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The European Community-1992 and Beyond: The Implications of a Single Europe on Intellectual Property

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I. Introduction

A. Historical Perspective and Present Situation

For the past forty years, the Western Bloc countries of Europe have been striving to achieve an integral market structure to promote cross-border trade. The development of the European Economic Community (EEC, popularly known as the Common Market)\(^1\) converted a group of independent countries into a homogeneous community of over 300 million consumers.\(^2\)

Western Europe's experience finds a counterpart in the development of the cross-border trade between the original American states in the development of United States commerce. The United States federal system, which insisted upon freedom of interstate commerce unfettered by state regulation, developed the internal market which strengthened American industry at the expense of foreign manufacturers. Taking a lesson from United States history, albeit two hundred years later, the European Community (the "EC" is the current designation for the organization previously known as the EEC) is seeking to strengthen its internal market, served by business organizations having a presence in the respective member states.

Many international business analysts have a healthy skepticism regarding the probable success of the endeavor. Certain historical events, such as Germany's three attempts within the last century to dominate Europe through military aggression, have engendered a

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2. The E.C. is comprised of Germany, France, Italy, Spain, the United Kingdom, Belgium, Denmark, Greece, Ireland, Luxembourg, the Netherlands, and Portugal. Prior to the re-unification of Germany the combined population was estimated at 320 million people. White Paper from the Commission to the European Council, June, 1985.
certain reluctance to allow the Germans to acquire a dominant position through economic strength.

In addition, the disparities between the various countries in terms of culture, language, political systems, stability, economic strength, employment, inflation, debt, currency exchange, religion, social welfare, world trade and similar factors, would suggest that a single state system could never be achieved. It would seem unlikely that any of the Common Market countries would relinquish its sovereignty to a supra-national authority comprised of other member states. The simple response is that they have done so. The willingness of the European Community countries to abide by the decisions of the EC Court of Justice is mute testimony that the EC countries are willing to trade some sovereignty for an opportunity to be a player in the European market.

Other potential problems include the lack of a common currency and a common language throughout the Common Market countries. Not even the wildest optimist expects the adoption of a single currency or a single language in the near future. However, the possibility that the EC can exist without a common currency and a common language is not at all bleak. The EC could adopt a supra-national currency and allow the currencies of the individual countries to float against it. Although there is an EC monetary unit, the ECU, it is merely used as a currency value for calculating certain regulatory formula and is not available in transferable negotiable instruments. The absence of a common EC language would appear to be detrimental to the EC's goal of unification. In reality, the lack of a common language is not an impediment to unity. Even in certain sections of the United States, large groups of non-English speaking residents exist quite comfortably.

B. The Problem

One area involved in the cross-border transfer of goods and technology is referred to as "intellectual property" (i.e. patents, trademarks, copyrights and trade secrets). Contrary to conventional wisdom, there is no international patent, international trademark or international copyright. Certain treaties do exist that grant reciprocal rights to citizens of countries that are signatories to the treaties; however, each country retains control over the issuance and enforcement of intellectual property rights that it grants.

At first glance, the objectives of the Common Market appear to
conflict with the current state of intellectual property rights and procedures. While the member countries are committed to eliminating impediments to cross-border flow of goods within the Common Market, the individual EC countries, however, continue to protect the intellectual property rights of their residents against importation of goods that infringe these rights.

For example, assume that the Deutschland Manufacturing Company has patent protection in Germany on a new laser device but has no equivalent patent in France. If a competing manufacturer makes the product in France, may the device be lawfully exported into Germany? The German patent law says "no," because such exportation would be a violation of the German patent. The EC law says "yes," because prohibiting export would be contrary to the spirit and regulations of the European Community.6

This Article will describe some of the inconsistencies between the EC law and the intellectual property laws of individual member states. It will also attempt to suggest solutions to resolve the conflicts.

II. Intellectual Property

A. Patents

Patents are creatures of statutes. Patents do not exist in the common law.7 Through statutory law governments grant exclusive rights to inventors who have made a significant advance in the state of technology. Each government determines the qualifications for issuing a patent as well as regulatory procedures for obtaining a patent. Applicants for a patent must scrupulously adhere to these requirements. Failure to do so may result in denial of the patent grant or invalidation of the patent if it is granted improperly.8

The absence of extraterritorial effect of patents requires the inventor to file a proper application in each jurisdiction in which he or she desires patent protection. While patent laws in each country are similar,9 there is also a certain amount of disparity. A patent issued in one country might be denied in another country because of the differences in the patent statutes.

All countries require the common thread of an invention, constituting a substantial advancement of technology, to justify the grant of a patent.10 Countries have widely divergent views as to the degree of the advancement necessary to support a valid patent. While some

10. Id. § 1.03.
countries examine the patent application for inventive merit before granting a patent, other countries issue a patent if the application is presented in the proper form and leave the issue of inventive merit to a later determination, should the patent be tested in court.

The disparity of patent laws in Common Market countries results in a likelihood that certain Common Market countries, having strict requirements for the grant of a patent, might refuse to grant a patent on a particular invention, whereas countries with more relaxed standards might grant a patent on the same invention. The patent may not protect the inventor against the importation of the product from an EC country in which the invention does not qualify for a patent, as illustrated by the Deutschland Manufacturing Company example.

