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Recent Development


This article analyzes significant recent legal developments emanating from the Council and Commission of the European Economic Community (EEC or Community), focusing on areas of practical importance to the international practitioner. The article is divided into three independent segments which study different areas of law. Each segment summarizes the state of the law, analyzes recent Community action, and explores the implications of the action for the transnational lawyer. The areas selected for review in this issue are franchising agreements, knowhow licensing, and securities regulation. Before examining these three fields, however, it is important to obtain a basic understanding of the EEC.

I. LEGISLATING THROUGH DIRECTIVES, DECISIONS, AND REGULATIONS

The principal goal of the EEC is to advance the quality of life in the Community by integrating Western European markets and uni-

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1. The European Economic Community was created at the signing of the Treaty of Rome on March 25, 1957. See Treaty Establishing a European Economic Community 2 U.N.T.S. 294-97 (French, German, Italian, and Dutch); 1-3 Common Mkt. Rep. (CCH) ¶ 100-5406 [hereinafter the Treaty of Rome].
2. See infra the text accompanying notes 13-62 (discussion of securities regulation), infra the text accompanying notes 63-143 (section on franchising agreements), and infra the text accompanying notes 144-200 (segment examining knowhow licensing).
fying European economic policies. The Council and the Commission are the lawmaking institutions entrusted with the responsibility of achieving these objectives. Community legislation takes place through regulations, decisions, and directives adopted by either the Council or the Commission. Regulations are paramount to national law and bind all natural and legal persons. In contrast, decisions and directives are binding only on the parties to whom they are addressed.

The effect of economic legislation by the Community institutions varies depending on whether the institutions issue regulations or directives. When administering the competition policy of article 85, for example, the Commission enacts regulations. These regulations create a uniform legal standard throughout the Community and supersede all conflicting national laws. In the field of securities regulation, on the other hand, the institutions use directives to harmonize national laws. Because member nations are free to select the form the directive will take, a Community directive allows some

3. Treaty of Rome, art. 2. The Treaty of Rome specifies several secondary objectives to achieve integration. The more significant secondary targets include: (1) implementation of a Community-wide competition regime; (2) the free movement of goods, capital, services, and labor; (3) the harmonization of laws; and (4) the establishment of a customs union and a common agricultural policy. Id. art. 3.

4. Article 145 of the Treaty of Rome empowers the Council to ensure the coordination of the general economic policies of the member states. Id. art. 145. See also id. arts. 145-54 (governing the composition, duties, and governance of the Council). Article 155 authorizes the Commission to ensure enforcement of the provisions of the Treaty and the measures taken by the institutions. Id. art. 155. See also id. arts. 155-63 (describing the composition, duties, and governance of the Commission). Article 189 empowers both institutions to take decisions, adopt regulations, and issue directives. Id. art. 189. See also id. arts. 189-92 (provisions common to the Community institutions).

5. Id. art. 189. The various provisions of the Treaty of Rome allocate direct authority to adopt regulations in the Council. See, e.g., id. art. 49 (vesting authority to provide for the free movement of workers by making regulations in the Council); id. art. 89 (vesting authority to make decisions implementing the competition policy of articles 85 and 86 in the Council). In certain areas, however, the Council delegates this regulation-making power to the Commission. See, e.g., Council Reg. 19/65, 2 Common Mkt. Rep. (CCH) ¶ 2717-25 (Oct. 4, 1977) (granting the Commission authority to adopt regulations governing the use of restrictive obligations in agreements involving the distribution of goods or the acquisition of industrial property rights).


7. Id. But see C.W.A. Timmermans, Directives: Their Effect Within the National Legal System, 16 COMMON MKT. L. REV. 533, 537-44 (1979) (discussing circumstances under which directives addressed to the member states create obligations on individuals without interference of national law).


10. See infra the text accompanying notes 13-62 (studying the Community securities regulation directives with special attention to the most recent directive).
variation from state to state.\textsuperscript{11} In addition to the potential for variation, member states sometimes resist or delay implementing legislation which fully effectuates the objects pursued by the Community.\textsuperscript{12} With this general understanding in mind, discussion turns to the selected areas of review.

II. Securities Regulation

In a relatively short period, the Community institutions have structured disclosure laws governing listed securities which are roughly equivalent to United States Securities and Exchange Commission (SEC) requirements.\textsuperscript{13} This segment reviews EEC securities offerings directives.\textsuperscript{14} The first section concentrates on the EEC securities directives which apply primarily to disclosure requirements for securities traded on official exchanges.\textsuperscript{15} The second section discusses a 1987 directive which attempts to streamline the procedure for admission to EEC exchanges by obliging states to recognize another state’s admission requirements.\textsuperscript{16} The final section examines the im-

\begin{enumerate}
  \item Treaty of Rome, art. 189.
  \item See P. Merloe, \textit{Internationalization of Securities Markets: A Critical Survey of U.S. and EEC Disclosure Requirements}, 8 J. COMP. BUS. & CAP. MKT. L. 249, 257 (discussing compliance lags by member states in implementing securities disclosure directives) [hereinafter Merloe]. \textit{See also infra} note 50 (discussing member states’ resistance to a proposed securities directive).
  \item \textit{See infra} the text accompanying notes 18-55 (discussion of EEC securities directives existing prior to 1987). The Council securities directives do not define the terms “official listing” or “stock exchange” but one commentator suggests that the phrase “official listing” refers to the part of the securities market to which admission is most difficult and which provides maximum investor protection). Woolridge, \textit{Some Recent Community Legislation in the Field of Securities Law}, 10 EUR. L. REV. 3, 6 (1985).
  \item \textit{See infra} the text accompanying notes 56-59 (outlining changes to the securities regulation scheme resulting from the 1987 directive).
\end{enumerate}
pact of EEC securities regulation on international offerings.17

