is commonly referred to as the Block Exemption for Patent Licenses. The Block Exemption is more permissive towards territorial restrictions than any of the draft regulations were.

Under the Block Exemption, sole and exclusive licenses are exempted as long as one of the patents covered by the license remains in force.<sup>35</sup> Further, an export ban between a patentee and a licensee is permitted. A patentee's promise not to sell in the licensee's territory is exempted as long as one of the licensed patents remains in force. Further, a licensee's promise not to sell in territories reserved for the patentee is exempted so long as the patent-based product is protected in those territories by parallel patents.<sup>36</sup>

The exemption for territorial protection between licensees is not as extensive as that between patentees and licensees. A complete export ban between licensees will only be exempted if it lasts no longer than five years after the patented product is put on the market in the EEC.<sup>37</sup> If passive sales into other licensees' territories are banned for longer than five years then the automatic exemption is not allowed.<sup>38</sup> A promise by a licensee not to pursue an active sales policy in another licensees' territories, however, is exempted for as long as the licensed product is protected in those territories by a parallel patent.<sup>39</sup> Though the exact scope of an active sales policy is unclear, it does encompass advertizing specifically aimed at another licensee's territory and the opening of a branch or any disposition depot in such a territory.<sup>40</sup>

Another type of territorial protection which will cause a patent license to lose an exemption is a promise to impose an export ban on resellers.<sup>41</sup> The Block Exemption stipulates that a promise by a patentee or licensee to refuse to supply

<sup>32</sup> B. CAWTHRA, *supra* note 10, at 60-62; Handler & Blechman, *An American View of the Common Market's Proposed Group Exemption for Patent Licences*, 14 INT'L LAW. 403 (1980); Holley & Siragusa, *The Status of the Commission's Proposed Patent Licensing Regulation*, 1 EUR. INTELL. PROP. REV. 350, 351 (1979).

<sup>33</sup> The development of these provisions is well-summarized in Stone, *supra* note 7, at 176-78 and V. KORAH, *supra* note 8, at 32, 40.

<sup>34</sup> See *supra* note 4.

<sup>35</sup> See *supra* note 4, at art. 1(1)(1) and (2). For a discussion of the meaning of the phrase "in so far as and as long as one of the licensed patents remain in force," see V. KORAH, *supra* note 8, at 34.

<sup>36</sup> See *supra* note 4, at art. 1(1)-(4).

<sup>37</sup> *Id.* at art. 1(1)(6).

<sup>38</sup> *Id.* at art. 3(10).

<sup>39</sup> *Id.* at art. 1(1)(5).

<sup>40</sup> *Id.*

<sup>41</sup> *Id.* at art. 3(11).



a customer who would market the product in other territories will cause the exemption to be lost unless there is an objectively justified reason for the provision.

The Block Exemption does not apply to all patent licenses. Instead, it only applies to agreements involving two parties.<sup>42</sup> With respect to export bans between licensees, however, the Block Exemption clearly applies to agreements forming a network of licenses if each agreement has the patentee and one licensee as its only parties.<sup>43</sup> In addition, the Block Exemption evidently does not apply to licensing agreements concerning sales alone.<sup>44</sup> The licensee must manufacture the patent-based product, as well as sell it. Licensing agreements involving sales alone can be exempted under Regulation 1983/83 on Exclusive Distribution Agreements.<sup>45</sup> An exemption of a patent license containing territorial provisions can be obtained in certain circumstances where it would not be exempted under the Block Exemption. Such an exemption can be obtained by applying to the European Commission. The Commission will grant an individual exemption if the agreement falls within Article 85(3). An individual exemption will have to be applied for if the agreement involves more than two parties or if the agreement contains a term which falls within the Block Exemption blacklist. An agreement loses its exemption under Regulation 2349/84 if it contains any of the terms in the blacklist.<sup>46</sup> The provisions discussed above relating to bans on passive sales between licensees' territories and to restrictions on customers are two examples of terms included in the blacklist.<sup>47</sup> The remaining terms included in the blacklist do not deal with territorial protection.<sup>48</sup>

#### IV. EVALUATION OF THE CURRENT LAW

In evaluating the recent development of the law relating to territorial restrictions in patent licenses, it is useful to examine the law from three perspectives. First, the economic theories underlying the recent developments in the law will be considered. Second, the market integration aspects of territorial restrictions will be discussed. Third, the administration and enforcement issues relating to the recent developments in the law will be analyzed.

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<sup>42</sup> *Id.* at art. 1(1).

<sup>43</sup> Stone, *supra* note 7, at 175.

<sup>44</sup> See *supra* note 4, at Preamble, para. 7 and art. 1(2). See V. KORAH, *supra* note 8, at 14-16. Stone holds the view that patent licenses dealing only with sales may be exempted under the Block Exemption. See Stone, *supra* note 7, at 178.

<sup>45</sup> Reg. 1983/83, 26 O.J. EUR. COMM. (No. L 173) 1 (1983).

<sup>46</sup> See *supra* note 4, at art. 3 for the Block Exemption blacklist.

<sup>47</sup> *Id.*

<sup>48</sup> Examples of such terms include imposing price controls, preventing the challenging of the licensed patent and requiring the licensee to assign improvements on the patent to the licensor. See *supra* note 4, at art. 3(11).

A. *Economic Issues*

## 1. General Considerations

The EEC's approach to territorial protection in patent licenses has become less strict in recent years. The European Court's decision in *Maize Seeds*, that intellectual property licenses granting territorial protection do not automatically fall within Article 85(1), is more permissive than the European Commission's view that all such licenses fell within Article 85(1). Likewise, the scope of the exemptions allowed in the Block Exemption is significantly wider than the scope of the exemption allowed by the Commission in granting individual exemptions. Prior to the Block Exemption, patent licenses incorporating export bans involving patentees and licensees were only granted exemptions in limited circumstances.<sup>49</sup> Even licenses incorporating only exclusive rights were not granted automatic exemptions.<sup>50</sup>

The concerns which have contributed to the relaxation of the law relating to territorial restrictions have primarily been economic in origin.<sup>51</sup> The European Court and European Commission's more liberal views toward territorial restrictions have arisen from a changed perception of the economic impact of such restrictions. Such restrictions are not perceived by the Court and the Commission as being as anticompetitive as was previously the case.<sup>52</sup> Further, the Court and the Commission are more receptive to the idea that such restrictions help to promote innovation and the diffusion of technology in the EEC.<sup>53</sup>

The European Court and the European Commission's consideration of economic factors is understandable in this context. Both patent and antitrust law are distinctly economic in content.<sup>54</sup> As one commentator has said, a coherent analysis of territorial restrictions in patent licenses in the EEC cannot be done without delving into economic theory.<sup>55</sup> Due to the importance of economic theory, it is necessary to discern whether the economic reasoning underlying the Court's decisions and the Block Exemption is sound.

It has been recognized for many years that the manner in which patent rights are utilized can conflict with competition law.<sup>56</sup> There have been many attempts

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<sup>49</sup> Stone, *supra* note 7, at 177.

<sup>50</sup> *Id.*; See also Gyselen, *Vertical Restraints in the Distribution Process: Strength and Weakness of the Free Rider Rationale Under EEC Competition Law*, 21 COMMON MKT. L. REV. 647, 660 (1984).

<sup>51</sup> Baillie, *Licensing Under the EEC Treaty: Practical Problems and Solutions*, 54 ANTITRUST L.J. 689, 695 (1985); Commission of the EEC, 14TH REPORT ON COMPETITION 13-14 (1984) [hereinafter Commission 14TH REPORT]; R. WHISH, *supra* note 10, at 363.

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> Kaplow, *The Patent-Antitrust Intersection: A Reappraisal*, 97 HARV. L. REV. 1815, 1886-89 (1984).

<sup>55</sup> P. DEMARET, *supra* note 13, at 1.

<sup>56</sup> L. SULLIVAN, *HANDBOOK OF THE LAW OF ANTITRUST* 505 (1977); Kaplow, *supra* note 54, at 1815-16, 1845-55; Austern, *Umbras and Penumbras: The Patent Grant and Antitrust Policy*, 33 GEO. WASH. L. REV. 1015 (1965).

to analyze and resolve this conflict.<sup>57</sup> Despite this history of analysis, recent articles in which economic analysis has been utilized are the most instructive. It has been emphasized that economic costs and benefits should be considered in resolving patent/competition law problems.<sup>58</sup> For example, relaxing restrictions on the exercise of patent rights may, in addition to having the beneficial effect of increasing incentives for innovation, give rise to economic costs arising from increased restraints on competition.

