Licensing Aspects of the Department of Justice's
Anti-Trust Guide for International Operation

by

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International licensing must be tested by the same anti-trust criteria as other international transactions because the Sherman Act (1) refers, in Section 1 and Section 2, to certain Acts that relate to "trade or commerce... with foreign nations". As is true with all international transactions, certain types of agreements are regarded as illegal, per se, including things which could be included in license agreements, such as agreements among competitors to fix prices at which the licensed products are sold or to allocate territories or customers for the licensed product in order to avoid competing with each other. However, as is true with most situations, licensing agreements will be tested against the "rule of reason" which has three parts.

1. Is the restriction ancillary to a lawful main purpose of the agreement?

2. Is the scope or duration of restriction in the agreement greater than necessary to achieve the lawful main purpose?

3. Is the restriction otherwise reasonable?

As the guide points out, the anti-trust enforcement of the U.S. government has two major purposes with respect to international commerce.

1. Protect the American consuming public by assuring it the benefit of competitive products and ideas produced by foreign competitors as well as domestic competitors.

2. Protect American export and investment opportunities against privately imposed restrictions.

The guide points out that when foreign transactions have substantial and foreseeable affects on U.S. commerce, they are subject to U.S. law regardless where they take place.

Parent and Subsidiary Actions

With respect to licensing, it should be noted that there is a major exception for certain acts which in many circumstances can be regarded as illegal. If certain acts, such as fixing prices, or allocating territories, are done by a single organization, such as a parent and fully controlled subsidiary in an international licensing context, the Department of Justice's position is that this is not objectionable. The anti-trust guide specifically states that the 1955 report of the Attorney General provides that "a parent corporation may allocate territory or set prices for the subsidiaries that it fully controls". The Department of Justice "has consistently accepted" this view.

However, the Department of Justice's position is that the parent must have effective working control. This is true where a majority of voting stock of the subsidiary is owned by the parent. But it may also be true in a situation where the parent owns a minority of the stock, but the remainder of the stock is owned or controlled in such a way that the minority ownership is effective working control. One specific example given in Case A, which discusses the 1951 Timkin Roller Bearing case (2), refers to American Timkin owning 30% of British Timkin and, in that particular instance, American Timkin controlled British Timkin.

Thus, in effect, an Act is not necessarily bad, per se, but may be bad only if it occurs as the result of a conspiracy or an agreement between two or more organizations. However, it should be noted that in the Code of Conduct for Technology Transfer discussions taking place at United Nations Conference on Trade and Development (UNCTAD) in Geneva, the developing countries want the Code of Conduct to cover license agreements between parents and subsidiaries. This is a point that is being discussed and, so far, the United States delegation is resisting this and does not want the Code to cover parent subsidiary license agreements. How it will finally develop remains to be seen.

I would like to discuss briefly a few of the particular examples set forth in the guide as they may relate to licensing and proprietary rights and make a few comments on them.

Case D - Joint Research

The U.S. producer of a certain metal, referred to as X metal, establishes a 50-50 ownership British joint venture with a British producer of X metal. The purpose of the joint venture is to do research to make this metal from a different ore than it is presently made from. In the arrangement, the U.S. company would get exclusive licenses to patent rights and know-how in North America, while the British company would get exclusive licenses in the United Kingdom, the other EEC countries and former British commonwealth countries, except Canada. The U.S. company is the second largest of five producers of this metal in the U.S. and the British company is one of the largest producers in the Common Market.

The particularly interesting point under discussion is that the Department of Justice feels, in view of the fact that the research is being done on a new process to make a metal that is already available, that any patents coming out of the joint venture will be limited to "a process relating to the production of X metals, not a product patent relating to

invention of the product itself". The Department of Justice feels that process patents which might be exclusively licensed to practice the process in certain countries would not be able to control the sales of the product made by the process and, thus, the patents cannot be used to territorially divide markets. On this basis, and because of other facts involved, they feel the arrangement is probably alright.

Now, as those of you who practice in areas involving metallurgy and chemistry know, it is quite common, in research on a new process to make a known product, to produce a product made by that particular process which does have somewhat different properties. Particularly in metals, a very small amount of an impurity may have quite a different impact on the actual properties of the materials involved. For example, in the aluminum industry, there are large numbers of aluminum alloys all of which have 90% or more aluminum with the remaining 10% varying quite widely in composition. These alloys all have different properties.