1. Types of patents.

   a. Product patents.—As the name suggests, product patents cover new and improved devices, machines, chemical compounds and other articles of manufacture. The patent precludes others from making, using or selling the patented device within the jurisdiction of the country issuing the patent. It also precludes the production of any similar devices embodying the patented concept.

   b. Process patents.—A process patent protects a new and useful process for making useful products even though the article itself is old and well-known. A patent also protects a process that makes an article at less cost, more quickly, or more reliably than other ways of making the product. Other manufacturers may continue to make the articles by known methods, but may not use the method covered by the patent.

2. Exportation of Patented Devices.—The Deutschland Manufacturing Company example of a product lawfully sold in France, where the inventor does not have patent rights, then exported to Germany, where the inventor has a German "product" patent, exemplifies the conflict between the EC objective of free trade and the objective of protecting intellectual property rights. Because patent rights have been granted to the inventor, the inventor's patent rights in Germany should be enforced. The free trade objectives of the EC, however, are not absolute. Whenever rights of individual or private

11. Id. § 19.01[1].
12. Id.
16. P. Rosenberg, supra note 7, § 6.01[1].
organizations confer a benefit on society in general, those rights should be protected, even at the expense of a minimal intrusion on the promotion of cross-border trade.

If a new process is used in the manufacture of an old device, and the process is protected by a patent in Germany but not in France, should a competitor be permitted to make the device by the new process in France and then export it to Germany without violating the inventor's German patent? This hypothetical example seems to be a variation of the previous example. Considerations involving process patents are, however, quite different from the scope of protection offered by product patents. As indicated, patents are a creature of statute and each country's patents have no extraterritorial effect. Since the manufacture is legal in France, the exportation to Germany does not infringe on the rights of the German inventor, which are limited to protection against use of the new process in Germany.

3. *EC Patents.*—Many lawyers and business persons within the EC favor enactment of a patent statute that would provide for a single patent, valid throughout the Common Market. This statute would be the equivalent of a United States patent that is valid and enforceable throughout the United States. While the concept is intriguing and the EC has expended considerable effort to pass legislation designed to create such patent rights, until recently little progress has been made. There does not seem to be any serious opposition, merely a lack of substantial support by the governments of the member states for this concept. Recently, however, the EC has been in communication with the European Patent Office (EPO) regarding the EPO's willingness to handle the administrative details of an EC patent. Should the EPO agree, an EC patent may in fact become a reality.

4. *Patent Licensing in the EC.*—While the cross-border transfer of patented goods within the EC creates interesting legal questions, the scope of patent licensing within the EC creates more difficult problems. An American company owning equivalent patents in both France and Germany may desire to license different companies to penetrate the markets in each of these countries. It may prefer to license a German company to penetrate the German market and a French company to represent it in France. Presumably, each com-

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18. R. PENNINGTON, EUROPEAN PATENTS AT THE CROSSROADS 3-7 (1975).
19. The European Patent Office was established in Munich, Germany to administer the European Patent Convention (E.P.C.). Most European countries are party to the E.P.C. The E.P.C. permits the filing of a single patent application which, if issued, may be registered in all countries belonging to the E.P.C. See P. ROSENBERG, supra note 7, §§ 19.01-.03.
pany would be able to develop the market within its own sphere of expertise, based upon its familiarity with the language, local distribution, and advertising. May the licensor prohibit, by contract, each of the licensees from selling goods into another licensee's territory? It would be very dangerous to do so in view of strong EC prohibitions against the restriction of cross-border transactions.\footnote{See Treaty of Rome, supra note 1.} Even in the United States licensors may grant exclusive licenses to different licensees in different geographical locations.\footnote{35 U.S.C. § 261 (1988).} A licensee operating outside of the defined area is considered an infringer. The thrust of the EC regulation is that once the patent owner distributes the product in any EC country, the licensee may further distribute it throughout the EC without the distribution being considered a violation of the licensor's patent rights.\footnote{See Terragon (Overseas) Ltd. v. Terranova Industrie C.A. Kapferer & Co., 1976 E. Comm. Ct. J. Rep. 1039, [1976] 2 Comm. Mkt. L.R. 482.}

B. Trademarks

1. Property rights.—A trademark is a word or symbol used to indicate the source of goods or services.\footnote{See, e.g., 15 U.S.C. § 1127 (1988).} Thus the trademark “IBM” used on computers indicates a product made by the International Business Machine Company. Likewise, the symbol of the Rock of Gibraltar identifies the Prudential Insurance Company. Once consumers identify these words or symbols with the source of the goods or services, the owner acquires a property right in the trademark.\footnote{W. KEATING, FRANCHISING ADVISER § 7.01 (1987).} Subject to certain restrictions,\footnote{See, e.g., 15 U.S.C. § 1060 (1988).} the trademark owner may transfer or license the trademark in the same manner as any other type of personal property. The owner has the right to preclude others from using the same or similar marks on the same or similar goods or services.\footnote{See, e.g., 15 U.S.C. § 1114 (1988).} A certain difficulty arises in determining the scope of trademark rights, in view of the intangible nature of trademarks. However, this is a concept that courts have dealt with for years, and courts have developed certain guidelines in defining the scope of trademark rights.\footnote{See, e.g., 15 U.S.C. § 1127 (1988).}

2. Licensed rights.—Again, the trademark owner may elect to license the trademark to different licensees in different geographical areas. Trademark licensing is especially sensitive because of the necessity that the licensor maintain quality control over the goods bearing the trademark, which the licensee sells.\footnote{Id. § 5.18.}
licensee to maintain a quality product may injure the reputation of the licensor as well as all other licensees. This quality control is important in trademark licensing of franchises. A poor reputation by one franchisee may injure the reputation of all the franchisees.