The most helpful, but at the same time most intricate, of the recent comments is by Louis Kaplow.<sup>59</sup> Even Kaplow acknowledges that his formula for resolving patent/competition law conflicts is too complex to be utilized by today's policy-makers.<sup>60</sup> Nevertheless, his basic analysis provides helpful insights into the decisions which policymakers face in this area.

As applied to territorial restrictions in patent licenses, Kaplow's analysis would operate as follows. A policy should be adopted when the result of doing so will be that the total benefits of territorial restrictions, these being incentives to potential innovators, exceed by the greatest possible amount the total costs, these being the detriment to the economy arising from the anticompetitive effects of the territorial restrictions.<sup>61</sup> To find the point where the net benefits of territorial restrictions are greatest, it is necessary to examine whether the ratio of benefits to costs arising from allowing a type of territorial restriction is greater than one. If it is, the restriction should be allowed. If not, it should not be allowed.

To understand this analysis, consider a situation where no territorial restrictions are allowed. At this point, the benefits and costs arising from territorial restrictions would be zero. The next step would then be to examine progressively stricter territorial restrictions. The restriction would be permitted so long as the ratio of benefits to costs for each restriction continued to be greater than one. This is because as each restriction is allowed, the difference between total benefits and costs increases. The restrictions would no longer be allowed when the ratio for the last restriction was less than one. If this restriction was allowed total benefits would exceed total costs by less than if the restriction was not allowed. It would be at the point before the last restriction was added that the total net benefits would be greatest.<sup>62</sup>

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<sup>57</sup> Kaplow provides a useful survey of them. See Kaplow, *supra* note 54, at 1845-55.

<sup>58</sup> Kaplow, *supra* note 54, and Ordover, *Economic Foundations and Considerations in Protecting Industrial and Intellectual Property*, 53 ANTITRUST L.J. 503 (1984) contain the most detailed economic analysis. See also Turner, *Basic Principles in Formulating Antitrust and Misuse Constraints on the Exploitation of Intellectual Property Rights*, 53 ANTITRUST L.J. 485, 489-95 (1984); Payne & Bagarazzi, *Effect of the EEC Rules of Competition on Industrial Property Rights and Technology Transfer*, in RECENT DEVELOPMENTS IN LICENSING 245 (1981).

<sup>59</sup> Kaplow, *supra* note 54.

<sup>60</sup> *Id.* at 1833, 1841-45.

<sup>61</sup> *Id.* at 1827.

<sup>62</sup> The foregoing is based on Kaplow, *supra* note 54, at 1829-34.

As mentioned, such an analysis cannot be used to form a policy towards territorial restrictions with any precision. This is because the problems of measurement are too great.<sup>63</sup> The analysis does, however, provide insights into how policies towards territorial restrictions have been formed. For example, in the United States there was a great deal of concern, during the 1960s and 1970s, about the anticompetitive effects arising from the exploitation of patent rights and little concern about the effect that restricting such exploitation would have on inventive activity.<sup>64</sup> According to Kaplow's analysis, the ratio of benefits to costs arising from allowing the exploitation of patent rights was thought to be low. Thus, it was perceived that the point at which the net benefits arising from the exploitation of patent rights was greatest when comparatively few methods of patent exploitation were allowed. Consequently, the antitrust restrictions on such exploitation were quite stringent.<sup>65</sup>

Presently in the United States there is a greater concern about the importance of providing incentives for innovation and less concern about the anticompetitive effects of patent exploitation. As a result, the ratio of benefits to costs arising from patent exploitation is perceived to be higher than it was during the 1960s and 1970s. Therefore, the point at which the net benefits from patent exploitation are perceived to be greatest is when comparatively more methods of patent exploitation are allowed. The antitrust restrictions on patent exploitation in the United States are consequently more relaxed than they were.<sup>66</sup>

A similar process has been occurring in the EEC regarding territorial restrictions in patent licenses. As mentioned, the EEC's more relaxed posture towards territorial restrictions has arisen, in part, because the European Court and the European Commission have been focusing more on the innovation that can be created by allowing territorial restrictions and less on the potential anticompetitive effects of territorial restrictions. In Kaplow's terms, the EEC's policy has changed because of a different perception of the ratio of economic benefits to costs arising from territorial restrictions. In light of the Kaplow analysis, this Article will proceed to examine the views of the Court and the Commission with respect to the economic benefit and costs of territorial restrictions in patent

<sup>63</sup> *Id.* at 1842-45; Ordovery, *supra* note 58, at 513.

<sup>64</sup> A. CROTTI, *TRADING UNDER EEC AND U.S. ANTITRUST LAWS* 259-61 (1977); Gibbons, *Domestic Territorial Restrictions in Patent Transactions and the Antitrust Laws*, 34 GEO. WASH. L. REV. 893, 903-04, 925 (1966); Turner, *The Patent System and Competitive Policy*, 44 N.Y.U. L. REV. 450, 459-60 (1969); Austern, *supra* note 56.

<sup>65</sup> See *supra* note 64 and especially Austern.

<sup>66</sup> On the background to the changes in the United States, see Note, *An Economic Analysis of Royalty Terms in Patent Licenses*, 67 MINN. L. REV. 1198, 1198-1201, 1225 (1983) [hereinafter *Royalty Terms*]; Andewelt, *Technology Licensing and the Antitrust Laws—the View from the Department of Justice*, in *THE LAW AND BUSINESS OF LICENSING: LICENSING IN THE 1980s*, 2B-319 (R. Goldscheider & T. Arnold eds. 1983); Hudspeth, *Recent Developments in the Patent/Antitrust Interface—Response to a New Reality*, 3 J. L. & COM. 35 (1983).

licenses. Next, it will be explained how these changed perceptions have altered EEC law.

## 2. Benefits

The European Commission's most recent *Reports on Competition Law* and the preamble to the Block Exemption indicate that the Commission maintains that allowing exclusive rights and territorial restrictions will promote innovation and the diffusion of technology, thus benefitting the EEC.<sup>67</sup> This contrasts with the Commission's suggestion in 1979 that the promotion of innovation by territorial protection in patent licenses was only relevant to smaller companies.<sup>68</sup> The language used in *Maize Seeds* indicates that the European Court supports the idea that allowing territorial restrictions promotes new technology.<sup>69</sup> The Court's favorable attitude towards the relationship between patents and innovation is also manifested in the Court's increased emphasis on the idea that the primary purpose of patents is to reward innovation.<sup>70</sup>

In order for the European Commission and the European Court to be correct about the benefits of territorial restrictions, three conditions have to exist. First, allowing exclusive rights and territorial restrictions in patent licenses must increase the reward to potential innovators. Second, increased rewards to patentees have to stimulate innovative activity. Finally, increased innovation has to increase social welfare.<sup>71</sup> An examination of the latter two conditions is beyond the scope of this Article, as they relate to the utility of the patent system in general.<sup>72</sup> Therefore, since an examination of territorial restriction in patent licenses presupposes the existence of patents, it will be assumed that giving an increased reward to innovators stimulates innovation and that innovation increases social welfare.<sup>73</sup>

In examining the first condition it is necessary to determine to what extent allowing territorial restrictions in patent licenses increases the reward to patentees. To answer this question it is important to consider two broad situations where allowing territorial protection will increase the reward to patentees. First,

<sup>67</sup> See Commission of the EEC, 13TH REPORT ON COMPETITION 46 (1983); 14TH REPORT, *supra* note 51, at 14, 40; see *supra* note 4, at Recital 12.

<sup>68</sup> Burnside, *Licences, Export Bans in the E.E.C.*, in *THE LAW AND BUSINESS OF LICENSING: LICENSING IN THE 1980s* 2B-57, 2B-70 (R. Goldscheider & T. Arnold eds. 1983).

<sup>69</sup> See *Nungesser*, 1982 E. Comm. Ct. J. Rep. 2015, at para. 57.

<sup>70</sup> See *supra* notes 18, and 19.

<sup>71</sup> Kaplow, *supra* note 54, at 1824; Turner, *supra* note 64, at 451-53.