In this particular situation, it would apparently be very interesting to be the patent lawyer in charge of attempting to obtain patents on the inventions made by the joint venture. If the claims which the attorney attempted to get were process claims, apparently the deal is alright with respect to the

anti-trust laws. If the attorney is able to get a product claim or even a product by process claim, apparently the deal would not be alright with respect to the anti-trust laws because the net effect of getting a product or product by process claim in one of these patent applications would result in a situation where a joint venture would be able to affect a territorial division in the product market solely by enforcement of their patent rights. Thus, we appear to have a situation where, at least with respect to the anti-trust laws, the companies involved are better off without a patent than they are with a patent. Also, apparently in this case, even if the Department of Justice did approve the original arrangement, if the patent lawyer was able to obtain allowance of a product claim or a product by process claim, the joint venture might be challenged by the Department of Justice at that time.

I won't speculate on the situation which might occur if the patent lawyer was able to get product claims in some countries and not in others. I'll leave that one to your imagination.

I suppose another possibility would be to give each of the parties exclusive rights under any process claims allowed and to only give them non-exclusive rights with respect to product claims.

Case E - Manufacturing Joint Venture and Know-how License

A U.S. company, which is the third largest manufacturer of certain key transistors parts with about 22% of the domestic market, and a Japanese company, which is one of Japan's largest industrial combines but does not at present make transistors, form a Japanese joint venture to use the U.S. company's know-how to manufacture transistors. The agreement provides that neither the Japanese company nor the joint venture will export transistors to the United States or other designated markets.

The Department of Justice feels that the joint venture, per se, is probably alright because it does not appear to eliminate any direct competition as the parties are not direct competitors in the U.S. market. However, the open ended restraint on the Japanese company and the joint venture which prevents them from selling transistors in the United States will be challenged.

There are two related questions here. First, is the Japanese company a potential competitor or a potential entrant into the U.S. market in the transistor business? Is it capable of developing the product and entering the U.S.

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market? Second, how long would it take for the Japanese company to develop its own technology to make transistors?

The guide states that the restraining period might be acceptable if it were limited to the period "no longer than the time it would take for the Japanese company to develop equivalent know-how itself (the 'reverse-engineering' period)". Where the restraint exceeds the reverse engineering period, the U.S. company must be prepared to bear the burden of proving the necessity of the restraint. The guide continues "the permanent restraints in this case would seem virtually impossible to justify".

The discussion involving the capability of the Japanese company to enter a market and the period of time it would take for the Japanese company to develop equivalent know-how itself, or the reverse-engineering period, sounds fine in theory and I am sure that both the Department of Justice and a number of courts can determine a period which they feel would be legitimate to accomplish these tasks. However, in actual corporate R&D, the capability test and the reverse-engineering test are extremely artifical and are not real life tests.

Those of you that have worked in corporations know who every company has to pick new products very selectively. Most

projects which are brought up to management are not selected and many that are, of course, do not succeed. It has been my experience that most large companies can do any single project that they set their minds to. But no large company can do all the projects that it considers at any given time. The selection of the particular project or new product is based on a number of factors some of which are objective and many of which are quite subjective, although usually couched in objective terms because of the necessity to rationalize the decision.

In the business world, what a company would actually do is what counts, not what a company has the capability of doing. Thus, while I think any significant company could develop technology to manufacture transistors, either itself or by purchase, the fact remains that there is only a small number that have done this. The ones that have done so have developed the technology for a particular reason, often in large part because of the background and experience of the management involved. Other companies with equal or even superior abilities have decided not to go into that particular business, again in large part because of the background and experience of the managers involved.

I am sure, for example, that the duPont Corporation has

the capability and ability to develop know-how sufficient to make transistors and integrated circuits and could go into that business. As far as I know, they have not decided to do so. I suppose it would be theoretically possible to determine a time period during which duPont could develop the ability to make transistors, although I believe from a realistic viewpoint this time period could be quite variable, depending on whether duPont was going to make this its primary development or if it was going to be one of some fifty developments. Many of us know that some companies have worked in fields for a number of years and have never really come out with a particular product, in large part because they did not devote sufficient R&D effort for doing so.