C. Copyrights

1. Nature of rights.—Copyrights protect authors and artists from plagiarism of their works. The scope of protection is limited to artistic and literary works, such as plays, books, songs, statues, movies, and to prevention of the "copying" of the artistic or literary work. A successful suit for copyright infringement requires the plaintiff to prove that the defendant had access to the plaintiff's work. The plaintiff must also bear the burden of proving that the defendant's work was a copy of the plaintiff's work, not just a similar treatment of a similar theme.

2. Copyright Protection

a. Reproduction and distribution rights.—Reproduction and distribution rights involve the production and sale of copyrighted works in tangible form, for example, books, records, tapes, paintings, statues and similar objects embodying copyrighted material.

b. Performance rights.—The copyright also protects performance rights—the rights to perform a play or a movie, even though a tangible object is not sold or transferred. The importance of this distinction will become apparent in the discussion of transmission of copyrighted performances across national borders, in which the performance is lawfully received in the first country but not in the second country.

3. International Protection of Copyrights.—While there are several international treaties protecting copyrights, none of them provides for extra-territorial effect of a copyright. The major treaties, the Berne Convention of 1886 and the Universal Copyright Convention of 1952, both grant reciprocal rights to citizens of countries that are signatories to the respective treaties. All EC coun-

32. Selle v. Gibb, 741 F.2d 896 (9th Cir. 1984).
35. See infra section 4.b.
tries are, in fact, members of both conventions. These treaties simplify the procedures that are required to obtain copyright protection. A copyright owner in France is automatically protected in Germany without having to file an application in Germany. The French copyright holder is entitled to the same protection in Germany as are German citizens.

4. The Problem.—There are two major problem areas in the field of international copyright. The first is the protection of computer programs. The second is the transmission of copyrighted television programs across national borders through satellite transmission.

a. Computer Programs.—A substantial body of law granting copyright protection for computer programs has developed. The U.S. has been the leader in the field, treating computer software as the equivalent of a textbook. Not all countries agree. Some countries require the same degree of technological advance to justify copyright protection of computer programs as they require for protection under patent laws. This attitude restricts protection to a minimal number of computer programs that involve a significant advance over the prior art. Germany grants copyright protection for computer programs, but only for works of extraordinary merit. Thus, computer software, worth billions of dollars, is subject to the same problems of patent protection that are described above. Some countries in the EC protect computer programs, and some do not. Should competitors be permitted to copy the software in a country where no protection is available and export it into other countries where protection is available, under the umbrella of the EC objective of promoting free trade across international borders?

b. Satellite transmission of copyrighted television programs.—The ability of the satellite to transmit television programs over a wide geographical area is well-known. A copyrighted program can easily be broadcast throughout Germany by means of satellite transmission. Assume that the program has international appeal without the need for translation, for example, a program including the copyrighted performance of the London Symphony Orchestra. The copyright owner is entitled to receive a royalty for the use of the copyrighted work in each country where it is received. Modern tech-

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41. Id.
42. Id.
nology permits the transmission of the broadcast into Austria, France and Italy, but there are no laws to ensure that a copyrighted royalty will be paid. While the payment of a royalty would seem to solve the problem, the copyright owner may prefer to license different parties in the respective countries in order to maximize income.

D. Trade Secrets

The concept of trade secrets (also referred to as “know-how,” “manufacturing data,” or “technical assistance”) is probably one of the most important and least understood forms of intellectual property rights. To the extent that confidential information is developed in the manufacturing and vending of commercial products, the company developing the information is entitled to protection against misuse of the information by anyone who acquires the information from the developing company.43

A practical example of trade secret protection involves a situation where a patent licensee also receives confidential manufacturing information to assist in the manufacture of the product line. Assume that the licensee agrees to hold the information in confidence and not to use it in a manner inimical to the licensor’s best interests. Is the licensee bound to refrain from using the technology after the main license agreement terminates? Under the EC regulations, can a covenant not to use the technology received from the licensor prohibit the licensee from selling products across borders? The tension between the promotion of cross-border trade conflicts again with the protection of intellectual property rights.44

The concept of trade secret protection appears collaterally associated with patent protection. Although both doctrines protect the investment in developing technology, they are, in fact, unrelated concepts. Trade secret protection may extend to business information that is not related to technology, such as customer or supplier lists, or future business planning.45 Patent protection is limited to technical improvements of products or processes.46 A showing of significant improvement over the prior art is required to support patent protection. While trade secret protection may cover significant technical advances, it may also include low level advances that are important in the aggregate.47 The main distinction is that patent protection is absolute, whereas trade secret protection only protects against disclosure by parties who derive the information from the original de-

44. U.P. TOEPKE, supra note 3, at 581 n.674.
45. M. JAGER, supra note 43, § 3.01, at 28.
46. See supra notes 11-12 and accompanying text.
veloper, or by those in privity with it.48

In a sense trade secret protection and patent protection may be incompatible. Because the patent is a public document, the information it contains may not be subject to trade secret protection. Thus in some instances, the developer must elect issuance of a patent or, alternatively, rely on trade secret protection.

