1. Restrictions which are imposed by way of contract by the proprietor of a patent upon the reproduction, use or exploitation of a patented invention otherwise than under a licence granted for that purpose and which derive from the application of national legislation intended to protect industrial property rights cannot, in themselves, be regarded as preventing, restricting or distorting competition within the common market within the meaning of Article 85(1).

2. A contractual obligation under which the grantee of a licence for a patented invention is required to pay royalty for an indeterminate period, and thus after the expiry of the patent, does not in itself constitute a restriction of competition within the meaning of Article 85(1) of the Treaty where the agreement was entered into after the patent application was submitted and immediately before the grant of the patent.

3. A clause contained in a licensing agreement prohibiting the manufacture and marketing of the products in question after the expiry of the patent and the termination of the agreement comes within the prohibition laid down in Article 85(1) only if it emerges from the economic and legal context in which the agreement was concluded that it is liable to appreciably affect trade between Member States.

REPORT FOR THE HEARING
delivered in Case 320/87 *

I — Facts and procedure

1. *The background to the main proceedings*

Mr Ottung, a civil engineer of Danish nationality, developed in about 1960 two control devices consisting of a valve box housing a pressure valve and a vacuum control valve for use on brewery tanks. One of these devices, fitted with a non-return valve for the admission of air, was patented in Denmark, Belgium, France, Germany, the United Kingdom and the United States. The other device, which from a commercial point of view is complementary, was not patented. After he had applied for the Danish patent but before it was granted, Mr Ottung, the inventor in question, transferred by licensing agreement the exclusive right to exploit the two safety devices to Anton Petersen and Henius'Eftf A/S, to whose rights the defendants in the main proceedings have succeeded.

* Language of the case: Danish.

Under the licensing agreement Mr Ottung is to be paid royalty on each device sold 'whatever its size and construction and irrespective of the number of accessories sold at the same time as the device or later'. Clause 5 of the agreement provides as follows:

'Either party may terminate this agreement by giving six months' notice expiring on 1 October of each year. On the termination of the agreement, AP & H shall thereafter only be entitled to sell any devices for the time being in stock, it being understood however that after notice of termination has been given, AP & H shall only be entitled to have the device manufactured in numbers corresponding to orders in hand or placed by customers up to the date of determination of the agreement less any items in stock. Royalty shall be payable on items sold in such circumstances, in accordance with the foregoing provisions.'

Under an addendum, the licensing agreement may no longer be terminated by Mr Ottung, whereas the defendants are still entitled to terminate it by giving the aforesaid notice.

For a number of years the defendants then paid the royalty due on the sale of the devices invented by Mr Ottung, the majority of which incorporated the non-return valve for the admission of air. The Danish patent expired on 12 April 1977 and the last patent in another country expired on 15 March 1980. From the end of 1980 the defendants ceased to pay the royalties on the grounds, *inter alia*, that all the patents had expired. However, they did not terminate the licensing agreement pursuant to clause 5 of the agreement.

Mr Ottung brought proceedings before the national court in the course of which he claimed that the defendants should be ordered to pay royalties due since 1 January 1981 on the basis of the licensing agreement or, alternatively, at a lower rate to be determined by the court. In support of his claims, he submitted that the licensing agreement was not for a fixed period of time and could only be terminated by notice given by the defendants in accordance with clause 5 of the agreement. Furthermore, he took the view that the licensing agreement mainly covered devices the design of which was still protected under Danish intellectual property law.

The defendants, on the other hand, contended that the action should be dismissed and submitted that Mr Ottung's right to the royalty ceased upon the expiry of the patents, the factual and legal basis for the payment of royalties. Furthermore, the licence for the exploitation of the device which was not patented was merely a consequence of the exclusive right to exploit the patented article. In any event they submitted that a licensing agreement concerning a patented invention which provided for the payment of royalties on the basis of the licence after the expiry of the patent was contrary to Article 85(1) of the EEC Treaty. They further considered that the termination clause in clause 5 of the agreement in question was also a restriction on competition within the meaning of Article 85(1).