It's a little bit like speculating how long it would take to get from Boston to New York. There are a number of answers which might be reasonable. A person could walk, bicycle, ride a moped, motorcycle, row a boat, sail, take a motor boat or a yacht or a hydrofoil, drive a car, take a bus or train, fly her own airplane or take the Eastern Shuttle. Each method of transportation would give a different answer which might be reasonable in certain circumstances.

Of course, this is one of the many situations which makes anti-trust laws so interesting. You can't predict what someone

will do. You can't predict that they will enter the market and how long it would take them to do so. On the other hand, you could not predict, even though they might say so at a particular time, that they will ever enter the market unless they are permitted to do it by the particular vehicle under discussion. I have seen situations where a company stated in good faith that it was not planning to develop a certain product in a certain market. However a year or two later, with new management, new decisions were made to go into the market with that particular product. In both instances, the company had the capability to do so, but the first decision not to develop that product was made because the company decided to put its efforts in other areas.

My employer, Itek Corporation, is the third largest factor in the eyeglass business in the United States. I am sure we have the capability to enter, and become a significant factor in, the eyeglass business in Ghana. We have not done so and we may never do so. In another instance, we thought we had the capability of entering the metal printing plate business in the United States. After trying for some time, we had a change in our profit picture which resulted in a change in our management and a decision to drop our metal printing plate project.

However, in the last few years we have successfully

entered the U.S. and European phototypesetting market, which were not in before. Yet, I am sure economists could easily demonstrate that we had, and still have, "the capability of entering the eyeglass business in Ghana and the capability of entering the metal printing plate business in the United States".

It should be noted that if the Japanese company were a majority-controlled subsidiary of a U.S. company, the agreement would be alright. Thus, the restraint per se, is not bad under U.S. anti-trust law, but the conspiracy to restrain is what is bad.

Case F - Know-How License

A small U.S. company possesses certain valuable unpatented technology. It enters into a 20 year know-how license agreement with a large German company. The U.S. company is a small, but growing, factor in the domestic market, but has not been very successful in the export business. The agreement provides that the German company will not compete in the U.S. for 20 years in any product in which the know-how is used. Also, it will purchase and use only the U.S. company's components in executing the process and it will use the U.S. company's trademark on all goods manufactured under the

license. The U.S. company is also negotiating a similar agreement with a large Japanese manufacturer who insists that the German licensee be barred from selling licensed products in Japan, Australia and East Asia.

The guide discusses this agreement and states that the agreement itself is probably illegal under the anti-trust laws for a number of reasons. First, it feels the 20 year period is too long to exclude the German company from the U.S. market. The guide says that if the time period were "reasonable", this restraint itself would appear reasonable because it involves (1) a unilateral territorial restraint imposed by the licensor upon the licensee, (2) the product substantially depends upon the the licensed know-how and (3) there is a single license of a specific piece of know-how. If the time period exceeded the time necessary for reverse-engineering of the technology, the time period would probably be too long unless the parties could somehow justify it as necessary to the technology sharing agreement which, apparently, in this example, they were not able to do.

The Department of Justice also objects to the part of the license agreement which contains a requirement that the German licensee use the U.S. manufacturer's components. The guide states "assuming this license is sufficiently valuable to

confer monopoly power, it is a tie-in and would be illegal, per se, under the Sherman Act and the Clayton Act if practiced in the domestic market." The guide points out that in the international context the situation is not quite the same and if the agreement were changed so that the German licensee had to buy only U.S. manufactured components, not limited to those of the U.S. company involved, it might be alright. In practice, it should be noted that it is quite unusual that know-how would be sufficiently valuable to confer monopoly power, particularly if all the components to practice the know-how could be supplied by other sources, as suggested in the guide.

The requirement that the German company must use the U.S. company's trademark on all goods made under the licensed process is not inherently illegal, but it may become an anti-trust violation where it has the purpose or effect of territorial allocation. The guide points out that the U.S. company is not assigning the German trademark and relinquishing all control over it. The guide then states that "presumably, after the 20 years, the German firm loses any property right in the trademark and the German trademark reverts to" the U.S. company. In actual fact, the German trademark was owned by the U.S. company all the time, and the German firm merely had a license to use the trademark. The Department of Justice feels,

however, that "there is a very real element of continuing control by" the U.S. company "over the trademark right in the U.S. and Germany". Of course, there must always be "control" over the quality of the products made by a trademark licensee, because without such control, the trademark owner would lose his trademark.(3) The guide continues "while this type of trademark licensing is not inherently illegal, as with other ancillary restraints it may become an anti-trust violation where it has the purpose or affect of territorial allocation."