A. The Community Securities Regulation Scheme

The Council issues securities directives pursuant to Treaty of Rome (Treaty) provisions which protect the freedom of Community residents to establish and conduct businesses in more than one member state.18 Article 54(3)(g) obligates the Community to coordinate national laws protecting the interests of investors.19 Article 100 empowers the institutions to harmonize national laws which directly affect the establishment of the common market and its ability to function.20 Relying on these powers, the Council has attempted to integrate securities markets by establishing consistent disclosure laws and exchange admission requirements.21

Three directives anchor EEC securities regulation.22 The first of these directives specifies conditions for admission of securities to an

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17. See infra the text accompanying notes 60-62 (concluding section discussing international implications of EEC securities directives).


19. Treaty of Rome, art. 54(g). Article 54(g) provides: The Council and the Commission shall carry out the duties devolving upon them ... in particular:

(g) by coordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by the Member States of companies or firms ... with a view to making such safeguards equivalent throughout the Community[.]

Id.

20. Treaty of Rome, art. 100. Article 100 states in relevant part: "The Council shall, acting unanimously on a proposal from the Commission, issue directives for the approximation of such provisions laid down by law, regulation or administrative action in the Member States as directly affect the establishment or functioning of the common market."

Id.

21. See, e.g., Admissions Directive, supra note 18, ¶ 1721, at 1383 ("[the coordination of conditions for admission] will make for greater interpenetration of national securities markets and therefore contribute to the prospect of establishing a European capital market").


22. Admissions Directive, supra note 18, ¶ 1721, at 1383; Listing Particulars Directive, supra note 18, ¶ 1731, at 1385; Periodic Reporting Directive, supra note 18, ¶ 1741, at 1391. These securities directives are part of a more comprehensive regulatory scheme which includes
official stock exchange (Admissions Directive). The second prescribes information required from issuers seeking admission to an official stock exchange (Listing Particulars Directive). The third directive imposes periodic reporting obligations on issuers with securities listed in an official stock exchange (Reporting Directive). In addition, the Council may adopt another fundamental directive which would establish compulsory disclosure requirements for unlisted securities (Prospectus Directive).

1. **Admissions Directive**

The purpose of the Admissions Directive is to provide uniform safeguards for Community investors and to create consistent conditions for admission to official listings. This directive outlines minimum conditions for admission to an official exchange and imposes further obligations on the issuer for the period the securities remain listed. The conditions for admission include a minimum capitalization of at least one million European units of account. For both initial and secondary distributions, the Admissions Directive requires indications that there is sufficient investor demand or public ownership of the securities to allow the market to operate properly. For initial distributions, the authorizing body must conclude that investors will purchase a threshold percentage of shares within a short time. The numerical test of sufficiency is twenty-five
percent of the subscribed capital in publicly held shares.\textsuperscript{32} Lower percentages are acceptable when a large number of shares of the same class are widely distributed.\textsuperscript{33} When an issuer makes a public offering before applying for admission, the exchange can quote the stock only after the subscription period has ended and a wide ownership base exists.\textsuperscript{34} The sufficiency of a secondary offering of the same class of shares depends on the actual or predicted distribution in relation to all the outstanding shares of that class.\textsuperscript{35} Finally, the authorizing body may consider shares listed outside the Community when determining if distribution is adequate.\textsuperscript{36}

The Admissions Directive also imposes a broad range of continuing obligations on firms admitted to an official stock exchange.\textsuperscript{37} These obligations include informing shareholders of meetings, permitting shareholders to exercise their voting rights, and treating shareholders who hold the same class of shares equally.\textsuperscript{38} The directive also requires the issuing firm to disclose annual accounts, annual reports, consolidated accounts, amendments to corporate instruments, and other information relevant to informed investor decision-making.\textsuperscript{39} These shareholder information rights are similar to the rights held by shareholders under American securities laws.\textsuperscript{40}

2. Listing Particulars Directive

The Listing Particulars Directive adds to the disclosure regime established by the Admissions Directive.\textsuperscript{41} Under this directive, member states must condition admission to an exchange on a firm’s

\textsuperscript{32} Id.
\textsuperscript{33} Id.
\textsuperscript{34} Id. supra note 18, sched. A(II)(3), ¶ 1722, at 1383-8.
\textsuperscript{35} Id. supra note 18, sched. A(II)(4), ¶ 1722, at 1383-6.
\textsuperscript{36} Id. Similar conditions apply to debt securities. Id. sched. B, ¶ 1722A, 1838-9, 10.
\textsuperscript{37} See id. supra note 18, sched. C, ¶ 1722B, 1383-10 to 1383-12; id. sched. D, ¶ 1722C, 1383-12, 1383-12, -13.
\textsuperscript{38} Id.
\textsuperscript{39} Id.
\textsuperscript{41} Listing Particulars Directive, supra note 18, art. 1, ¶ 1371A, at 1385-2.
publication of listing particulars.\textsuperscript{42} The information required is exhaustive.\textsuperscript{43} The published particulars must supply information necessary to make an informed assessment of the firm's assets, liabilities, and profits and losses.\textsuperscript{44} The particulars must also include information relating to shareholders' rights.\textsuperscript{45}