2. *The questions referred to the Court of Justice*

Under those circumstances, the Sø- og Handelsret considered that certain questions were raised concerning the application of Article 85(1) of the EEC Treaty to the present case. It therefore decided, by order of 23 September 1987, to stay the proceedings and to refer the following questions to the Court of Justice for a preliminary ruling under Article 177 of the Treaty:

'(1) Does a contractual obligation under which a licensee of a patented invention is to pay royalty for an indeterminate period, and thus even after the expiry of the patent, consitute a restriction of competition of the kind referred to in Article 85(1) of the Treaty of Rome where the agreement was entered into after the patent application was submitted and immediately before the grant of the patent?

In that connection is it of any significance that the grantor cannot terminate the agreement whereas the licensee can bring it to an end by giving a certain notice of termination and, according to the terms of the agreement, is thereafter not entitled to exploit the patent?

(2) To be answered if Question 1 is answered in the affirmative:

Does a contractual obligation under which a licensee of a non-patented product is to pay royalty for an indeterminate period, and thus even after the patent for products also covered by the licensing agreement has expired, specifically in respect of that product constitute a restriction of competition of the kind referred to in Article 85(1) of the EEC Treaty where it is established that the non-patented product complements the product for marketing purposes and that the agreement was entered into after the patent application was submitted and immediately before the grant of the patent?

In that connection is it of any significance that the licensee only entered into the agreement to pay royalty in respect of the non-patented product because otherwise he would not obtain a licence for the patented invention?

(3) To be answered if Question 1 is answered in the affirmative:

Does a contractual obligation under which, for the use of a design protected by the law of copyright or under the Marketing Law, a licensee is to pay royalty for an indeterminate period, and thus even after the expiry of the patent on the product in question, constitute a restriction of competition of the kind referred to in Article 85(1) of the Treaty of Rome where it is established that the agreement was entered into after the patent application

was submitted and immediately before the grant of the patent?

In that connection is it of any significance that the licensee only entered into the agreement to pay royalty for exploitation of the copyright or for protection against passing off under the Marketing Law because he would obtain a licence for the patented invention?

(4) To be answered if Question 1 is answered in the negative:

Does a provision in a licensing agreement according to which a licensee is not entitled to sell the product in question after the termination of the agreement constitute a restriction of competition of the kind referred to in Article 85(1) where the licensing agreement relates to a patented product and the patent has expired and where the agreement was entered into after the patent application was submitted and immediately before the grant of the patent?'

3. *Observations of the national court*

The national court takes the view that the licensing agreement covers not merely the patented product but also the devices which are not patented and that neither by virtue of the terms of the licensing agreement nor by virtue of mandatory rules of Danish law does the payment of royalties cease upon the expiry of the patent. The court has not, however, come to any conclusion on Mr Ottung's arguments concerning copyright and the protection of products against passing off under the Danish Marketing Law.

4. *Procedure*

The order of the national court was received at the Court Registry on 14 October 1987.

In accordance with Article 20 of the Protocol on the Statute of the Court of Justice of the European Communities, written observations were submitted by the defendants in the main proceedings, represented by S. Lassen, of the Copenhagen bar, the United Kingdom, represented by H. Purse, Treasury Solicitor, acting as Agent, and the Commission of the European Communities, represented by A. McClellan and I. Langermann, of its Legal Department, acting as Agents.

Upon hearing the report of the Judge-Rapporteur and the views of the Advocate General, the Court decided to open the oral procedure without any preparatory inquiry.

II — Summary of the written observations submitted to the Court

1. *The defendants in the main proceedings*

The defendants in the main proceedings submit that they entered into the agreement concerning the payment of royalties for the product which was not patented solely because had they not done so they would

not have obtained the right to exploit the patented invention under licence. They argue in essence that the plaintiff in the main proceedings used his exclusive right and monopoly as patent holder to obtain the payment of royalties and to insert clause 5 of the agreement, under the terms of which the defendants are not entitled to sell the product in question after the contract has been terminated. So long as the patents remain in force, the defendants, in relation to their competitors, enjoy an exclusive right which justifies such payment of royalties and such a termination clause. However, upon the expiry of the patents the exclusive right ceases to exist and the obligation to continue to pay royalties and the obligation to cease selling the products in question if they elect to terminate the contract causes a significant weakening of the defendants' competitive position since the products in question are an integral part of the goods which the defendants offer for sale.

They submit further that the object and the effect of the clauses in dispute in this case are the same as those in dispute in *Windsurfing International* v *Commission* (Judgment of 25 February 1986 in Case 193/83 [1986] ECR 611), that is to say, to use patents to confer on the grantor of a licence advantages based on factors unrelated to the patents and thereby to weaken the position of the licensees in relation to their competitors.