<sup>72</sup> On these assumptions see Turner, *supra* note 64, at 453-55; P. DEMARET, *supra* note 13, at 8-10; BOWMAN, *PATENTS AND ANTITRUST* 3, 8-9, 15-38 (1973); Levin, *Patents in Perspective*, 53 *ANTITRUST L.J.* 519 (1984).

<sup>73</sup> These assumptions are presently widely accepted. See *Royalty Terms*, *supra* note 66, at 1198-1200; Hudspeth, *supra* note 66, at 35-39, 48.

assuming a patentee is going to market the patent-based product in his territory, he will increase his revenue from sales if he does not face competition in his territory from his licensees or others. In this situation he may well be able to charge higher prices in his territory, regardless of how the product is marketed outside his territory. Second, assuming that the patentee will be utilizing licensees to market his product outside his territory, granting territorial protection to the licensees may result in the patent-based product being marketed more profitably by himself and his licensees.

There is a distinction between these two situations. While in both the profit from sales of the patent-based product will be higher, the proportion of the increase going to the patentee differs.<sup>74</sup> In the first situation all the increase goes to the patentee, while in the second a portion goes to the licensees. This is significant because it is the reward to the patentee which is crucial for promoting innovation.<sup>75</sup> Consequently, this distinction acts as a partial economic justification for the Block Exemption giving patentees more protection from competition from their licensees than licensees have from other licensees. As mentioned, the Block Exemption allows a complete export ban between patentees and licensees, but does not allow a ban on passive sales by licensees into other licensees' territories to last more than five years.

This reasoning, however, is not entirely sound.<sup>76</sup> This, in part, is because a patentee will often have a better understanding of how to utilize and market the patented process. As a result, he will have a competitive advantage and will not need to be insulated from competition.<sup>77</sup> Further, even if the patentee does not have a competitive advantage, the patentee can set the licensees' royalties payments high enough to give himself such an advantage or to compensate for his loss of sales.<sup>78</sup> Beyond this, even if the territorial protection in the Block Exemption is sufficient to protect a patentee from competition with his licensees, this will do little to increase the patentee's reward if there are close substitutes for the patent-based product. This is because customers will buy a lower priced close substitute if the patentee tries to raise the price of the patent-based product too much. Thus, the greater protection from competition which the Block Exemption allows for patentees will not always increase the reward to the patentees.

As has been discussed, the second broad situation where a patentee's reward will be increased is where the patentee grants territorial protection to licensees

<sup>74</sup> Kaplow, *supra* note 54, at 1835–37, 1860, 1879, recognizes that the portion of the reward going to the patentee has to be kept in mind.

<sup>75</sup> This is because potential patentees will only be induced to invent by the reward they receive and not by the reward their licensees receive. See P. DEMARET, *supra* note 13, at 73.

<sup>76</sup> Hoffmann & O'Farrell, *supra* note 8, at 108–09, see little justification for the distinction.

<sup>77</sup> *Id.* See also Casati, *supra* note 13, at 347.

<sup>78</sup> See Kaplow, *supra* note 54, at 1855–1857; P. DEMARET, *supra* note 13, at 57.

used to market his product outside his territory. There are two general circumstances where such territorial restrictions will result in a patent-based product being sold more profitably by a patentee and his licensees. One is when the territorial protection is being used as part of a collusive attempt to establish market division and control.<sup>79</sup> In this circumstance the patentee's reward will increase not only because the patentee will be protected from competition in his territory, but also because his licensees will pay higher license fees and royalties than they would otherwise. This is because the licensees will be able to make monopolistic profits in their territory which they could not if faced with competition.

The second circumstance where territorial restrictions will result in a patent-based product being sold more profitably is where the restrictions facilitate the efficient distribution of the patent-based product. Again, if the patent-based product is distributed more efficiently and profitably, the patentee's reward will increase not only because his sales revenue might increase, but also because his licensees will pay higher royalties as a result of their higher profits.<sup>80</sup> There are a number of reasons why using patent licenses incorporating exclusive rights and territorial protections might facilitate the distribution of a patent-based product. Relying on licensees might reduce the risk faced by a patentee.<sup>81</sup> Administrative costs may be lower when there is one rather than several licensees in each territory.<sup>82</sup> The structure of the market in a particular territory may be such that it can only profitably support a single firm.<sup>83</sup> Territorial protection may facilitate territorial price discrimination.<sup>84</sup> Finally, territorial protection might be necessary to induce someone to take a license in a particular territory which the patentee would not otherwise be able to exploit.<sup>85</sup>

Justification of the EEC's expansive approach towards territorial restrictions in patent licenses on the basis that patent-based products will be marketed more profitably by patentees and licensees is limited. As will be discussed, though use of territorial restrictions to establish market division increases the reward to patentees, the costs to society invariably are much greater. Further, the EEC's law relating to exclusive rights and territorial restrictions will often not be necessary for, or will do little to promote, the efficient distribution of patent-based products.

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<sup>79</sup> See P. DEMARET, *supra* note 13, at 25, 46–49; Wheeler, *A Reexamination of Antitrust Law and Exclusive Territorial Grants by Patentees*, 119 U. PA. L. REV. 642, 662–66, (1971); see Kaplow, *supra* note 54, at 1858–62, 1879.

<sup>80</sup> See Andewelt, *supra* note 66, at 2B-321.

<sup>81</sup> *Royalty Terms*, *supra* note 66, at 1200, 1223, 1227–1234; Fowlston, *supra* note 10, at 35–39.

<sup>82</sup> P. DEMARET, *supra* note 13, at 24–25.

<sup>83</sup> Turner, *Basic Principles*, *supra* note 58, at 496.

<sup>84</sup> P. DEMARET, *supra* note 13, at 32–35, 45–46, 65–67; Wheeler, *supra* note 79, at 650–56.

<sup>85</sup> P. DEMARET, *supra* note 13, at 25, 50–53.

As mentioned, there are a number of reasons why territorial protection might facilitate the distribution of patent-based products. Territorial protection, however, often will not really be necessary for the most efficient distribution of a patent-based product. For example, while relying on licensees reduces a patentee's risk, many prospective licensees will take a license without territorial protection. As a result it will often not be necessary to grant licensees exclusive rights and territorial protection as inducement. As well, if administrative costs are lower with only one licensee in a territory or a particular territory can only support one licensee, the patentee simply needs to refrain from granting more licenses. Again, it is not necessary that the patentee grant exclusive rights and territorial protection.

The argument that territorial protection may facilitate territorial price discrimination merits a closer examination. Territorial price discrimination can increase the return of patentees. Territorial protection in patent licenses can facilitate territorial price discrimination. This situation is illustrated by the following example. Assume that the sales revenue for a patent-based product is maximized in France when the price is 150 ECUs<sup>86</sup> and is maximized in the Netherlands when the price is 200 ECUs. Total sales revenue for the patent-based product will consequently be maximized if these prices are charged. Thus, the patentee's return necessarily will be higher if the different prices are charged than if the same price was charged in both countries.<sup>87</sup> If the patentee is utilizing licensees in such a situation his return will be increased because of the higher royalties resulting from the maximized sales revenues in each country.

In order for territorial price discrimination to be practiced, barriers to trade must exist between the territories where the different prices are charged. Otherwise, purchasers in the higher priced territories will simply get their supplies from the lower priced territories.<sup>88</sup> Suppliers in lower priced territories will be able to sell in the higher priced territories provided that the difference between prices in the territories is sufficient to cover the cost of transport and marketing.<sup>89</sup> In this situation, licensees in lower priced territories, and their customers, will be willing to sell in higher priced territories for a lower price than the profit maximizing price in the higher priced territories. If such sales occur the system of territorial price discrimination breaks down. Territorial restrictions in patent licenses can be used to prevent this from occurring. This is because patent licenses can include provisions prohibiting licensees and their customers from selling outside their territories.<sup>90</sup> Thus, allowing such restrictions in patent

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<sup>86</sup> European Currency Units.

<sup>87</sup> P. DEMARET, *supra* note 13, at 45; Wheeler, *supra* note 79, at 652.

<sup>88</sup> P. DEMARET, *supra* note 13, at 33.

<sup>89</sup> *Id.* at 33-34.

<sup>90</sup> *Id.* at 33-35, 45; Wheeler, *supra* note 79, at 653; V. KORAH, *supra* note 8, at 86.



licenses could facilitate territorial price discrimination and thus could increase the reward to patentees.