Query. Would the clause providing the German company's use of the trademark be a problem if the use by the German company was voluntary and it was permitted to use its own trademark if it so desired? Possibly an additional royalty should be charged when the mark was actually used with a lower royalty being charged if the know-how is used but not the trademark.

Normally, a licensee takes a license under a trademark because they want to use it, not because they are required to use it. My company has taken a number of trademark licenses and we have never been forced to take one and use one that we did not wish to do so. We pay royalties for the right to use trademarks owned by others because we feel this use on our products will increase our sales more than enough to cover the

royalties. If this was not true, we would not take such a license.

One last comment on Case F. The fact that the agreement provides that the German licensee could not sell in Japan, Australia and East Asia does not come within the subject matters jurisdiction of the U.S. anti-trust laws. The result might be different if the restriction barred a significant amount of imports into the U.S. or if the overseas market allocation were part of a broader scheme affecting the U.S. market. Thus, as far as the U.S. anti-trust laws are concerned, you may be able to restrict exports between non-U.S. countries markets.

Case G - Tying of Licensed Technology

A major U.S. manufacturer licenses a company in a less developed country to manufacture products under its patents and know-how. Royalty rates in this country are subject to government approval and are notoriously low. Also, the central bank of that country has currency restrictions which often further limit the basis on which royalties may be calculated. Thus, the arrangement includes a provision that components needed to manufacture the product involved must be bought exclusively from the U.S. licensor, even though these

components are unpatented and are sold by other manufacturers in the U.S. Also, the license includes certain patents which the licensee has no desire to have or intention of using.

The Department of Justice feels that even though the U.S. company is simply trying to increase its effective rate of return on the patent license and thereby reduce the impact on it of the exchange control systems in the developing country, such a motive does not justify the corporation in doing what would otherwise be illegal under the U.S. anti-trust law. While the requirement to buy components would be objectionable within the U.S., in the overseas market it is only objectionable under U.S. law to the extent that it unreasonably forecloses other U.S. based sellers from making sales or affects goods re-exported to the United States. In this case, requiring the purchase of these components from U.S. sources might not serve the U.S. company's purpose in increasing its effective rate of return.

The focus of the U.S. anti-trust inquiry would be on whether U.S. exports would be reduced by the agreement. If U.S. exports are possible by others, the license agreement could not provide that the components must be required by the U.S. company. If U.S. exports are not possible, then no effective exclusion exists. The guide does not say so, but if

the components were patented, it would appear that U.S. exports would not be possible and maybe the provision would be alright if it did not extend past the life of the patents involved.

The second restriction of package licensing a number of unwanted patents is illegal, per se, in the United States, but it would not be objectionable in this particular case because the Department of Justice does not feel it would have a significant effect on U.S. commerce. If this clause had some significant effect on overseas licensing opportunities for other U.S. companies or similar impact on sales in the U.S., it might then be objectionable, but under the present facts, it appears to be no problem. Again, the laws of other countries must be kept in mind.

Case H - Licensing a State-Owned Enterprise

In this case, a U.S. company licenses unpatented technology to make a chemical compound to a foreign government-controlled company with a prohibition against export of the compound into the U.S. or other Western Hemisphere country. The Department of Justice feels that the permanent prohibition against export is probably illegal with respect to the U.S. If there were U.S. patent rights, the agreement

would not require this particular restriction, as the patent might be used to prevent the import of the product to the United States. Because only know-how is involved, the Department of Justice feels that the territorial restriction must be limited in duration to the reverse-engineering period or some other specific period which the parties can establish is justified by the facts in these situations.

The prohibition on export to other Western Hemisphere countries does not directly effect U.S. commerce and, therefore, raises no objection under U.S. anti-trust laws.

