Territorial tests

Francois Illouz explores licensing across multiple territories

The concession of a licence by a licensor to a licensee over several territories must conform to many points in order to establish a clear and fruitful relationship between the parties involved. Among the things to consider are:

- What kind of licence should be granted? Would it be a simple licence or a master licence? A master licence would allow the licensee to sub license the IP rights.
- How to be certain that IP rights are protected on the involved territory?
- How to protect the licensed territory?
- How to set up an efficient sub licence and how to pass on the obligations between the grantor and the licensed master and the licensed master with his sub-licensee?
- How to manage with European Economic Community (EEC) regulations, which forbid the partitioning of the markets and the licence per territory within the European market and its corollary that includes the distinction active sales/passive sales and online sales?; and
- How to choose the applicable law to the contract?

In an increasingly globalised world, the demarcation of markets appears unnatural; however, it is essential to protect the territory granted to a licensee in order to guarantee on the one hand, a high level of service to the final consumer and on the other hand, the most efficient way of organising the distribution of the products.

First, the licensor and the licensee must enter into a formal licence agreement, which can be published to be opposable to third parties. A formal licence agreement defines clearly the IP rights granted, the territories where the licence will apply, the duration, quality control of the products, the applicable law and jurisdiction in case of a dispute.

It is important to be sure, before entering into a licence contract, that the licensor is in the capacity to grant the licence of the IP rights. That means that he should possess a copyright if he licenses an author right, or a registration certificate if the object of the licence is a brand, a model or a patent.

The parties then need to discuss whether the contract is a simple licence or a master licence. In case of a master licence, the rights, as well as the obligations of the licensee, are reinforced. The licensee will be permitted to sub-license the IP rights, but he also will have the obligation to organise the distribution network and to control the sub-licensee activities. Generally, in case of IP infringement, the master licensee also has more rights than a simple licensee allowing him to take legal actions to protect the IP rights.

The IP rights must be protected in the territory where the licence will apply. This may seem obvious, but it is not always the case. For example, the products or services involved may not have been protected in every country, or they may have been registered for more than five years before the licence agreement took effect. Consequently, protection might have lapsed.

Therefore, the contract must provide guarantee clauses that protect the licensee. The best guarantee indisputably consists in attaching the IP rights to the licence agreement, ie, the certificate of registration, if it is a trademark a patent or a design licence.

Also, it is advisable that the licensee conducts due diligence to confirm what the licensor is offering.

Once the IP rights are well determined, how can a licensor ensure that territorial rights are respected where multiple licensees exist?

Europe

This certainty is quite problematic within the European market, because there are no borders enforced between the different countries. Meanwhile, there are a lot of licences granted for territories inside the European market like France, Italy, Benelux, etc.

Licences are most of the time granted to different licensees who want to be sure that they will make sufficient sales to meet the minimum guarantee they have to pay to the licensor. This contractual relationship is not easy to organise with efficiency, because it is very easy for a licensee, considering the EEC regulations, to circumvent

contractual obligations.

For example, the licensee can sell products in his territory to a wholesaler who will then be able to sell these same products all over the European market. In this case, the licensee will not be directly acting unlawfully, even if he is aware of what his client is doing. Consequently, he frustrates the rights of the other licensee and disorganises the distribution network.

Active/passive

EEC legal principles make a distinction between active and passive sales. Active sales can be dealt with, because the agreement can provide a stipulation laying down an obligation for the licensees to respect territorial rights. However, to transform an active sale into a passive sale is easy. For example, a licensee might make a phone call to a customer in another territory and say: "I'm not going to market the products in your territory, but you can always make a request to me by email. Ask me the price and I will sell to you."

It is essential that the contract includes a good-faith clause, which stipulates that every licensee must act in good faith to protect the territory of each licensee within Europe.

Active sales can also have an impact on the minimum guarantee. If, for example, the licensor discovered that a licensee was selling outside of his territory, the licensor should notify the licensee network and ask the sales to stop. If this notification is not respected, the licensor may then increase the minimum guarantee of that licensee, because he *de facto* works in another market. Furthermore, a licensee who suffers sales from another licensee on his territory may ask for a reduction of its minimum guarantee to the licensor.

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Online

The situation is even more tricky regarding online sales. Since a decision of the Court of Appeal of Paris and of the Court of Justice of the European Union, in 2011 (*Pierre Fabre Dermo Cosmetique* C-439/09), it is forbidden within the EU to prevent a licensee or distributor from selling online.

As a result, it is necessary to include clauses in licensing agreements specific to online sales. They may specify, for example, wording to prevent to the purchase of Google ad words that could aid the sales outside the correct territory. They might also prevent the use of the brand as a domain name, which would otherwise make it easier to sell outside of the territory.

When countries which do not belong to EEC are involved, the situation is clearer. It is possible then to provide clauses which prohibit sales outside the territory, granted by the licence agreement, whether the sales are online or not.

In the US, for example, the contract will define the territory in the grant clause, where that particular licensee can exercise the licence rights in just a particular state or region of the US, on the condition that the licence is exclusive.

With regard to online sales, it is also possible to limit shipping addresses to the territory in question or limit the use of credit cards issued outside the territory in question. These are good tools to protect the demarcation of licensing rights.

In the frame of an international licence contract, the applicable law issue is important. In case of a dispute regarding the contract, the issue will be influenced by the applicable law, the applicable jurisdiction and the cost.

Reference is usually made to the recommendation of the ROME 1 Regulation (Regulation (EC) No 593/2008) of the European Parliament and of the Council of 17 June 2008 on the applicable law applicable to contractual obligations) regulation, which governs the choice of law in the EU.

This is not always useful however, because the regulations say that the contract must be ruled by the law and the jurisdiction chosen by the parties.

Governing law

The choice of governing law is usually linked to the contract, along such lines as the registration of the brand or the country where the licence is granted. Problems can begin when multiple parties argue for the selected law or jurisdiction to be their own.

It is recommended that the applicable law is the same as the jurisdiction, because, otherwise, it is necessary to ask for a legal opinion and rely on the judges to correctly enforce the law of a foreign jurisdiction.

It is sometimes appropriate to designate the applicable jurisdiction of the defendant in any dispute. This means that if the claimant wants to make a claim, or go to trial, he has to make the effort to do so under the law of the defendant. This measure often helps to drive an amicable settlement.

It can also be interesting for the parties to choose to go to arbitration to settle the dispute. This is faster, confidential but sometimes more expensive.

Alternatively, parties can choose neutral jurisdictions and laws in case of international disputes. For example, Switzerland is willing to assist many countries and international contracts, although judges do not always accept Switzerland as the venue of a licencing agreement dispute. Sometimes the contract must establish a clear link to Switzerland to qualify it as the place of jurisdiction.

As far as European countries are concerned, Swiss judges are more likely to agree to hear agreement disputes. When agreements involve China or an African country, Swiss judges may refuse to proceed. However, arbitration proceedings can be held in Switzerland, if the parties choose to have them here.

Sometimes when an EEC party is involved in a dispute with a non-EEC party, the contract may designate the UK as a jurisdiction, because the UK is open to foreign lawsuits and is used to handling them. London courts deal with proceedings in a fast and effective manner.

Author

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