3. \textit{Reporting Directive}

A third directive requires firms with listed securities to draft biannual statements for investors.\textsuperscript{46} The statements must disclose recent financial information and discuss relevant anticipated activities.\textsuperscript{47}

4. \textit{Proposed Prospectus Directive}

The Council intends to expand the securities regulation regime to encompass unlisted securities offerings.\textsuperscript{48} The Prospectus Directive, if adopted, will require member states to condition subscription or sale of unlisted securities on publication of a prospectus.\textsuperscript{49} Some member nations, however, question the need for the Prospectus Directive and this may delay its adoption.\textsuperscript{50}

5. \textit{Summary of EEC Securities Regulation Scheme up to 1987}

When combined, the three securities directives create uniform minimum standards for admission to EEC securities exchanges and
impose a system of continuous disclosure for firms with listed securities. The directives create shareholder’s rights associated with the ownership of securities. Member states may impose more stringent admission and disclosure requirements when implementing the directives into national legislation, provided the additional burden applies equally to all issuers. Further, if the Council adopts the Prospectus Directive, the regulation scheme will extend to unlisted securities. Finally, the disclosure and shareholder’s provisions of the directives parallel SEC rules for listed securities.

B. The 1987 Mutual Recognition Directive

As is the case with other EEC securities directives, the Mutual Recognition Directive is part of a larger movement to increase the attractiveness of EEC securities markets to international investors. The Mutual Recognition Directive amends the Listing Particulars Directive by requiring member states to admit securities to exchanges based on disclosure texts drafted in accordance with another member nation’s laws. In its original form, the Listing Particulars Directive allowed member states to condition exchange admission on the submission of listing particulars drafted in accordance with that member nation’s laws. Under this provision, firms might be obliged to draft particulars in accordance with the laws of each member state where the firm plans to list securities. Such a duplicative obligation is precisely the impediment the Community seeks to eliminate from the regulation system. Therefore, the Mutual Recognition Directive allows firms issuing multinational offerings to submit listing particulars drafted in accordance with the laws of one nation to all EEC exchanges.

51. See supra the text accompanying notes 27-40 (describing the minimum standards for admission).
52. See supra the text accompanying notes 37-40 (describing shareholder’s rights).
54. See supra the text accompanying notes 48-50 (describing the Prospectus Directive).
55. See supra notes 40, 45, and 47 (discussing similarity of EEC and SEC securities regulations).
58. See Listing Particulars Directive, supra note 18, preamble, ¶ 1371, at 1385 (citing the elimination of difficulties obtaining admission as on the objectives of the Listing Particulars Directive).
C. Implications of EEC Securities Directives for International Offerings

In the fairly short span of ten years, the Community has instituted a disclosure scheme equivalent to that existing in the United States with regard to securities traded on official exchanges. One fundamental principle of the disclosure scheme is to provide continuous financial reports and other relevant information to investors. As well, this scheme includes meaningful shareholder participation in the control of the firm. The similarity of EEC disclosure statements to SEC requirements evidences the evolution of an international standard based on the purposes and principles underlying the disclosure provisions.60

The Mutual Recognition Directive moves recognition of nonmember nations' listing particulars closer to realization. As it currently stands, mutual recognition in the EEC serves only firms established in the Community.61 The Council, however, intends to negotiate reciprocal recognition agreements with nonmember nations.62 Consequently, international issuers may soon obtain admission to all EEC stock exchanges by filing a single disclosure statement.

III. FRANCHISING AGREEMENTS

In the last decade, franchising agreements have become considerably more popular in the EEC as numerous undertakings rely on franchising to expand successful distribution networks.63 The increas-

60. See supra notes 40, 45, and 47 (discussing similarity of EEC disclosure requirements implemented in the securities directives with SEC disclosure forms).
61. Mutual Recognition Directive, supra note 56, art. 24a(5), at 82. Article 24a(5) provides that: "Member States may restrict application of [mutual recognition to firms] having their registered office in a Member State." Id.
62. Mutual Recognition Directive, supra note 56, art. 25a, at 83. Article 25a states, in relevant part, that: "[t]he Community may, by means of agreements with non-member countries ... recognize listing particulars drawn up and checked, in accordance with the rules of the non-member country or countries, as meeting the requirements of this directive, subject to reciprocity ... ." Id.
63. A 1987 Commission Press Release estimates that there are 1500 franchise networks in the Community comprised of 85,000 franchise outlets. Comm'n Press Release, 3 Common Mkt. Rep. (CCH) ¶ 10,894, at 12,148-49 (July 16, 1987). Franchise systems or networks consist essentially of licenses of intellectual property rights and/or commercial knowhow and expertise to be exploited in selling goods or providing services. The franchise outlets usually share a
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The popularity of franchising agreements, however, caused practitioners to worry because of the uncertain legal status of franchising agreements under Community antitrust laws. This uncertainty arises because the agreements involve restrictions on commercial freedoms traditionally subject to antitrust scrutiny. In establishing a coordinated marketing network, the franchisor maintains some control over the franchisee's business operations, grants the franchisee territorial exclusivity, and suggests retail prices.

A definitive Community position with regard to exploitation of these restrictive obligations in franchising agreements is necessary to ensure the validity of the agreements. The controlling Treaty provision is article 85 which governs agreements or practices which restrict competition. Pursuant to article 85, illegal agreements are unenforceable in national courts and punishable by fine. In a burst…

common appearance. The popularity of the franchise mechanism with successful distributors lies in the opportunity it affords to rapidly penetrate markets without the need for major investments. Id. Franchisees bear the initial investment costs and, consequently, the risk of failure. This independence fosters entrepreneurial qualities, contributing to the efficiency of the system. See Comm'n Decision, Computerland, 30 O.J. Eur. Comm. (No. L 222) 12 (1987), 3 Common Mkt. Rep. (CCH) ¶ 10,906, at 12,165 (Aug. 27, 1987) [hereinafter Computerland].