Case I - Exclusive Grant-back Licensing

In this case, a U.S. company has licensed three organizations under certain patents and know-how in three different countries. The first license is to a subsidiary which is 85% owned by the U.S. company. The second is to a subsidiary which is 30% owned by the U.S. company, but the remaining stock is held by the general public. The third license is to a completely non-related company. All the license agreements require the licensee to grant back title or an exclusive license on any new patent or know-how "related to the licensed technology right".

The guide comments that the exclusive grant-back is alright with respect to the majority-owned subsidiary. If the 30% owned company is effectively controlled by the U.S. company, the exclusive grant-back arrangement would be acceptable. If the 30% interest was not sufficient to effectively control the subsidiary, the grant-back would be objectionable under U.S. anti-trust law, if the use is part of a larger monopolistic arrangement.

As the guide states, the Department of Justice has objected for a number of years to the need for and appropriateness of exclusive grant-back provisions. The guide states that the Department of Justice "may, in an appropriate case, wish to assert that an exclusive grant-back requirement involving independent parties is, per se, illegal". The Department of Justice feels that a non-exclusive grant-back is normally all that is necessary, particularly in the case of a non-blocking improvement patent.

Thus, the license back to the unrelated company would probably be objected to, but a number of factors would be considered. This particular grant-back would be objected to as being too broad because it is "related to" the license technology. If (1) the exclusive grant-back were limited only to newly developed improvement patents, and (2) the exclusive

license were only for the term of the original patent, the Department of Justice might not challenge the grant-back. This would be so because, in effect, the holder of the original patent would have the right to stop someone else from using the improvement, because practice of the improvement would infringe the original patent. The guide states that broad grant-back obligations which are too broad in scope and too long in time are likely to be challenged if the parties to the license could in any way be regarded as actual or significant potential competitors in the U.S. market. Thus, the relationship of the parties involved may be quite important in decisions in the Department of Justice on whether to challenge international grant-back obligation.

In Case I, the Department of Justice feels that it would be much safer for the U.S. company to provide only for a non-exclusive grant-back which still would permit the licensee to compete in the United States domestic and export markets after the expiration of the original licensed patent.

General Comments

In general, the guide should be regarded as helpful in the licensing field because, at least, there are specific comments and certain examples that express the feeling of the Department

of Justice at the time the guide was issued. The guide, of course, is not law, but is merely the Department of Justice opinion. Often the members of the Department of Justice are surprised at recommendations which lawyers make to their clients in anti-trust matters because many times Department of Justice feels private lawyers take positions which are more conservative than the Department of Justice would feel necessary. I am sure this occurs in part because the lawyer, by being too conservative, cannot later be proved wrong, where if he is more aggressive and risk taking, even though the agreement might be acceptable under the law as interpreted at the time the agreement was made, it might be challenged later and, in effect, be regarded as invalid ab initio because of opinions which occur in U.S. courts after the date of the original agreement.

This, of course, is one of the problems which lawyers live with and, frankly, if they did not have such problems, possibly there would not be such a need for lawyers. A specific example of this is that some years ago, nearly every license agreement I saw had a clause which prevented the licensee from challenging the validity of the patents under which the licensee was licensed. Since the Lear v. Adkins (4) case, I don't see these clauses anymore, as they are no longer used, although they were regarded as being legal and proper before

the Lear v. Adkins case. There was no change in the statutory law, but the Supreme Court, by giving their opinion, in effect, changed the impact of the law and the way that license agreements were negotiated. I am sure there will be other changes which will involve clauses and actions which are regarded by those experienced in the licensing field as perfectly legitimate and proper today, which will be illegal and improper in the future because of other court opinions.

Also keep in mind that the vast majority of changes in the case law of licensing, as in the case of other areas of the law, are not due to actions of the Department of Justice, but are due to lawyers for the prevailing party convincing a court that the law should be as the court finally decides. Certainly this was true in the Lear v. Adkins case, and will also be true in future "changes".

1. 15 USC 1 and 2

2. Timkin Roller Bearing Co. v. United States, 341 U.S. 593 (1951).

3. 15 USC 5,45 (The Lanham Act). Other countries often have similar legislation or case law. See also Gilson, Trademark Protection and Practice Sec. 6.01 (4), (1977). A trademark licensor "must control...the quality of the goods...sold under the mark by the licensee...".

4. Lear Inc. v. Adkins, 395 USC 653 (162 USPQ1) (1969).