They also refer, in support of their argument, to Commission Regulation (EEC) No 2349/84 of 23 July 1984 on the application of Article 85(3) of the Treaty to certain categories of patent licensing agreements (Official Journal 1984, L 219, p. 15). Article 3(4) of that regulation provides that Article 85(3) of the Treaty is not applicable to categories of patent licensing agreements when:

'the licensee is charged royalties on products which are not entirely or partially patented or manufactured by means of a patented process, or for the use of know-how which has entered into the public domain otherwise than by the fault of the licensee or an undertaking connected with him, without prejudice to arrangements whereby, in order to facilitate payment by the licensee, the royalty payments for the use of a licensed invention are spread over a period extending beyond the life of the licence patents or the entry of the know-how into the public domain'.

The defendants in the main proceedings claim that each of the four questions referred by the national court should be answered in the affirmative. As regards the supplementary questions attached to the first three questions, they suggest that the Court should reply that in those circumstances the clauses are also invalid by virtue of Article 85(1) since, like the clauses referred to by the main questions, they involve an unjustified extension of the protection conferred by the patent which weakens the competitive position of the defendants.

2. *The Commission of the European Communities*

The Commission stresses that cases where a product is protected by a patent or an intel-

lectual property right or where the know-how of the grantor of the licence is essential for its manufacture should be distinguished from cases where the invention has entered into the public domain. It is only where the invention has entered the public domain that an obligation preventing the former licensee from exploiting it must be assessed in terms of Article 85(1) and be regarded as a restriction on free competition.

Consequently, the Commission considers that Article 85(1) must be interpreted as meaning that a contractual provision which prevents one of the parties to the contract from exploiting the invention when the invention has entered the public domain is a restriction on competition within the meaning of that article (provided that the national court considers that the restriction has an appreciable effect on competition).

As for the payment of royalties, the Commission considers in particular that their payment after the patent has expired does not fall within Article 85(1) when that form of payment is adopted in order to facilitate payment or constitutes a means of calculating the royalties. In the Commission's view, the same is true when a licensing contract remains in force after the patent or the intellectual property right initially granted in the licence has expired and the parties had agreed that the licensee would continue to pay royalties after the expiry of the patent for as long as the contract remained in force. Referring to the judgment of 25 February 1986, *supra*, the Commission maintains that in such a case the parties are free to calculate the royalty as they wish.

Consequently, the Commission considers that Article 85(1) must be interpreted as meaning that a clause in a licensing agreement whereby the parties agree that the licensee will pay to the grantor of the licence a royalty calculated on the basis of turnover as payment for the right to exploit the invention after the expiry of the patent granted by the licensing agreement and for as long as the agreement remains in force is not a restriction on competition within the meaning of that article.

3. *The United Kingdom*

The United Kingdom takes the view that each case must be examined on its merits to determine whether there is or may be a restriction of competition in the circumstances described in the questions referred in the present case. Relevant factors in determining that question will be the duration of the period for paying royalties, the significance of the royalty in relation to the licensee's overall cost of production of the product and the reason for payment of the royalties. However, the subjective motive of the licensee in entering into the agreement is irrelevant. Thus, for example, there is not, in the United Kingdom's view, a restriction of competition of the kind referred to in Article 85(1) where payments for the use of a licensed invention are spread over a period extending beyond the life of the patent but are payable in respect of previous use of the licensed invention so that early payments can be lower than they would otherwise be.

Furthermore, the United Kingdom considers that in certain circumstances an obligation to pay royalties after the patent has expired where the royalties are payable in respect of other intellectual property rights, or of secret know-how, which extend beyond the

life of the patent is not a restriction of competition when the rights remaining are substantial and can be separated from the patent in the sense that they are not necessary to exploit the invention which is the subject of the patent. However, it is the view of the United Kingdom that such an obligation may constitute a restriction where the remaining intellectual property rights or secret know-how are of relative insignificance or are necessary for the exploitation of the patented product, subject to an examination of all relevant factors.

Finally, there may be circumstances in which it may not be a restriction of competition within Article 85(1) for a licensee to be prevented from selling the product in question in the event of termination of the agreement. An example might be where the licensee is required to pay royalties after the expiry of the patent and, on the facts, that does not amount to a restriction of competition.

T. F. O'Higgins
Judge-Rapporteur