This argument, however, has little validity in the EEC context. The European Court, in *Maize Seeds*, held that the inclusion of a term in a patent prohibiting licensees' customers from selling outside their territories would ensure that an exclusive license was closed and would consequently fall within Article 85(1). Likewise, Article 3(11) of the Block Exemption provides that including restrictions on resale will cause a patent license to lose its exemption. Thus, since resales by customers cannot be prevented, EEC law does little to facilitate territorial price discrimination.

An argument which supports the EEC's expansive approach to territorial restrictions to patent licenses is that patentees will be able to get licensees to take licenses where licensees would not otherwise have done so.<sup>91</sup> Every time that a licensee takes a license that neither he nor anyone else would have taken without exclusive rights and territorial protection, the patentee's reward has been increased. This is because the patentee will receive license fees and royalties he would not have received if the license were not taken.

This argument, however, is weakened by the fact that situations where territorial protection will be necessary to induce licensees to take a license are infrequent. Territorial protection will only induce a licensee to take a license when the protection will increase the return of the licensee by allowing him to charge higher prices. This may not occur very often in the EEC, given the types of territorial protection permitted under EEC law. For example, as discussed previously, if there are price differences between Member States and there are no natural barriers to trade, parallel imports from customers will prevent a licensee from charging higher prices even if he has exclusive rights and territorial protection from the patentee and other licensees. Thus, in these circumstances, promising to grant a licensee the territorial protection allowed under EEC law will not be much of an incentive for the licensee to take a license. Further, if there are close substitutes for the patent-based product, a licensee will be unable to charge higher prices regardless of the territorial protection he has and regardless of price differences or barriers to trade. This is because the customer would simply buy a close substitute if the licensee attempted to charge higher prices.

A situation in which exclusive rights and territorial protections are likely to induce the taking of a license is where the patent involves a new or significantly different type of technology. This is because there will probably be no close substitutes for the patent-based product. Moreover, in such situations other

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<sup>91</sup> This is discussed by Wheeler, *supra* note 79, at 656-62; FOWLSTON, *supra* note 10, at 38-39; P. DEMARET, *supra* note 13, at 52-53; Turner, *supra* note 58, at 495-96; Gibbons, *supra* note 64, at 895.

licensees will be reluctant to take a license due to the significant development costs and/or risks. This consideration suggests that there may be some validity in the European Court's emphasis, in *Maize Seeds*, on new technology.<sup>92</sup> The Court's focus on new technology will be discussed below with respect to the costs arising from territorial restrictions.

An analysis of the benefits of territorial restrictions permitted under EEC law thus shows that the reward to patentees only increases in limited circumstances. It thus seems likely that EEC law in this area provides only a limited incentive for innovation. This should, however, be qualified in one way. If the reward that innovators perceived they could obtain was higher than that they in fact would obtain from the permitted territorial restrictions, EEC law could provide a greater incentive to innovation than the foregoing suggests. As Kaplow has pointed out, innovators' decisions may be influenced, and thus innovation may be promoted, by innovators' perceptions of potential rewards, which are at variance with the rewards they will actually receive.<sup>93</sup> The distinction between innovators' perceptions and actual rewards, however, is a largely unexplored area.<sup>94</sup> Due to this, and given that there is reason to question the extent to which patentees' rewards are in fact increased under present EEC law, it is not surprising that the relaxation of EEC law in this area has arisen not only from the idea that innovation will be promoted, but also from a decreased concern about the anti-competitive costs of territorial restrictions.

### 3. Costs

Territorial restrictions in patent licenses can impose a cost on society. This is because the use of such restrictions can detrimentally affect competition. Specifically, economic costs arise when territorial restrictions are used to establish or maintain a division of the market.<sup>95</sup> Territorial restrictions can cause market division in two situations. The first is where there are no close substitutes for the patent-based product. In this situation the only competition which occurs is between sellers of the same product.<sup>96</sup> This type of competition is known as intrabrand competition. Here, exclusivity and territorial protections can be used

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<sup>92</sup> A number of commentators recommend that exclusive rights and territorial restrictions be allowed in such circumstances. See Wheeler, *supra* note 79, at 656-62; Gibbons, *supra* note 64, at 895; R. WHISH, *supra* note 10, at 357; A. CROTTI, *supra* note 64, at 273. As discussed, *supra* note 20, Valentine Korah holds the view that the *Maize Seeds* doctrine should include situations where there is no close substitute for a new product. The analysis in the text is applicable to this situation as well, since the analysis rests on the idea that there are no close substitutes for the patent-based product.

<sup>93</sup> Kaplow, *supra* note 54, at 1838-39.

<sup>94</sup> *Id.*

<sup>95</sup> See generally L. SULLIVAN, *supra* note 56, at 224-29.

<sup>96</sup> Baden Fuller, *Economic Issues Relating to Property Rights in Trademarks: Export Bans, Differential Pricing, Restrictions on Resale and Repackaging*, 6 EUR. L. REV. 162, 169 (1981).

to restrict intrabrand competition between those selling the patent-based product. If the restrictions are strict enough, the patentee and each licensee will have market control in their respective territory.

If there are close substitutes for a patent-based product, regardless of the strictness of restrictions on intrabrand competition, the restrictions will fail to give a patentee or his licensees market control in their territories. This is because the patentee and licensees will face interbrand competitions, that is, competition from sellers of similar, though not identical, products.

Territorial restrictions in patent licenses, however, can be used to restrict interbrand competition. To see how, assume that there is interbrand competition between several producers. One of the producers could invent a slight, but patentable, improvement to his product which he would then patent. Instead of utilizing the patent he could agree with his competitors that he would grant licenses to them so they could incorporate his patented improvement in their products. The patent licenses would each give the patentee and his licensees exclusive rights in their particular territory and would prevent sales in each other's territory. The patent licenses would thus be used to eliminate the interbrand competition between the several producers and would give each market control in their particular territory.

The result of the patentee and licensee attaining market control is the same regardless of whether such control is gained through restrictions on intrabrand or interbrand competition. In both situations, the patentee or licensee will be able to charge a higher price for the patent-based product than he could if he was facing competition. The patentee or licensee has the incentive to charge a higher price since doing so will maximize his total revenue. If he does raise the price, less of the product will be purchased as some consumers who would have purchased at the competitive price will not at the higher price. This means that some of society's resources are being allocated towards what would have been a less efficient use of resources absent the restraints on competition. The less efficient use of resources resulting from the restraints is a loss to society.<sup>97</sup>

Thus, the economic argument against allowing a particular territorial restriction in patent licenses is that the societal loss which arises from permitting the restriction will exceed the benefits which arise from the incentives to invent provided by allowing the restriction.<sup>98</sup> Generally, it is recognized that if the patentee and licensees were allowed to use territorial restrictions to establish collusive divisions of the market the resulting costs would greatly exceed the benefits.<sup>99</sup> Upon closer examination, however, the costs arising from exclusive rights and territorial restrictions in patent licenses may not be as substantial as

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<sup>97</sup> L. SULLIVAN, *supra* note 56, at 2-3, 540-41.

<sup>98</sup> See P. DEMARET, *supra* note 13, at 34.

<sup>99</sup> Kaplow, *supra* note 54, at 1859; Bowman, *supra* note 72, at 63; L. SULLIVAN, *supra* note 56, at 554.

the foregoing suggests. The reason is that exclusive rights and territorial restrictions may not be as anticompetitive as the analysis above indicates. This is because in various circumstances they may create intrabrand competition or interbrand competition.

In circumstances where a patent license would not have been granted without exclusive rights and territorial protection, intrabrand competition is created. Here, the patent-based technology will be manufactured and sold in a territory where it otherwise would not have been. As a result, consumers in the licensee's territory will gain access to the product where they otherwise might not have. Further, depending on the nature of the territorial restrictions in the license, the licensee or his customers may be able to sell the patent-based product in other territories. This would increase intrabrand competition in those territories.<sup>100</sup>

The primary situation where exclusive rights and territorial protection in patent licenses can promote interbrand competition is where they are included for a vertical purpose.<sup>101</sup> This occurs when the purpose of the restrictions is to make distribution of the patent-based product more efficient. In such a situation the patentee, who may still sell the product, views his licensees as distributors of the product, rather than as competitors.<sup>102</sup> This would be the case, for example, where a patentee who operated in the United Kingdom did not want to operate in the rest of Europe and relied on licensees to manufacture and sell the patent-based product in the rest of Europe.