64. See, e.g., Goebel, The Uneasy Fate of Franchising Under EEC Antitrust Laws, 10 Eur. L. Rev. 87 (1985) [hereinafter Goebel].

65. Article 85 is one of the Community's principal antitrust statutes. Treaty of Rome, art. 85. Parties violating article 85 are subject to fines (Council Reg. 17/62, art. 15, 5 J.O. Eur. Comm. Eur. (No. 13) 204 (1962), 2 Common Mkt. Rep. (CCH) ¶ 2401, at 1713 (April 11, 1985), which may be substantial when the rule broken is of great notoriety and significant importance. See Goebel, supra note 64, at 96-104 (summarizing fines imposed by the Commission for parallel import restrictions, cross-supply bans, and resale price influencing). The other Community statute is article 86, which prescribes abuse of a dominant position. See Treaty of Rome, art. 86.

66. See, e.g., Comm'n Decision, Pronuptia, 30 O.J. Eur. Comm. (No. L 13) 39 (1987), 4 Common Mkt. Rep. (CCH) ¶ 10,854, at 12,037 (Feb. 26, 1987) [hereinafter Pronuptia 2] (including provisions, among others, whereby the franchisee agrees to carry on the business in the particular manner developed by the franchisor and to refrain from competing with other outlets); Comm'n Decision, Yves Rocher, 30 O.J. Eur. Comm. (No. L 8) 49, 4 Common Mkt. Rep. (CCH) ¶ 10,855, at 12,047 (Feb. 26, 1987) [hereinafter Yves Rocher] (including provisions, among others, whereby the franchisor agrees not to permit other outlets within a franchisee's contract territory and to circulate recommended resale prices). See also Goebel, supra note 64, at 88-89 (listing other provisions common to franchising agreements).

67. See Treaty of Rome, art. 85(2) (invalidating agreements that impermissibly restrict competition).

68. Treaty of Rome, art. 85. See infra the text accompanying notes 73-76 (describing the provisions of article 85).

69. Treaty of Rome, art. 85(2). Council Reg. 17/65, art. 15, 5 J.O. Eur. Comm. (No. 13) 204 (1952), 2 Common Mkt. Rep. (CCH) ¶ 2401, at 1713 (April 11, 1985) (authorizing the Commission to impose fines on parties entering agreements in violation of article 85). Regulation 17/65 allows parties to an agreement which may violate article 85 to notify the Commission of the agreement and obtain approval for the restrictions. Council Reg. 17/65, art. 2, ¶ 2411, at 1715. Notification can foreclose the imposition of fines for illegal agreements (id. art. 15(5)(a), ¶ 2541, at 1771) but may involve complications if the Commission uses the
of activity in the past year, the Commission rendered three decisions approving standard form franchising agreements. Subsequently, the Commission adopted a draft regulation exempting franchising agreements from article 85 antitrust scrutiny (franchising regulation).

The following sections examine the commercial restraints authorized in the franchising regulation. The study includes reference to the Commission's franchising decisions, which elucidate practical aspects of the general principles contained in the regulation. The concluding section discusses the prospective ramifications of the franchising regulation and decisions.

A. General Application of Article 85 to Franchising Agreements

The Commission’s position regarding the use of franchising agreements builds on the articulation of Community competition policy contained in article 85 of the Treaty of Rome. Article 85(1) prohibits agreements which distort, restrict, or prevent competition. These agreements are void unless they qualify for exemption under article 85(3) by improving production or distribution, promoting technical or economic progress, and transferring the benefits of progress to consumers. Consequently, while agreements within the scope of

notified agreement as policy precedent. See Goebel, supra note 64, at 90-92 (discussing the pros and cons of notifying agreements). In Pronuptia de Paris v. Irmgard Schillgalis (4 Common Mkt. Rep. (CCH) (1987) ¶ 14,245, at 16,434 (1986)), the first case in which the Court of Justice adjudicated the application of article 85 to franchising agreements, the defendant attempted to avoid payment of royalties by having the contract declared invalid under article 85. Id. ¶ 14,245, at 16,436.

70. Computerland, supra note 63, ¶ 10,906, at 12,165; Yves Rocher, supra note 66, ¶ 10,855, at 12,047; Pronuptia 2, supra note 66, ¶ 10,854, at 12,037.

71. Standard form franchising agreements are the contracts a franchisor proposes to sign with all its franchisees. See Pronuptia 2, supra note 66, ¶ 10,854, at 12,042.


73. The Commission’s authority to administer the policy of article 85 by issuing individual decisions derives from article 89 of the Treaty of Rome. See Treaty of Rome, art. 89.

74. Treaty of Rome, art. 85(1). In relevant part, article 85(1) prohibits: “agreements between undertakings which may affect trade between Member States and which have as their object the prevention, restriction or distortion of competition within the common market . . . .” Id.