III. Analysis of Vehicles Used to Penetrate the EC Market

A. Methods Employed to Penetrate the Market

A non-EC company attempting to sell into the EC market may employ any one of several vehicles to accomplish this objective. Some of the more important vehicles include:

1. Exportation.—The company may attempt to manufacture abroad and serve the EC market through exportation of its goods into the EC.

2. Intellectual Property Licensing.—In exchange for a royalty, the company may elect to license its intellectual property rights to one or more companies that are already doing business in a Common Market country.

3. Franchising.—The company may negotiate a franchise license agreement with a company doing business in an EC member state. The franchisee makes and sells the products according to the franchisor’s specifications, and pays a royalty to the franchisor.

4. Joint Venture.—The company may set up a subsidiary in a Common Market country, with the subsidiary being partially owned by a local company already having a presence in the EC.

5. European Economic Interest Grouping.—The EC has recently developed the concept of the EEIG49 in order to create a business enterprise that is governed by Community law rather than by the laws of a particular member state. While it is subject to some limitations,50 the EEIG is useful in developing joint ventures between partners from different member states or with non-EC organizations that have a presence in the EC. Because the concept of EEIG’s did not become effective until July 1, 1989,51 there is limited experience with this business form; and the regulations governing EEIG’s have

48. See generally M. JAGGER, supra note 43, § 5.04.
50. The EEIG is limited to a maximum of 500 employees and may not borrow on financial markets or be used as a holding company. See generally Donald, supra note 49.
51. Id.
not been interpreted. However, the EEIG is an option that businesses should consider for EC penetration.

6. Wholly-Owned Subsidiary.—The company may establish a subsidiary in an EC country, and retain full ownership of the subsidiary.

B. Considerations in Selecting a Suitable Vehicle

1. Exportation.—Direct selling into an EC country involves the lowest financial commitment. Except for transportation and tariffs, the administrative costs of selling goods directly to the customer in an EC country are fairly low. They are also limited to a transactional basis, so there is no long-term commitment of funds. In the event that the transaction is unsuccessful, the seller can withdraw with a minimum of expense. The seller who chooses direct sale also has the least amount of presence in the foreign market. The seller does not commit assets or personnel to the venture, and may avoid local liability or local taxes levied against the enterprise.

The disadvantage is that direct selling is the least successful way of penetrating a foreign market. Unless the seller has a good relationship with a large customer in the foreign country who will purchase in volume and handle administrative details, it is difficult for the seller to penetrate a foreign market through direct sales.

2. Intellectual Property Licensing.—Negotiating an agreement with an enterprise in a Common Market country that has the capability of manufacturing and selling a product enables the licensor to collect a royalty for all foreign sales without investment or presence in the foreign country. An acceptable royalty rate will be considerably less than the level of profit the licensor traditionally would realize through manufacture and sale. The licensor must also have solid intellectual property protection on the product line: If the patent is protected in one Common Market country, the licensee cannot be prohibited from selling the product in other Common Market countries.

3. Franchising.—Product distribution through franchising has become quite popular in the United States and is presently spreading throughout the rest of the world. Major franchisors such as McDonald’s, Kentucky Fried Chicken, and Holiday Inn are employing franchise systems to penetrate foreign markets. The franchise system is essentially a trademark and trade secret license. The licensee operates under the umbrella of the trademark, presenting the ap-

52. W. Keating, supra note 24, § 12.01.
pearance of being a branch of the parent company. The franchisee is, in fact, totally independent of the franchisor, except for the contractual relationship created by the franchise agreement. The franchisor specifically disavows any liability for the activities of the franchisee. The franchisor is thus able to penetrate foreign markets through contractual control over the franchisee, without subjecting itself to the jurisdiction of the foreign government.54

4. Joint Venture/European Economic Interest Grouping.—If the enterprise shares manufacturing and distribution with a local company, it increases the expected return on investment. While the return would not be as great as profits realized from direct sales, the profits would still be considerably higher than the royalty rate generated by licensing.55 The difference in profits is justified by the expertise that a joint venture acquires through a partnership with an EC company that has experience dealing in the Common Market.56

The disadvantage is that the non-EC company acquires a degree of presence in the EC country. To the extent that the joint venture owns assets or hires employees in the EC country, it subjects itself to that country’s jurisdiction. Certain liabilities such as taxes, labor regulations, and jurisdiction for civil or criminal actions attach. In addition, the non-EC company must rely very heavily on the foreign partner for success.