If a product is distributed more efficiently, this will enable the product to compete more effectively with close substitutes. Thus, if exclusive rights and territorial restrictions are included in patent licenses for a vertical purpose and there are close substitutes for the patent-based product, the exclusive rights and territorial restrictions should foster interbrand competition. Including exclusive rights and territorial restrictions in patent licenses, as described previously, may not be a very effective way to improve distribution of a patent-based product. A patentee will presumably alter his pattern of exclusive licenses and territorial restrictions, however, if they are causing him to lose sales and royalties revenue because of competition from close substitutes. Thus, if exclusive rights and

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<sup>100</sup> On the foregoing, see L. SULLIVAN, *supra* note 56, at 525-26; B. CAWTHRA, *supra* note 10, at 75; Handler & Blechman, *supra* note 32, at 407-08, 427.

<sup>101</sup> The following is based on R. WHISH, *supra* note 10, 347-49; Andewelt, *supra* note 66, at 2B-321; Gyselen, *supra* note 50, at 654-57, 662-63; Selinger, *A Reappraisal of Post-Sale Vertical Restrictions Under the Sylvania Rule of Reason*, in *THE LAW AND BUSINESS OF LICENSING: LICENSING IN THE 1980s* 2B-217, especially at 2B-228-40 (R. Goldscheider & T. Arnold eds. 1983); V. KORAH, *EXCLUSIVE DEALING AGREEMENTS IN THE EEC: REGULATION 67/67 REPLACED*, 7-9 (1984); Joliet, *Territorial and Exclusive Trademark Licensing Under the E.E.C. Law of Competition*, 15 INT'L REV. OF INTELL. PROP. & COPYRIGHT L. 21, 28-29, 33-34 (1984).

<sup>102</sup> Kaplow, *supra* note 54, at 1865.

territorial restrictions have been adopted for a vertical purpose, market forces should force them to be altered or dropped if they are not promoting interbrand competition.<sup>103</sup>

In adopting the Block Exemption the European Commission did not expressly rely on the argument that allowing exclusive rights and territorial protection in patent licenses promotes interbrand competition. In fact, the Commission is somewhat skeptical of this line of reasoning.<sup>104</sup> The Commission, however, did rely in part on the assertion that allowing such provisions can promote intrabrand competition.<sup>105</sup> This is indicated by Recitals 12 and 15 of the Block Exemption. Recital 12 states that a primary reason for allowing exclusive licenses and the territorial protection set out in the Block Exemption is to encourage the granting of licenses. The Commission maintains that this will lead to more companies having the opportunity to manufacture and sell patent-based products and to a wider distribution of patented technology in the EEC. Recital 15 says that the intrabrand competition created by the granting of licenses will not be eliminated by restrictions in the licenses. The rationale underlying this claim is that parallel imports and some passive sales are safeguarded.

In *Maize Seeds* the European Court's attitude towards intrabrand and interbrand competition was unclear. The Court indicated in paragraph 57 of the judgment that open exclusive licenses promote interbrand competition. The Court said in that paragraph that if licenses were not granted, because open exclusive licenses were not permitted, this would be damaging to the dissemination of a new technology and would prejudice competition in the EEC between the new product and similar existing products.

The European Court's emphasis on openness and new technology, however, is more consistent with the idea that the Court was concerned with intrabrand rather than interbrand competition.<sup>106</sup> The Court's ruling that patent licenses incorporating export bans on licensees or resellers would be closed, and thus would automatically fall within Article 85(1), indicates that the Court was seeking to preserve intrabrand competition. Further, in a situation where a new technology is involved, the preservation of intrabrand competition will likely be more relevant than the promotion of interbrand competition. This is because the newer the technology in a patent-based product, the less chance there is for

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<sup>103</sup> See, e.g., Gyselen *supra* note 50, at 645–55.

<sup>104</sup> Van der Esch, *supra* note 9, at 541–45, 560–61; Gyselen, *supra* note 50, at 658–61, 667–68; *Current Practical Problems in Distribution: Panel Discussion*, 54 ANTITRUST L.J. 643, 643–45 (1985) [hereinafter *Current Practical Problems*]; Caspari, *EEC Enforcement Policy and Practice: An Official View*, 54 ANTITRUST L.J. 599, 603–05 (1984); Collins, *Efficiency and Equity in Vertical Competition Law: Balancing the Tensions in the E.E.C. and the United States*, in ANNUAL PROCEEDINGS OF THE FORDHAM CORPORATE LAW INSTITUTE—ANTITRUST AND TRADE POLICIES OF THE E.E.C. 501, 524–26 (B. Hawk ed. 1983).

<sup>105</sup> See *supra* note 4, at Recitals 12 and 15. See also 14TH REPORT, *supra* note 51, at 13–14, 37–40.

<sup>106</sup> The following is based primarily on Hoffmann & O'Farrell, *supra* note 8, at 106.

close substitutes so that interbrand competition can occur. Thus, where a new technology is involved, the preservation of intrabrand competition may be crucial because intrabrand competition might be the only type of competition which can occur. If the Court had taken this line of reasoning to its logical conclusion, it would have held that territorial restrictions promote intrabrand competition. While such an argument was advanced in *Maize Seeds*, the Court did not, however, express a view on the effect of territorial restrictions on intrabrand competition.<sup>107</sup> Although in *Maize Seeds* the Court's view on territorial protection and interbrand competition was problematic, other cases indicate that the Court is becoming more sympathetic to the idea that vertical restrictions are procompetitive. In both *Coditel* and *Pronuptia*, a franchising case, the Court held that vertical restrictions did not automatically fall within Article 85(1).<sup>108</sup> In the *Windsurfing* case, however, the Court found that some vertical restrictions in patent licenses which were not territorial in nature did fall within Article 85(1).<sup>109</sup>

The European Court's noncommittal attitude towards the idea that territorial protection in patent licenses have a positive effect on intrabrand competition is understandable. First, it can only really be said that exclusive rights and territorial restrictions create intrabrand competition by causing licenses to be granted if the licenses would not have been granted absent the exclusive rights and territorial restrictions. This will not occur often because in many circumstances licensees can be compensated satisfactorily for the lack of exclusive rights and territorial protection through lower license fees and royalty payments.<sup>110</sup> Next, it should be recognized that territorial restrictions can restrict intrabrand competition. This occurs, for example, because the granting of an exclusive license prevents the patentee from granting licenses in the future. Territorial restrictions may also restrict intrabrand competition if a patent license places restrictions on where the patent-based product can be sold.<sup>111</sup>

The European Commission has been criticized for its lack of enthusiasm concerning the idea that exclusive rights and territorial restrictions promote interbrand competition.<sup>112</sup> The Commission's attitude, like the European

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<sup>107</sup> *Id.* at 104.

<sup>108</sup> See *Current Practical Problems*, *supra* note 104, at 665-66; *Pronuptia v. Pronuptia*, 1 Common Mkt. L.R. 414 (1986).

<sup>109</sup> Case 193/83. The Court's decision in this case had not been reported at the time of writing. The Commission's decision is reported in 1 Common Mkt. L.R. 1 (1984).

<sup>110</sup> P. DEMARET, *supra* note 13, at 50.

<sup>111</sup> The Commission relied on arguments similar to this, without referring specifically to intrabrand competition, in holding in the mid-1970s that exclusive rights and territorial restrictions infringed Article 85(1). For criticism of the Court's view, see P. DEMARET, *supra* note 13, at 112-14; GLEISS, COMMON MARKET CARTEL LAW 237-38 (1978).

<sup>112</sup> V. KORAH, *supra* note 8, at 61, 111; R. WHISH, *supra* note 10, at 349, 363-65; Gyselen, *supra* note 50, at 666-68; Joliet, *supra* note 101, at 33-36.

Court's attitude with respect to intrabrand competition, is, however, understandable. As discussed above, the extent to which exclusive rights and territorial restrictions make distribution of patent-based products more efficient is questionable. This suggests that exclusive rights and territorial restrictions may frequently be used for purposes other than promoting interbrand competition. For example, exclusive rights and territorial restrictions may be used to establish market control.

If close substitutes for a patent-based product exist, then the concern about exclusive rights and territorial restrictions being used to establish market control is minimal. The competition from the close substitutes will prevent the patentee and licensees from charging supracompetitive prices and market forces will cause the exclusive rights and territorial restrictions to be dropped if they are not promoting the efficient distribution of the patent-based product.