75. Treaty of Rome, art. 85(2); Id. art. 85(3). § 2 of article 85 declares any agreement violating § 1 void. Id. art. 85(2). Article 85(3) exempts any agreement which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting
article 85(1) are not automatically void, they must satisfy the requirements of article 85(3) in order to be valid.\textsuperscript{76}

By enacting a regulation exempting a specific category of agreement from article 85(1), the Commission guarantees the legality of that type of agreement.\textsuperscript{77} These regulations commonly specify classes of obligations which are permissible and declare certain restrictions unenforceable.\textsuperscript{78} A regulation declaring the compatibility of restrictive obligations with the policy of article 85 does not, however, completely preclude the use of restrictions which exceed the parameters defined in the regulation.\textsuperscript{79} When the parties to an agreement, because of the peculiar nature of their relationship or the relevant market, believe additional restrictions are necessary, they may apply for Commission approval of the additional obligations.\textsuperscript{80} Thus, although the limitations prescribed in the regulation provide general guidelines, the Community maintains a receptive attitude toward innovative agreements.

B. Permissible Restraints on the Commercial Freedom of Members of a Franchising Network

The Community position with regard to franchising agreements attempts to strike a balance between fostering the effective use of franchising networks and maintaining restraints on commercial freedoms within reasonable limits.\textsuperscript{81} The Commission perceives the franchise mechanism as a legitimate means of earning profits by applying the business expertise and product reputation developed by the franchisor.\textsuperscript{82} More importantly, the Commission favors the franchise

\textit{Id.}

\textsuperscript{76} Treaty of Rome, art. 85(3).

\textsuperscript{77} Commission authority to issue regulations is discussed \textit{supra} at note 5 and the accompanying text.

\textsuperscript{78} See, e.g., Franchising Regulation, \textit{supra} note 72, arts. 2-5, ¶ 10,916, at 12,215-17. Articles 2 and 3 describe permissible restrictions on competition while articles 4 and 5 indicate which obligations preclude exemption.

\textsuperscript{79} See, e.g., \textit{id. supra} note 72, art. 6, ¶ 10,916, at 12,215.

\textsuperscript{80} \textit{Id.}

\textsuperscript{81} See Comm'n Press Release, 4 Common Mkt. Rep. (CCH) ¶ 10,894, at 12,148-49 (July 16, 1987). Article 85 on its face seems dedicated to monitoring the attempts of private entities to ensure that this balance is assured. See \textit{supra} notes 73-76 (outlining the provisions of article 85).

\textsuperscript{82} Computerland, \textit{supra} note 63, ¶ 10,906, at 12,165.
mechanism as a means of expansion because of its ability to rapidly penetrate markets, rationalize distribution, and benefit consumers. These favorable consequences make the Commission more likely to approve franchising agreements because they mirror the policy concerns of article 85(3).

In its decisions and draft regulation, the Commission directs the most extensive attention to the following five classes of obligations: (1) obligations connected to the basic service of the franchise; (2) terms intended to protect the franchisor's knowhow and expertise from benefiting competitors; (3) clauses directed to preserving the integrity of the network image and product reputation; (4) provisions creating a contract territory; and (5) terms influencing a franchisee's pricing policy.

1. Obligations Connected to the Basic Services of the Franchise

The basic service of the franchise is the transfer of a package of intellectual, industrial, and other intangible rights in exchange for consideration, usually royalties. The franchisor transfers these rights in the form of trademarks, tradenames, shop signs, utility models, designs, patents, copyrights, and/or commercial knowhow. The Commission considers obligations on the part of the franchisor to provide a business formula the basic service of the franchise. In return for the right to exploit the franchisor's successful business

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83. Id. at 12,166. The Computerland system provides an example of the rationalization envisioned by the Commission. Computerland acts as a centralized purchasing agent. It takes orders from the franchisees, purchases the goods, then resells them to the franchisees. Through this system, Computerland procures more favorable prices for its franchisees by purchasing in bulk and, at the same time, increases the speed with which goods move from suppliers to retail outlets. Consumers benefit from this rationalization in the form of reduced prices. Id. at 12,175.


85. See infra § B(1) (section discussing obligations connected to the basic services of the franchise).

86. See infra § B(2) (section discussing clauses intended to protect the franchisor's knowhow from benefiting competitors).

87. See infra § B(2) (discussing the protection of a franchisor's image and reputation).

88. See infra § B(3) (examining the use of territorial restrictions in franchising agreements).

89. See infra § B(4) (text discussing terms related to pricing policy).


91. Franchising Regulation, supra note 72, art. 1(2)(b), ¶ 10,916, at 12,215.

92. The business formula consists of initial and continuing assistance in selecting and outfitting the premises, advertising, training, and other information or practices which promote the competitive advantage of the franchisee. Id.

93. Id.
formula, the franchisor may receive royalties based on a percentage of the franchisee’s sales.94

In the Commission’s view, these obligations are not restraints within the meaning of article 85(1).95 The Commission’s position draws from a 1986 decision of the European Court of Justice (Court) in Pronuptia v. Schillgalis.96 In Pronuptia, the Court evaluated the legal status of franchising agreements under article 85(1).97 The Court concluded that the basic franchise relationship, the transfer of a franchise package in exchange for royalties, does not in itself interfere with competition.98 Rather, the agreements are a legitimate method for an undertaking to earn profits from its expertise without investing its own capital.99 Consequently, obligations which require the franchisor to supply the business formula, and reciprocal obligations which require the franchisee to pay royalties, do not restrain competition within the context of article 85(1).100

2. Restrictions Intended to Protect the Franchisor’s Knowhow and to Preserve the Reputation of the Franchise

The Commission directs higher scrutiny on a franchisor’s attempts to prevent disclosure of the business formula to competitors and to protect the identity and reputation of the network.101 In Pronuptia, the Court held that provisions reducing the risk of disclosure are not restrictions within the meaning of article 85(1).102 However, the franchising regulation and Commission decisions clearly establish that the franchisor can protect the commercial knowhow and other intangible rights transferred to the franchisee only if the restraints are reasonable and motivated by an acceptable purpose.