5. Wholly-Owned Subsidiary.—The benefit of the wholly-owned subsidiary is an increased expectation of profit for the corporation. The manufacturer also has more control over decisions dealing with the operation of the business, and need not defer to its local partner. With control and increased profits come increased presence. All capital investments, equipment, property, bank accounts, and personnel necessary to operate the business are subject to attachment in the event of civil or criminal litigation.

6. Miscellaneous.—The wide variety of vehicles for penetrating foreign markets include brokers, manufacturer’s representatives, agents, and sales offices. Many of them are variations of the vehicles described above. In general, the deeper market penetration a com-

54. Id. § 12.01, at 366.
pany desires, the greater its exposure to foreign jurisdiction.

C. The Problems Created by these Vehicles

1. Exportation.—The problem created by the exportation of a patented product to any EC country is that the product may be resold in any other Common Market country. In spite of the fact that the American Manufacturing Company, Inc. has patents in both Germany and France, the lawful sale of a product exhausts any further rights the patent owner of that product may have in other Common Market countries. The activity, known as “parallel importation,” illustrates the precedence of unimpeded cross-border trading over local intellectual property rights.57

2. Intellectual Property Licensing.—The major problem in regulating intellectual property rights in the Common Market involves the right of the owner of such property to restrict distribution of products covered by such rights, either by territory or by allocation of customers or field of use. For a variation of the previous example, assume that the American Manufacturing Company, Inc. has developed a new laser device and has issued patents in both France and Germany, as well as in the United States. Further assume that it has licensed La France S.A. as its exclusive licensee in France and Deutschland G.m.b.H. as its exclusive licensee in Germany. American Inc. would prefer to restrict sales by La France S.A. to customers residing in France and prohibit exportation to Germany. It would also like to restrict sales by Deutschland G.m.b.H. to German customers and preclude exportation to France, without violating any regulations governing restrictive trade practices in either country. This arrangement would provide for orderly marketing and maximum sales penetration in each country.

The nature of intellectual property rights allows for this arrangement, without specifically requiring the licensees to restrict sales to designated territories. Since La France S.A. is not licensed under the German patent to sell lasers covered by the patent in Germany, such sales would constitute infringement of the licensor’s German patent.58 Sales by the German licensee into France would likewise constitute infringement of the French patent.59 Thus the licensor would be able to restrict the sales territory of its licensees, and avoid using restrictive covenants that are inconsistent with the Common Market objective of complete freedom of cross-border marketing.

57. See also K Mart Corp. v. Cartier, Inc., 486 U.S. 281 (1988), for a discussion of “parallel importation.”
58. See generally Treaty of Rome, supra note 1.
59. Id.
Applying the regulations of the Treaty of Rome60 (the basis for the EC) requires a different analysis. If the licensor controls a significant share of the market, then enforcement of the patent rights to restrict cross-border trade could be considered abuse of a dominant position and, therefore, enforcement is in violation of the EC regulations.61 Activities that are otherwise lawful may be considered unlawful, when implemented by firms that have a dominant position in the market place and seek to extend their control over cross-border trading.62

Even if the licensor does not hold the dominant position in the market share of the patented products, enforcement of the patent rights distorts competition and could violate article 85 of the Treaty, which contains a broad prohibition against restricting trade.63 This interpretation is, however, inconsistent with article 222, which states: “This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership.”64 Article 36 states that regulations prohibiting restrictions on exports or imports shall not apply to restrictions intended to protect industrial or commercial property.65 However, such restrictions may not constitute arbitrary discrimination or disguised restraints of trade.66 Since Germany has the authority to prohibit the importation of devices which infringe German patents, the fact that the device was lawfully made in France under a French patent should not compel a different result. Conversely, the French government has authority to enforce its patent laws.

One advantage of the Treaty is that activities that restrict cross-border trade may be exempt from the reach of the Treaty if the Commission responsible for interpreting the rules determines that the pro-competition effect outweighs the negative effect.67 The Commission may grant an individual exemption to specific petitioners, upon a proper showing that the activity promotes trade and has only a minimal restrictive effect.68

If a significant number of members of the industry petition for an exemption, the Commission may grant a “block” exemption.69 In this situation, the Commission sets forth the guidelines for the ex-

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60. Id.
61. Id. art. 86.
62. Id.
63. Treaty of Rome, supra note 1, art. 85.
64. Id. art. 222.
65. Id. art. 65.
66. Id. art. 36.
67. Id. art. 85(3).
68. Treaty of Rome, supra note 1, art. 85(3).
69. Keating, supra note 24, § 12.11, at 396.
emption. All industry members operating within the guidelines are automatically exempt. Requests for individual exemptions and block exemptions are published before a decision is reached. Interested members of the public are invited to comment on the effect of the exemption.

3. Franchising.—The legal validity of restrictive covenants is well-developed in the EC. The leading case of Pronuptia of Paris GmbH, Frankfurt am Main v. Rosalinde Iringard Schillgalio involved a French franchisor who had a number of franchisees in France and Germany that were engaged in selling wedding dresses and related items. The franchise agreement limited the activities of the franchisees, and gave the franchisor control over every aspect of the business. The agreement prohibited sales outside of the assigned territory; in exchange, it granted the franchisees the right to use the franchisor's trademark. A franchisee stopped paying royalties but continued to use the trademark. The franchisor brought suit for past royalties and trademark infringement. The franchisee defended on the basis that the agreement was unenforceable because it prevented cross-border sales and, therefore, was contrary to the Treaty of Rome.