The situation is different if there are no close substitutes for the patent-based product. In that situation it is unlikely that exclusive rights and territorial restrictions would be included in a patent license for a vertical purpose.<sup>113</sup> This is because the patentee and licensees will be able to charge supracompetitive prices in their own territory. These prices will be successful since the patentee and his licensees do not compete in each other's territory and there are no close substitutes for the patent-based product. As a result, where exclusive rights and territorial restrictions are included in a patent license, in such circumstances, the purpose and effect of such exclusive rights and restrictions will likely be to stifle competition and create or maintain market control.

If no close substitutes exist, in that the technology involved in the patent is particularly new, the situation may well be different.<sup>114</sup> In these circumstances it is less likely that a patentee will consider using his patent for market control purposes. This is due to the fact that he potentially will be able to make significant profits on the basis of his patent alone. In addition, in this situation granting patent licenses with exclusive rights and territorial protection may well be a logical and sensible way of distributing the patent-based product. The patentee will want licensees in order to help spread the risk involved in marketing a new product, to defray what will probably be significant development costs, and to market the product in territories the patentee might not otherwise be able to exploit. The licensees, in turn, may want exclusive rights and territorial protection before becoming involved in a potentially risky project.

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<sup>113</sup> See P. DEMARET, *supra* note 13, at 46-47, who asserts that collusion is most likely where there are relatively few firms in the market and the patent is of minor importance. This is consistent with the analysis here as it is unlikely that there will be a significant number of close substitutes for the patent-based product under these circumstances.

<sup>114</sup> Wheeler, *supra* note 79, at 656-62.

This line of reasoning suggests a justification for the emphasis on new technology in *Maize Seeds*. While some commentators agree with this assertion,<sup>115</sup> the European Court in *Maize Seeds*, despite references to new technology, did not appear to rely on such reasoning. If the Court had, it would not have stressed the importance of competition with existing products. This is because, as the basis of the foregoing analysis indicates, the newness of the technology means that there are no close substitutes for the patent-based product.

To summarize the discussion of economic costs, while territorial restrictions can impose anticompetitive costs on society, this is not always the case. Territorial restrictions can have procompetitive effects. The European Commission has recognized that territorial restrictions can increase interbrand competition and the European Court is becoming increasingly sympathetic to the idea that territorial restrictions can promote interbrand competition. The fact that the Commission and the Court have ambivalent attitudes about interbrand and intrabrand competition respectively, however, indicates that there is some confusion in the EEC about the competitive effects of territorial restrictions. As a result, the extent to which territorial restrictions are in fact procompetitive or anticompetitive is unclear.

#### 4. Conclusion

Having discussed the economic costs and benefits of territorial restrictions, some conclusions can be drawn. It is quite easy, from an economic perspective, to categorize the situations where exclusive rights and territorial protection in patent rights are beneficial or detrimental. If there are close substitutes for the patent-based product in question, there is little reason to object to patentees and licensees providing for exclusivity and whatever territorial protection they see fit. The presence of interbrand competition will prevent the patentee and licensees from charging supracompetitive prices. Further, if allowing exclusive rights and territorial protection in these circumstances does permit patent-based products to be distributed more efficiently and profitably it will benefit the market and promote innovation. The market will benefit from increased interbrand competition. Innovation will be promoted because the greater profits will provide an incentive for inventive activity.

Further, an argument, based on economics, can be asserted to allow exclusive rights and at least some territorial restrictions for products which have no close substitutes because a patented, novel technology has been utilized. This is because permitting exclusive rights and territorial restrictions may encourage

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<sup>115</sup> Two commentators who think that exclusive rights and territorial restrictions are most justified when the patent involves a new technology are Wheeler, *supra* note 79, at 657-62 and Gibbons, *supra* note 64, at 895.



licensees to take licenses where they otherwise might not. This will be beneficial to patentees as they will be able to: (1) diffuse risk; (2) defray development costs; (3) obtain license fees and royalty payments they otherwise might not have obtained; and (4) exploit territories they might not otherwise have been able to operate in. These increased benefits to patentees will presumably be an incentive to innovation. The fact that allowing exclusive rights and territorial restrictions will encourage licensing is also beneficial because this will increase intrabrand competition. This is particularly important because the lack of close substitutes means that there will be no interbrand competition.

The situation where there is little justification for exclusive rights and territorial restrictions in patent licenses is where there is little or no competition with the patent-based product and the patent does not involve a particularly novel technology. In this situation establishing and maintaining market control and division is the likely motivation for including exclusive rights and territorial restrictions in patent licenses. Further, the effect of exclusive rights and territorial restrictions in these circumstances is that the patentee and his licensees will be able to charge monopolistic prices in their territories. In this situation, as discussed previously, the economic costs to society invariably exceed the benefits.

This suggests that from an economic viewpoint exclusive rights and territorial restrictions should be permissible in some circumstances but not others. Factors such as the presence of close substitutes and the novelty of the patent may help to determine the desirability of exclusive rights and territorial restrictions in individual cases. If a policymaker is going to adopt a general policy towards exclusive rights and territorial restrictions, however, the policy adopted will depend on the policymakers' perceptions about the likelihood that exclusive rights and territorial restrictions will be used to establish market division and control. In light of the detrimental effects which arise when such rights and restrictions have this purpose, and the neutral or beneficial effects otherwise, if a policymaker believes that the rights and restrictions are frequently used to divide and control a market, then a strict posture should be adopted. Conversely, if the policymaker believes the rights and restrictions are not used to divide and control a market then a more expansive approach is justified.

The European Commission is skeptical concerning the argument that exclusive rights and territorial restrictions create interbrand competition. This skepticism suggests that where a patent is not particularly novel, the Commission will frequently suspect that such rights and restrictions have an anticompetitive effect or purpose.<sup>116</sup> In light of this skepticism one would expect the Block

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<sup>116</sup> Two Commission staff members who have expressed views similar to this are Van der Esch, *supra* note 9, at 549 and Caspari, *supra* note 104, at 604. See also V. KORAH, *supra* note 8, at 39-40.

Exemption to take a fairly strict approach towards exclusivity and territorial restrictions. The Block Exemption, however, takes a relatively expansive approach towards territorial restrictions.<sup>117</sup> This Article will next outline a possible explanation of why the Block Exemption takes such an approach.

### B. *Market Integration*

In the EEC it is impossible to consider exclusive rights and territorial restrictions in patent licenses from a purely economic perspective. This is because market integration is a central objective of EEC competition law.<sup>118</sup> Thus, a major purpose of EEC competition law is to prevent the establishment of private economic barriers within the Common Market.<sup>119</sup>

The European Commission and European Court's strict approach towards exclusive rights and territorial protections originally arose more from concern over market integration than from worries about the anticompetitive effects of such rights and restrictions.<sup>120</sup> This is not surprising in light of the fact that two of the central purposes of territorial protections directly conflict with the elimination of private economic barriers in the EEC.<sup>121</sup> One such purpose is to restrict patent licenses to particular territories which are frequently based on the borders of the Member States. The second purpose is to restrict movement of patent-based goods between territories.

As mentioned, the European Commission's posture towards exclusive rights and territorial restrictions is significantly more expansive than it was a few years ago. In fact, despite the concern over market integration in the EEC, the Block Exemption is only marginally stricter on exclusive rights and territorial restrictions than the law in the United States where market integration is not a concern.<sup>122</sup>

It can be argued that the European Commission's more relaxed view towards territoriality in patent licenses is justified on a market integration basis. For example, if territorial protection does significantly promote interbrand competition, market integration might be enhanced by a permissive approach towards territorial protection. This is because promoting more intensive inter-

<sup>117</sup> See text accompanying notes 28 & 107.

<sup>118</sup> J. PELKMANS, MARKET INTEGRATION IN THE EUROPEAN COMMUNITY 1-3, 189 (1984); Casati, *supra* note 13, at 322, 325, 348 n.217; Hawk, *supra* note 21, 737-38.

<sup>119</sup> Gyselen, *supra* note 50, at 650-51.

<sup>120</sup> Lang, *supra* note 16, at 60-61; Ewing, *Antitrust Enforcement and the Patent System: Similarities in the European and American Approach*, 11 INT'L REV. INTELL. PROP. & COPYRIGHT L. 279, 294 (1980).

<sup>121</sup> Lang, *supra* note 16, at 60, 70-71; A. CROTTI, *supra* note 64, at 253-54; R. MERKIN & K. WILLIAMS, *supra* note 6, at 331; Casati, *supra* note 13, at 327.