94. See id. art. 1(2)(a).
95. See Pronuptia 2, supra note 90, § 10,854, at 12,042.
97. Id. at 16,435-40. The Court held that (1) the compatibility of franchise agreements for the distribution of goods with article 85(1) depends on the provisions of the agreement, provisions taken individually and in their economic context; (2) provisions strictly necessary to prevent competitors from benefiting from the franchisor’s knowhow and expertise and to preserve the identity and reputation of the franchise are not restrictions subject to article 85(1); (3) provisions resulting in the sharing of markets constitute restrictions within the meaning of article 85(1); (4) price recommendations by the franchisor do not, without more, come within article 85(1); and (5) that franchise agreements which involve market sharing affect trade between Member States. Id. at 16,441-42.
98. Id. at 16,438.
99. Id.
100. See Pronuptia 2, supra note 66, ¶ 10,854, at 12,042.
101. Franchising Regulation, supra note 72, ¶ 10,916, at 12,214.
Common protection obligations include post-term noncompetition clauses and use restrictions. The Commission subjects noncompetition clauses to several limitations. Post-term noncompetition obligations must be reasonable in duration and geographical extent. For example, in Yves Rocher, the Commission approved the franchisee's promise to refrain from carrying on a competing business in the contract territory for one year after termination of the agreement. Upon termination of the agreement, the Commission stated that the franchisor was entitled to a reasonable time in which to reestablish a competitive presence in the area without competition from the franchisee.

Post-term use bans imposed on the franchisee are permissible in order to protect the franchisor's knowhow from benefiting competitors. However, a franchisee may protect business methods which are separable from those imparted as part of the franchise. The Commission considers independently developed methods separable from the franchise package and eligible for immediate use by the franchisee upon termination of the franchise agreement. Thus, a provision preventing a franchisee from challenging the validity of the franchisor's intellectual property rights is illegal because the franchisor may use this provision to prevent a franchisee from using independently developed knowhow.

The Commission allows franchisees wide leeway to control the identity and reputation of the network. The franchisor can prohibit assignment of the franchise without its consent and prevent the franchisee from carrying on its business in unsuitable premises. The franchisor may require the franchisee to use the knowhow to

103. See, e.g., Yves Rocher, supra note 66, ¶ 10,855, at 12,051 (obligation not to compete with Yves Rocher in the contract territory for a period of one year after termination of the agreement); id. at 12,050 (clause permitting franchisee to employ franchised rights only in connection with the operation of the franchise).
104. Computerland, supra note 63, ¶ 10,906, at 12,171; Pronuptia 2, supra note 66, ¶ 10,854, at 12,042; Yves Rocher, supra note 66, ¶ 10,855, at 12,054.
106. Yves Rocher, supra note 66, ¶ 10,855, at 12,054.
107. Id. This provision, however, does not stop the franchisee from establishing a competing business outside the contract territory. Id.
108. Franchising Regulation, supra note 72, ¶ 10,916, at 12,216.
109. See Computerland, supra note 63, ¶ 10,906, at 12,167-68.
110. See id.
111. Id.
112. Franchising Regulation, supra note 72, art. 2(a), ¶ 10,916, at 12,215; id. art. 3(l)(n), ¶ 10,916, at 12,216.
113. Id. art. 2(b), ¶ 10,916, at 12,215; id. art. 3(l)(m), ¶ 10,916, at 12,216.
select the premises and to carry out the business. With regard to promotion, the agreement can require the franchisee to obtain the franchisor's approval of local advertising. A franchisor may determine the source and nature of the goods sold at the outlet. The franchisor may also limit the franchisee's clientele.

Using these types of obligations, franchisors can create divergent distribution networks. Compare, for instance, the networks maintained by Computerland and Yves Rocher in the EEC. Computerland operates a network offering microcomputer products and addresses its marketing format to business users. The franchisees may sell products from any supplier, as long as Computerland approves them. The marketing strategy of Yves Rocher, on the other hand, stresses the unique natural composition of Yves Rocher beauty products. As a consequence, the franchisee may not sell to resellers outside of the network nor distribute goods of other producers. Yves Rocher also maintains stringent controls over the franchisee's trading methods, outlet layout, sales techniques, and promotion. The two networks differ in that the Computerland franchisees are given a much higher degree of commercial freedom. In a field such as beauty products, however, where an image of exclusivity plays a significant role in the network's success, the franchisor can control virtually every detail of the operation of franchise outlets.

3. Clauses Establishing Contract Territories

The Commission acknowledges that guarantees of territorial protection constitute restrictions of competition within the meaning of article 85(1) The franchising regulation grants an exemption for

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114. Id. art. 3(1)(j), (k), ¶ 10,916, at 12,216.
115. Id. art. 3(1)(k), ¶ 10,916, at 12,216.
116. Id. art. 3(1)(a), (b), ¶ 10,916, at 12,216.
117. Id. art. 3(1)(a), (b), ¶ 10,916, at 12,215-16. The franchisor may not exclude from the class of buyers other franchisees or third parties who may obtain the same goods from other sources for resale. Id.
118. Computerland, supra note 63, ¶ 10,906, at 12,165; Yves Rocher, supra note 66, ¶ 10,855, at 12,047.
120. Id. at 12,168-69.
121. Yves Rocher distributes only through franchised outlets and by mail order. Yves Rocher, supra note 66, ¶ 10,855, at 12,049. The Yves Rocher product theme is natural beauty from plants. Id. at 12,052.
122. Id. at 12,051.
123. Id.
124. Franchising Regulation, supra note 72, ¶ 10,916, at 12,214.
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these guarantees. The Commission, however, does limit the manner in which a franchisor can structure territorial exclusivity.