The court of first instance (trial court) ruled for the defendant, and held that the agreement did indeed violate the Treaty of Rome and was unenforceable. The Federal Court (court of appeals) certified the issue to the European Court of Justice (ECJ). The ECJ held that although some of the terms and conditions of franchise agreements may have a restrictive effect, the overall benefit of franchise distribution outweighed the disadvantages. The Court tested the individual clauses in the agreement to ascertain which clauses were justified in promoting competition.

The nature of a franchising system results in a marketing arrangement that is inherently inconsistent with the EC objectives of permitting free trade across borders. The franchisor grants each franchisee an exclusive marketing area, with the stipulation that the franchisees will not sell outside of their respective market areas. This is contrary to the EC objective of permitting any enterprise in a

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70. Id.
71. Id.
72. Id. § 12.11, at 397-98.
74. W. Keating, supra note 24, § 12.11.
75. Id.
76. Id. § 12.10, at 382-83.
77. Id.
78. Id.
Common Market country to sell to any customer in the EC. 79

Subsequently, a number of franchisors submitted a request for exemptions 80 and the Commission granted exemptions, provided that the franchisors conformed their franchise agreements to the decision in Pronuptia. 81 Eventually, the Commission published a block exemption for franchise distribution that set forth the guidelines for approval. 82

4. **Joint Venture.**—Assuming that the American Manufacturing Company, Inc. wishes to develop its foreign markets through a joint venture with La France S.A. in France and Deutschland G.m.b.H. in Germany, a separate company “Amerfrance S.A.” would be incorporated in France. It would be owned jointly by American Manufacturing Company, Inc. and La France S.A. The American Manufacturing Company could transfer its French rights in intellectual property to Amerfrance, along with whatever contribution of capital might be necessary to operate the company successfully. La France could also make its contribution of capital, along with any other assets named in the joint venture agreement. The companies would agree to their respective ownership shares, payment of dividends, structure and duties of management, amendment of by-laws, and even provisions for dissolution of the joint venture.

The American partner might prefer that products made in France be sold only in France, so that it would be able to develop other foreign markets through similar joint ventures with other partners. The American company may wish to develop a separate joint venture with a German partner. The French partner might object to any restrictions that would limit its ability to maximize sales, especially the restriction of export sales into Germany. While article 36 of the Treaty of Rome protects intellectual property rights, 83 it warns that agreements disguised as intellectual property rights should not be used to divide markets arbitrarily.

The same situation would exist in Germany, where the U.S. company would prefer to restrict sales to Germany. The German partner would prefer to maximize sales by permitting sales into France.

5. **Wholly-Owned Subsidiaries.**—The use of a wholly-owned subsidiary as a vehicle for penetrating the EC market would seem to

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79. *See supra* notes 1-2 and accompanying text.
82. *Id.*
83. *See Treaty of Rome, supra* note 1, art. 36.
eliminate the need to restrict cross-border sales. Because the American company has full control over both the French and the German subsidiaries, the parent company can dictate sales policy to the subsidiaries, without the need for a formal documentation that includes restrictions. While unwritten policies might violate the EC regulations, they are difficult to discover and to prove. A serious problem could arise, however, if a customer in Germany wished to purchase goods from a subsidiary other than the German subsidiary, in order to take advantage of price variations. For example, assume that the American company also had a wholly-owned subsidiary in Greece, where the labor rates are considerably lower than in Germany. If a customer in Germany placed an order with the Greek subsidiary rather than the German subsidiary, the Greek subsidiary's refusal to honor the order could be considered a form of illegal restrictive trade practice. The situation would be especially sensitive if the American company held a dominant position in the EC market.


Penetration of the European market by non-European companies, through licensing, franchising, joint ventures or wholly-owned subsidiaries, generally involves the grant of an intellectual property license to specific licensees in different geographical areas. It is crucial to the success of the program that the licensor be able to limit the scope of the license to the specific geographical area where the licensee has the expertise to promote the licensor's goods or services. As indicated, this restriction appears to be contrary to the terms and spirit of the Single European Act, which seeks to eliminate all cross-border restrictions on the free flow of commerce among the member states.

A. Accommodations in Patent Licensing

1. Patent License Block Exemptions.—The EC has attempted to accommodate the seemingly inconsistent goals of free flow of commerce and protection of patent rights by granting block exemptions in certain intellectual property licenses. EC Regulation No. 1983/83, 26 OJL 173/1 (1983) and Regulation 1984/83, 26 OJL 173/5 (1983) set forth terms and conditions of patent licenses that are not violative of the Treaty of Rome, in spite of their restrictive

84. See supra notes 61-63 and accompanying text.
85. See supra notes 58-67 and accompanying text.
86. W. Keating, supra note 24, § 12.10.
89. See Treaty of Rome, supra note 1.
effect on cross-border trade. Territorial restrictions that protect the licensee and achieve an orderly local market are believed to promote trade by supporting the licensee, in spite of the fact that such restrictions have a tendency to restrain trade. The EC has adopted a balancing test and concluded that, on balance, the benefits of the restrictions outweigh their negative effects.