<sup>122</sup> A number of commentators say that the emphasis on market integration in the EEC has resulted in EEC law being stricter. See, e.g., A. CROTTI, *supra* note 64, 14-15; Baillie, *supra* note 51, at 689; Caspari, *supra* note 104, at 600.

brand competition throughout the EEC may do more to promote market integration than would ensuring that a product is available at the same price throughout the Common Market.<sup>123</sup> Further, it can be argued that it is futile to try to attack exclusive rights and territorial protections in order to ensure that products of the same brand are available at the same price throughout the EEC. A much better method to ensure the same price would be to attack the primary causes of the price differences, such as different national regulations.<sup>124</sup>

The European Commission, however, placed no emphasis on these arguments in adopting a more permissive approach towards territorial protection in the Block Exemption. As previously mentioned, the Commission similarly did not adopt any arguments that territorial restrictions promote interbrand competition. This suggests that the Commission may still have concerns about the negative impact of exclusive rights and territorial protection on market integration and interbrand competition. Indeed, some observers have said that the Commission is still skeptical about the desirability of territorial protections.<sup>125</sup>

If the European Commission is still concerned about the impact of exclusive rights and territorial protections on competition and market integration one important question arises. Why was the Block Exemption's treatment of territorial protection more liberal than the Commission's previous position? In answer to this question, it appears that the change likely came about, at least in part, because of lobbying. In the mid-1970s, business interests and certain Member States began to put pressure on the Commission to relax its views on exclusivity and territorial restrictions.<sup>126</sup> This pressure intensified when the Commission was developing the Block Exemption. The proposed provision which attracted the most attention set out that the automatic exemption for exclusive rights and export bans was restricted to companies with a turnover of less than 100m. ECUs.<sup>127</sup> The Commission stated, at the time, that only small and medium sized companies needed the incentive to develop technology provided by exclusive rights and territorial restrictions.<sup>128</sup> It is arguable that the Commission also thought that the adverse effects on market integration and competition would be less if the automatic exemption applied to small and medium sized companies.

In the face of continued lobbying the European Commission, in 1984, agreed to delete the turnover limit. The Commission's position on the turnover limit

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<sup>123</sup> Gyselen, *supra* note 50, at 667-68; Handler & Blechman, *supra* note 32, at 410; Fuller, *supra* note 96, at 173.

<sup>124</sup> See Gyselen, *supra* note 50, at 667-68.

<sup>125</sup> See sources cited *supra* note 104 and V. KORAH *supra* note 8.

<sup>126</sup> B. CAWTHRA, *supra* note 10, at 207-08; Casati, *supra* note 13, at 348, n. 214.

<sup>127</sup> Brunsdold, *supra* note 31, at 291-96; Holley & Siragusa, *supra* note 32, at 350-51.

<sup>128</sup> Burnside, *supra* note 68, at 2B-70.

was once apparently steadfast.<sup>129</sup> It was relaxed, however, because the provision would have been difficult to administer<sup>130</sup> and the Commission was eager to obtain the consensus thought to be necessary for the adoption of the regulation. This was particularly important in light of the increasing backlog of applications to exempt patent licenses.<sup>131</sup>

The European Commission thus appears to have downplayed concerns about market integration and competition in the face of lobbying and administrative concerns.<sup>132</sup> It may also be asserted that the Commission adopted a more liberal view towards territorial restrictions in part because it developed a more favorable view of the extent to which territorial restrictions promote innovation and intrabrand competition. Exclusive rights and territorial restrictions, however, can impose significant economic costs and can detrimentally effect market integration. Given this, it would have been reassuring to have the Commission make more of an effort to come to terms with these concerns in adopting the Block Exemption. Instead, it appears that the Commission downplayed them because of lobbying and administrative pressures.

### C. Administration and Enforcement

In addition to being relevant to patent licenses, *Maize Seeds* and the Block Exemption raise issues relating to the administration and enforcement of EEC competition law. It is not possible to deal with all of these here. Still, it is impossible to evaluate the EEC's approach to exclusive rights and territorial restrictions in patent licenses without at least considering administration and enforcement.

From an administration and enforcement perspective, the Block Exemption certainly has its faults. A primary fault is that the Block Exemption will probably act as a code of conduct. Parties are likely to structure the terms of their patent license agreements in order to ensure that the agreement falls within the Block Exemption.<sup>133</sup> The reason for this is that if a patent license contains a term which is more restrictive than those set out in the Block Exemption, the patent license does not gain an automatic exemption and is unlikely to be exempted under an individual application.<sup>134</sup> The European Commission, as previously

<sup>129</sup> Brunsvold, *supra* note 31, at 294.

<sup>130</sup> Hawk, *supra* note 21, at 762.

<sup>131</sup> Lewin & Martin, *supra* note 8, at 61.

<sup>132</sup> Hawk, *supra* note 21, at 764-65; V. KORAH, *supra* note 8, at 39-40.

<sup>133</sup> Baillie, *supra* note 51, at 695; R. WHISH, *supra* note 10, at 364; Forrester & Norall, *The Laicization of Community Law—Self-Help and the Rule of Reason: How Competition Law Is and Could Be Applied*, in ANNUAL PROCEEDINGS OF FORDHAM CORPORATE LAW INSTITUTE—ANTITRUST AND TRADE POLICIES OF THE E.E.C. 305, 319-20 (B. Hawk ed. 1983); V. KORAH, *supra* note 8, at 110; *Questions and Answers*, 54 ANTITRUST L.J. 703, 706-07 (1985).

<sup>134</sup> Baillie, *supra* note 51, at 695.

mentioned, is still skeptical of territorial restrictions. As a result, it is unlikely that the Commission would exempt territorial protections which are more comprehensive than those allowed under the Block Exemption.<sup>135</sup> Further, even if an individual exemption could be obtained it would involve a significant delay. This delay will probably exist even if the Block Exemption reduces the number of agreements being sent to the Commission.<sup>136</sup>

If the Block Exemption does function as a code of conduct, it may retard innovation and interbrand competition. For example, a license containing restrictions on where purchasers of the patent-based product could sell the product will not fall within the Block Exemption by virtue of Article 3(11).<sup>137</sup> Furthermore, such a license probably would not be exempted under an individual application. As previously described, however, restrictions on resale are probably necessary for territorial price discrimination to be practiced and probably would encourage licensees to take licenses. Restrictions on resale, therefore, can significantly increase the reward of patentees and may facilitate the efficient distribution of patent-based products. Thus, because a likely effect of the Block Exemption will be preventing restrictions on resale, the Block Exemption probably retards innovation and interbrand competition.

On the other hand, the Block Exemption, in some instances, may allow patent license agreements which have significant anticompetitive effects or are detrimental to market integration to go undetected. Such a situation would result, for example, if a patentee and his licensees control a substantial part of the market and parallel imports are unlikely because price differences between territories are small. In this situation the territorial restrictions which are exempted under the Block Exemption may be sufficient for the patentee and the licensees to charge supracompetitive prices and may reduce substantially the free movement of goods in relation to the market in question.<sup>138</sup> Such agreements would not have to be notified because of the Block Exemption. Further, they probably would remain undetected. This is because the European Commission uncovers relatively few Article 85 violations by acting on its own initiative and because the likely absence of a damages remedy discourages complaints from individuals.<sup>139</sup>

It is relatively easy to identify the problems inherent in the Block Exemption. Proposing a viable alternative, however, is more difficult. One such alternative is to amend the Block Exemption. This could be accomplished by making the Block Exemption responsive to the market share of the parties. The possibility

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<sup>135</sup> V. KORAH, *supra* note 8, at 40.

<sup>136</sup> *Id.* at 110; Forrester & Norall, *supra* note 133, at 342.

<sup>137</sup> See *supra* note 4, at art. 3(11).

<sup>138</sup> See P. DEMARET, *supra* note 13, at 49.