Territorial protection is necessary to persuade franchisees to undertake the initial investment and shoulder the risks of the enterprise. In conjunction with this purpose, the franchisor may agree not to permit the establishment of competing outlets within the franchisee's contract territory. In return, the franchisor may impose an obligation not to establish competing outlets in other franchisee's contract territories. However, restrictions should relate to location of competing outlets and not to the franchisee's ability to sell to consumers from other outlet's territories.

Territorial guarantees, because they require exemption pursuant to article 85(3), may not afford the parties the possibility of eliminating competition. Accordingly, the franchising agreement may not prohibit sales between the franchisees. The territorial protection installed by the Computerland standard agreement conform to the requirements of the Commission franchise regulation. The agreement provides the franchisee a protected area of one kilometer where the franchisor will not permit the establishment of competing Computerland outlets. The franchisee agrees to operate exclusively from the premises approved by the franchisor. The protection obligation, however, is not one of clientele exclusivity.

4. Obligations Related to Pricing Policy

The Commission approved communications between the franchisee and the franchisor regarding pricing policy, subject to the condition that the franchisor does not exert any pressure to adopt the circulated prices. The Commission also prohibits using injury to a product's

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125. See, e.g., id. art. 2(a), ¶ 10,916, at 12,215.
126. Pronuptia 2, supra note 66, ¶ 10,854, at 12,038.
127. Franchising Regulation, art. 2(a), supra note 72, ¶ 10,916, at 12,215.
128. Id. art. 3(1)(c), ¶ 10,916, at 12,215.
129. See Yves Rocher, supra note 66, ¶ 10,855, at 12,056.
131. Franchising Regulation, supra note 72, art. 2(c), ¶ 10,916, at 12,215.
132. Computerland, supra note 63, ¶ 10,906, at 12,168.
133. Id. at 12,168. The franchisor may, however, make sales outside the premises and set up satellite selling facilities within the contract territory. Id.
134. Id.
135. Id.
136. See Franchising Regulation, supra note 72, art. 5(d), ¶ 10,916, at 12,217; Computerland, supra note 63, ¶ 10,906, at 12,172.
reputation as a means of maintaining higher prices. This proscription eliminates the Commission's concern that a franchisor will manipulate markets by controlling the prices of goods or services provided through the franchise distribution network.

D. Implications of the Franchising Regulation for Community Competition Policy

The application of the franchising regulation is limited in two respects. First, with regard to manufacturing franchises, the regulation only applies if the agreement does not involve the transfer of a manufacturing license. In some cases, manufacturing franchises that fall outside the scope of the franchising regulation can still qualify for an exemption pursuant to the Commission regulations governing knowhow and patent licensing. Second, the agreement cannot come within the purview of Commission regulations governing other distribution systems. The distinction turns primarily on whether the agreement conveys the right to exploit a substantial intangible property package. Another distinguishing feature of franchising agreements is the subordination of supply and purchase obligations to the establishment of a network of uniformly managed outlets.

137. Pronuptia 2, supra note 66, ¶ 10,854, at 12,041.
138. See Treaty of Rome, art. 85(1)(a) (specifying that agreements or practices which directly or indirectly fix prices are prohibited); id. art. 85(3)(b) (precluding exemption from article 85(1) prohibition for restrictive terms which allow parties to eliminate competition).
139. Franchising Regulation, supra note 72, ¶ 10,916, at 12,213.
140. Id. The knowhow and patent licensing regulations are discussed in § IV of this article.
142. See Franchising Regulation, supra note 72, ¶ 10,916, at 12,213.
The Commission policy towards franchising agreements permits substantial freedom to develop a brand image and network reputation. This approach attributes value to the elements of the franchise package and allows the franchisor to freely transfer the package in exchange for royalties. However, the Commission prevents franchisors from exercising excessive control over the customers served, the sources of supply exploited, and the prices charged by the franchisee. By controlling the use of these terms, the Commission attempts to preserve both interbrand and intrabrand competition.

IV. KNOWHOW TRANSFER AND LICENSING

A fundamental objective of the European Economic Community is to promote the rapid development and diffusion of new technologies. In an ongoing program, the Commission is developing a technological information exchange network designed to foster increased technological innovation in the EEC. Technological enterprises, however, are often unwilling to transfer proprietary information without adequate assurances against disclosure and competitive application of the knowhow. The Community is concerned that if it precludes these firms from controlling the exploitation of transferred knowhow, then the firms will attempt to realize the value of the knowhow themselves. Consequently, the Commission allows enterprises wide latitude to control the exploitation of technical knowhow, but attempts to encourage the development and exploitation of innovations.

144. See Treaty of Rome, art. 85(3) (permitting exemptions from Community restrictive practices laws for agreements which promote technical or economic progress); Draft Commission Regulation on Knowhow Licensing Agreements, 30 O.J. Eur. Comm. (No. C 214) 12 (1987), 4 Common Mkt. Rep. (CCH) ¶ 10,911, at 12,193 (Aug. 27, 1987) [hereinafter Knowhow Regulation] (citing technology transfer as promoting technical progress by increasing the number of production facilities, improving the quality of goods, and expanding the possibilities of further technical development).