The block exemption also lists those restrictions that are prohibited from use in a license agreement. Clauses that constitute price fixing or that limit production are considered so anti-competitive that they are unjustified, even though they have some pro-competition advantages. Restrictive clauses that are not included on either list may receive a special exemption if a request for approval to the EC is submitted.

In 1984 the EC issued Regulation 2349/84, 27 OJL 219/15 (1984), which permits the licensor of a patent license to restrict sales by limiting the geographic scope of the license. The restriction may be effective for a maximum term of five years, beginning on the date when the product is first sold in the EC. The licensor may restrict the licensee's ability to solicit sales for an additional five years, but may not prevent the licensee from accepting orders which are received spontaneously, without solicitation. In the example discussed above, the American licensor could prohibit the French licensee from selling patented goods in Germany or filling orders received spontaneously from a German customer for a period of five years from the introduction of the products into the market. After that time, the American licensor could prohibit the French company from actively soliciting orders in France, but not from filling orders initiated by German customers (referred to as "parallel importation"). After the expiration of the second five-year period, the American company could not restrain the French company from soliciting orders in Germany. However, in a fast moving technology, improved products might be developed, thus generating new patent rights which would start the term over again for the new products.
2. Field of Use Licensing.—While the discussion of patent license restrictions has involved geographical limitations, in a proper case the licensor may wish to limit the licensee's field of use of the invention to promote more efficient marketing. For example, assume that an American manufacturer has developed a fractional horse-power motor that controls motor speed with great precision. The device is quite useful in the recording industry, where the speed of the tape player must match the speed of the recording device to achieve fidelity. The device would also be useful in an entirely different field, scientific instruments, in which precise motor drive is desirable. The companies manufacturing scientific instruments are generally not the same companies that manufacture audio/video recording equipment. The royalty rate in the scientific field of use might be higher than traditional royalty rates in the audio/video recording field of use.

Assuming the American manufacturer has perfected its patent rights throughout the world, the licensor would prefer to license its patents to certain manufacturers of audio/video equipment in different geographical areas. It would also seek to license the patent to manufacturers of scientific equipment, perhaps at a different royalty rate from the audio/video license agreements. It would seek to prevent the licensees from selling to customers outside of the designated fields of use.\textsuperscript{100}

The validity of such restrictions, within the EC, involves the same considerations that were examined in the case of geographical limitations on licensees. The limitations are an obvious restraint of trade. Are the pro-competitive effects sufficiently compelling to justify the limitations?

A licensor who wants to insert such provisions in a license agreement would be well advised to notify the Commission of its intent and seek a favorable ruling that the agreement does not violate the Treaty of Rome. If a ruling is not obtained, the licensor may apply for an exemption, and argue that the pro-competitive effect outweighs the disadvantages that might accrue through trade restraints.\textsuperscript{101} The petition for exemption should be supported by factual allegations of the advantages of the license agreements, as well as the necessity of inserting such clauses into the license agreements so that the licensor may achieve the benefits of the patent rights. The petition should also contain arguments to convince the Commission that the probable restraint of trade is minimal.

\textsuperscript{100} U.P. TOEPKE, supra note 3, at 359-65.
B. Accommodations in Trademarks/Franchising

1. Approval by the European Court of Justice.—Trademark licensing, including franchising, has been given specific approval through the European Court of Justice, as well as through a block exemption. In 1986 the ECJ decided a case that involved Pronuptia de Paris and gave the franchisors the right to restrict business operations of their franchisees in certain important respects, despite the impeded cross-border flow of goods that resulted. Clauses regulating the source of goods, location, quality control, and non-competition were held to be reasonable because they promote the franchise, but have a minimal effect on restraint of trade. The court still considered price fixing, production control and similar predatory practices illegal. In 1989 the Commission gave the decision its blessing by incorporating the terms of the decision into a block exemption.

2. Customer Restrictions.—It may be that in an appropriate case the franchisor would prefer to reserve a particular class of customers to itself, rather than include the class in the franchisee's customer base. For example, the Ford Motor Company may grant a franchisee the right to sell Ford cars to consumers in a particular geographic area. However, it may prefer to reserve the right to make large volume sales to a single customer (known as “fleet sales”) through the parent organization. Fleet sales to government agencies, state police, and automobile leasing companies are sold through the franchisor organization specializing in this type of distribution. These sales are made through competitive bidding, where the profit margin is low because of limited expense for advertising and dealer preparation. Even in the food service industry, the franchisee is granted the exclusive right to serve the general public, while “institutional accounts,” such as hospitals, schools, prisons, and airlines, are served by a separate agency of the franchisor that specializes in this type of distribution.

May an American franchisor insert provisions into its agreements with licensees in the EC that limit the franchisees by categories of customers? Since the franchise agreement is tied to a trademark license, the limitations would appear to violate the Treaty of Rome, which prohibits such restraints of trade.