<sup>139</sup> D. GUY & G. LEIGH, *supra* note 7, at 373.

that exclusive rights and territorial protection will have anticompetitive effects is significantly greater when the patentee and licensees have a large market share. This is because close substitutes will not be readily available. Thus, in situations involving a large market share it might be desirable to require the parties to apply for an individual exemption. An example of such a situation is where the parties want to incorporate extensive territorial protections, such as export bans, on the patentee and the licensees.<sup>140</sup>

Determining when an individual exemption should be applied for is the primary problem with the amendment suggested previously. Indeed, the European Commission encountered the same difficulty in preparing the Block Exemption. The Commission wanted to limit most automatic territorial exemptions to small and medium sized companies.<sup>141</sup> This was the purpose of the maximum turnover limit.<sup>142</sup> Because the Commission realized that the turnover limit would be difficult to apply, it considered relying on market share. The Commission, however, could not come up with a workable solution based on market share. This was because the calculations involved would have been imprecise. Accordingly, it may be impossible to devise a feasible way of ensuring that companies with large market shares apply for an exemption.

Given the problems with the Block Exemption, some writers have recommended an entirely different approach.<sup>143</sup> They assert, recognizing that the need for the Block Exemption arose from the European Commission being overloaded with individual applications, that Article 85(1) should be interpreted less strictly. They suggest, for example, that patent license agreements which promote interbrand competition more than they restrict intrabrand competition should not fall within Article 85(1). The result of such an approach would be that fewer patent license agreements would violate Article 85(1). This, consequently, would decrease the demand for Article 85(3) exemptions.

The European Court has taken steps in recent cases which are consistent with such an approach. In *Maize Seeds*, *Coditel*, and *Pronuptia*, the Court has held that provisions which do or potentially could restrict intrabrand competition do not violate Article 85(1). The Court has yet to develop a consistent line of reasoning in these cases. It is distinctly possible, however, that the Court is moving towards

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<sup>140</sup> In the United States a similar approach has been adopted in relation to vertical restrictions. The courts will allow almost any vertical restrictions as long as the market share of the parties is small. If the market share is large, however, the parties are called upon to present evidence to justify the agreement. See Gyselen, *supra* note 50, at 645-58.

<sup>141</sup> The following is based on Brunsvold, *supra* note 31, at 293-95; Holley & Siragusa, *supra* note 32, at 351; and Handler & Blechman, *supra* note 32, at 408.

<sup>142</sup> See text accompanying notes 127-30.

<sup>143</sup> See, e.g., Forrester & Norall, *supra* note 133, at 306-12, 332-33; Baillie, *supra* note 51, at 695-97; V. KORAH, *supra* note 8, at 111; *Industrial Property Under E.E.C. Law: Panel Discussion*, in ANNUAL PROCEEDINGS OF FORDHAM CORPORATE LAW INSTITUTE-ANTITRUST AND TRADE POLICIES OF THE E.E.C. 563, 69-73 (B. Hawk ed. 1983).

a position where agreements which promote competition more than they restrict competition do not violate Article 85(1).

There are problems, nevertheless, with this approach as well. First, this approach could emasculate Article 85.<sup>144</sup> The parties of licensing agreements would, in essence, be given the authority to decide whether to notify their agreements to the European Commission. This is because such parties would make the initial decision whether their agreement was anticompetitive and thus needed an exemption. In exercising such authority, it is reasonable to assume the parties would not notify the Commission. This is due to both the delay involved in such notice and the fact that such parties would usually take a favorable view of their own agreements. This pattern would be reinforced since the Commission would have little opportunity to analyze wrong decisions. In fact, in these circumstances a patent license would come to the Commission's attention only by virtue of a complaint or the Commission's investigations.

A second problem with interpreting Article 85(1) less strictly and with abandoning the Block Exemption is that the law would be more uncertain. Presently in the United States, exclusive rights and territorial restrictions in agreements are most frequently examined under the Rule of Reason. Under the Rule of Reason analysis the legality of Exclusive rights and territorial restrictions is determined by discerning whether their overall effect is procompetitive or anticompetitive. This approach has rendered the law relating to territorial restrictions in patent licenses uncertain.<sup>145</sup>

If the procompetitive or anticompetitive effects of territorial restrictions were used in the EEC to determine the legality of such restrictions, the law would become as uncertain as it is in the United States. This would be detrimental to licensing as uncertainty in this area makes parties reticent to license.<sup>146</sup> Uncertainty is a problem which is less likely to arise with the Block Exemption. While the Block Exemption is arguably too rigid, it should make the law relating to patent licenses more predictable.<sup>147</sup>

## V. CONCLUSION

One finds no easy answers to the problems raised by exclusive rights and territorial restrictions in patent licenses.<sup>148</sup> Insights into the issues involved can

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<sup>144</sup> See Van der Esch, *supra* note 9, at 550-52, 560; 2 H. SMITH & P. HERZOG, *THE LAW OF THE EUROPEAN ECONOMIC COMMUNITY: A COMMENTARY ON THE E.E.C. TREATY*, 3-25-6 (1984).

<sup>145</sup> Selinger, *supra* note 101, at 2B-237-40; Taylor, *Appendix B: Analyzing Licensee-licensor Relationships; The Methodology Revisited*, 53 ANTITRUST L.J. 577, 608-09 (1984).

<sup>146</sup> B. CAWTHRA, *supra* note 10, at 72; L. SULLIVAN, *supra* note 56, at 545; and *Royalty Terms*, *supra* note 66, at 1198 n.3, 1200 n.11.

<sup>147</sup> Lewin & Martin, *supra* note 8, at 65, 67; Hearn, *supra* note 8, at 326; R. WHISH, *supra* note 10, at 364; see *Distribution Under E.E.C. Law*, in *ANNUAL PROCEEDINGS OF FORDHAM CORPORATE LAW INSTITUTE-ANTITRUST AND TRADE POLICIES OF THE E.E.C.* 527, 528 (B. Hawk ed. 1983).

<sup>148</sup> Kaplow emphasizes this. See Kaplow, *supra* note 54, at 1815, 1888-89.

be gained by considering the economic costs and benefits of such rights and restrictions. In attempting to pinpoint a policy which will maximize the net economic benefits arising from territorial protection, however, one is simply faced with further questions. Are there close substitutes for the patent-based product? Is the exploitation of the patent-based product going to be risky and expensive? Is a potential innovator's perception of the reward he will receive from including territorial protection in patent licenses consistent with the actual reward he will receive? Because the answers to these and other relevant questions will differ in each case, it is difficult to state authoritatively which policy towards territorial protection will be the most sensible from an economic viewpoint.

Given this, the European Commission and the European Court face a difficult task in defining what types of territorial protections should be allowed in patent licenses. Their problems are compounded by the fact that such provisions can hinder market integration. Thus what might be the most sensible policy from an economic viewpoint might conflict with one of the other fundamental objectives of the EEC.<sup>149</sup>

Further, even if the European Court and European Commission could develop an approach towards territorial protection which is satisfactory from an economic and market integration point of view, limitations in the EEC's system of competition law may prevent the approach from being adopted. The chosen policy may be too sophisticated to incorporate in a Block Exemption. For example, the policy may require a case by case analysis. Under present circumstances, however, a case by case approach probably cannot be adopted in the EEC. Past experience has shown that the Commission cannot satisfactorily consider violations of Article 85(1), as it is presently interpreted, on a case by case basis. On the other hand, reducing the scope of Article 85(1) and having the parties to an agreement decide at first instance whether the agreement violates Article 85(1) is probably also undesirable. This is because many agreements which are anticompetitive or contrary to market integration might escape detection as few violations of Article 85 are revealed by private complaints or the Commission's actions.

While the European Commission and European Court admittedly face a difficult task with respect to formulating an EEC policy towards territorial protection, their policy is not beyond reproach. In the past, the Commission and the Court have liberalized the law relating to exclusive rights and territorial restrictions. This liberalization arose because they became more receptive to the idea that such provisions promote innovation and less concerned about the possible anticompetitive effects of such provisions. This change of view is jus-

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<sup>149</sup> *Current Practical Problems*, *supra* note 104, at 655-66; Collins, *supra* note 104, at 525-26.



tified in that policies towards territorial protection in patent licenses are often altered when policymakers' perceptions of the costs and benefits involved change.

In adopting the Block Exemption, however, the European Commission may have downplayed some of its concerns about the adverse effects of exclusive rights and territorial restrictions for other reasons. In particular, the Commission may have succumbed to lobbying and to time pressures dictated by an ever-increasing backlog of patent licenses that had to be considered for individual exemptions. Such an approach is undesirable in an area where the issues are as complex as they are with territorial restrictions and where the Block Exemption will probably form the basis of the relevant law for some time to come. One can only hope that despite the Commission's actions the EEC has developed the most suitable and workable policy towards exclusive rights and territorial restrictions in patent licenses.