As one might expect, there is little law dealing with this specific

102. See supra note 42.
104. W. Keating, supra note 24, § 12.11.
106. W. Keating, supra note 24, § 5.23.
107. Id.
issue, probably because franchise distribution is a fairly recent marketing innovation in the EC countries.\textsuperscript{108} The franchisor should seek a specific exemption from the EC, and detail the advantages of franchise distribution and the need for employing such clauses, as well as the minimal intrusion on cross-border trade. The history of the Commission’s rulings suggests that it will grant a favorable ruling in a proper case.\textsuperscript{109} If the Commission concludes, however, that these clauses are a disguised mechanism for controlling prices or restraining trade, it will deny the exemption.\textsuperscript{110}

**C. Accommodations in Trade Secrets**

The rights and limitations of trade secret licensing follows the patent licensing block exemption, Regulation No. 556/89.\textsuperscript{111} In fact, the patent license and trade secret license may be combined into a single document.\textsuperscript{112} Again, the regulation permits five years of total exclusivity and five years of prohibition against the solicitation of business outside the limited area.\textsuperscript{113}

**D. Accommodations in Copyrights**

At present, there are no specific provisions granting block exemptions to copyright licenses. The cross-border control of copyrighted performances has been the subject of numerous treaty negotiations between the European countries.\textsuperscript{114}

**E. Accommodations in Joint Ventures and Wholly-Owned Subsidiaries**

The EC has approved and encouraged the formation of a business in EC countries by direct investment.\textsuperscript{115} The only criterion is that the enterprise be in the best interests of the economy of the member state.\textsuperscript{116} Presumably, drug cartels would not be welcome. There is a growing sentiment in some areas that enterprises owned by investors outside of the EC may not be in the best interests of the local economy. Establishing a presence in an EC country before the enactment of any regulations controlling equity participation by non-EC nationals would be a shrewd move.

\begin{itemize}
\item \textsuperscript{108} Id. \S 12.01.
\item \textsuperscript{109} Id. \S\S 12.10, 12.11.
\item \textsuperscript{110} Treaty of Rome, supra note 1, art. 36.
\item \textsuperscript{111} 32 O.J. EUR. COMM. (No. L 61) 1 (1989).
\item \textsuperscript{112} Id.
\item \textsuperscript{113} Schoenbaum, Storming Fortress Europe, 17 KOREAN J. COMP. L. 67, 86 (1989).
\item \textsuperscript{114} Id.
\item \textsuperscript{115} See generally Donald, supra note 49.
\item \textsuperscript{116} Id.
\end{itemize}
V. Strategy

A. Realignment of Manufacturing and Distribution

Many previous corporate decisions about the location of manufacturing and distribution sites to serve the European market were strongly influenced by the effect of import duties. While labor rates are lower in Spain than in West Germany, the advantage would be lost through the expense of German tariffs. In many cases the cost of tariffs would dictate parallel manufacture of the same product in both Spain and Germany. Thus, the most efficient method of serving the EC market was to establish joint ventures or wholly-owned subsidiaries in each country where the enterprise intended to do business.

With the elimination of tariff barriers between the EC countries, foreign companies doing business in the EC should reconsider whether the most efficient locations for manufacturing and distribution have changed. While Greece has a low labor rate, it lacks availability of highly skilled labor. Items that require precision manufacture, such as scientific instruments, should be made in locations where skilled labor is readily available. Mass produced products which are primarily manufactured by machine can be fabricated in low labor rate areas and imported into other markets. If a market analysis proved feasible, a full service subsidiary in Germany might be converted into a product distribution center. The product could be manufactured in Spain, shipped in bulk to Germany, and labelled for the German market.

B. Establishment of a Presence

While no one can predict with any certainty the short-range or long-range effects of the Single European Act, prudence suggests that any non-EC company with an interest in the EC market should establish a presence in the EC, preferably before December 31, 1992. At the moment, it is relatively easy to establish such a presence. After 1992, penetration of the EC market is likely to become more difficult. Any company with a presence in the EC before that date will probably receive the benefit of "grandfather

118. Id.
119. Id.
120. AMP, Inc., ranked 161 in the Fortune "500" American companies, has eleven wholly-owned subsidiaries in eleven different EC countries. AMP, INC., 1987 ANNUAL REPORT (1987).
122. Id. at 265.
clauses that establish rights as of the time that the company first began doing business in the EC and exempt it from later regulations.

VI. Conclusion

The Single European Act of 1992 will offer American merchants a challenge and an opportunity to participate in a market larger than the internal U.S. market. It will require an assessment of the advantages and disadvantages of attempting to participate in market penetration. If the vehicle used depends on intellectual property, American companies must appreciate and understand the tension between the EC's objectives in promoting freedom of cross-border trade and the right of the intellectual property owner to control the market through intellectual property management.

Restructuring of the commercial organization should be undertaken with an appreciation of the cost and the effect of such revisions. The best time to make these changes is prior to any move by the EC to restrict the ability of non-EC companies to participate in the EC internal market. The time to make these changes is NOW.

123. A “grandfather clause” permits continued operation of a practice, prospectively made prohibited. Generally, the operations are allowed to continue to prevent hardship through ex post facto application of a law.