145. See Comm'n Information Memo, 4 Common Mkt. Rep. (CCH) ¶ 10,831, 11,946-47 (Nov. 6, 1986) (announcing Commission approval of a proposal for a program for innovation and technology transfer which extends a presently existing transnational innovation program).


148. See infra the text accompanying notes 196-200 (summarizing the Commission's position with regard to obligations imposed in connection with technology transfers).
The Treaty of Rome reserves the right to legislate in the area of intellectual and industrial property rights to the national legislatures of member states. The Community policy, however, governs the restrictions a holder of these rights may impose on third parties acting in EEC markets. Soon after the Treaty of Rome was signed, the Council authorized the Commission to regulate agreements that transfer industrial property rights. Pursuant to this authority, the Commission reviewed several restrictive obligations arising from knowhow transfers. The Commission's activity, however, failed to address the use of restrictive obligations within the context of a knowhow licensing agreement. In 1987, the Commission issued a draft regulation directly which controls obligations connected to knowhow licensing (Knowhow Regulation). The Knowhow Regulation represents the latest step in formulating Community standards for the concerted exploitation of technical knowhow.

This segment of the article examines the application of Community restrictive practices laws to knowhow transfer and licensing. The first section discusses the early Commission regulation of knowhow transfer in sale and purchase agreements, subcontracting agreements, mixed knowhow-patent licenses, and joint research ventures. The


150. See Consten and Grundig-Verkaufs-GmbH v. EEC Commission, supra note 149, ¶ 8046, at 7618 (1966) (holding the Community competition system does not permit using rights flowing from trademark law to restrict competition). Article 85 of the Treaty of Rome governs restrictive practices, prohibiting practices which distort competition unless the practice promotes economic, technical, and social progress. Treaty of Rome, art. 85. See supra the text accompanying notes 73-76 (discussing article 85 restrictive practices prohibitions). See also id. art. 86 (Treaty antitrust provision governing the abuse of dominant positions).


152. Knowhow Regulation, supra note 144, ¶ 10,911, at 12,191. If adopted, the Knowhow Regulation will become effective on July 1, 1988. Id. art. 13, ¶ 10,911, at 12,202. The period for public comment ended November 1, 1987. Id. at 12,191.

153. This article focuses on technical, as opposed to commercial, knowhow. The Commission regulation applies generally to nonpatented technical information. Id. Commercial knowhow transferred as part of a franchise package is the subject of a 1987 draft Commission regulation. The state of Community law with regard to franchising agreements is reviewed supra in the text accompanying notes 63-143.

154. See infra the text accompanying notes 157-180 (discussion of knowhow transfers within these types of agreements). A mixed license transfers rights to exploit a patent as well as knowhow. Knowhow Regulation, supra note 144, ¶ 10,911, at 12,192.
second part draws attention to the Commission’s proposed regulation governing “pure” knowhow licenses. The final section summarizes the Commission’s policy with regard to technology transfer.

A. The Development of Community Policy Towards Knowhow Transfer

The Commission regulates knowhow transfer pursuant to the article 85 provisions governing restraints on competition. Agreements within the scope of article 85 are unenforceable unless they contribute to social and economic progress. When ruling on the legality of restrictive agreements under article 85, the Commission evaluates the terms of the agreement individually. Generally, the Commission declares terms related to the protection of the value of industrial property, such as obligations not to disclose the knowhow or to grant sublicenses to third parties, outside of the scope of article 85. Territorial and field-of-application restrictions, on the other hand, infringe on article 85 and the Commission controls these terms to facilitate technological development.

1. Sale and Purchase Agreements

In Reuter/BASF, the Commission reviewed restrictions on the exploitation of knowhow imposed in connection with the sale of a business. The vendor challenged provisions of the purchase agreement which prevented him from competing with the purchaser and conducting noncommercial research and development. The Commission declared the noncompetition obligation invalid beyond the period necessary for the purchaser to realize the full economic value.
of the knowhow.\textsuperscript{164} The Commission held that five years was a reasonable realization period, given the rapid advance of technology in the field.\textsuperscript{165} In addition, the Commission invalidated the restriction prohibiting the vendor from further research and development and declared that a purchaser could not prevent a vendor from improving the technical process.\textsuperscript{166} The purchasing party must, therefore, prepare to compete against innovations as well as the transferred technology on expiration of the agreement.

2. \textit{Subcontracting Agreements}

Later, the Commission approved absolute bans on subcontractors' future use of knowhow.\textsuperscript{167} The Commission's position is particularly oppressive with regard to improvements since the contractor may prohibit the subcontractor from exploiting its own innovations.\textsuperscript{168} This position is probably based on the fact that the contractor receives no royalties for the transfer.\textsuperscript{169} A subcontractor, unlike the business vendor in \textit{Reuter}, does not originally possess the ability to develop innovations from the knowhow, nor does a subcontractor purchase this right.\textsuperscript{170} This interpretation suggests that the lending of knowhow for a specific purpose, such as in a subcontracting agreement, is not sufficient to give the transferee the right to compete with innovations.

3. \textit{Patent Licensing Agreements}

In a regulation adopted in 1984, the Commission approved the use of territorial and field-of-application obligations in patent licensing agreements.\textsuperscript{171} The parties may share markets through geographic divisions but not by classes of customers.\textsuperscript{172} The parties to a licensing agreement must also avoid customer-based market sharing when

\begin{footnotes}
\footnotetext{164. Id. at 9899-10,-11.}
\footnotetext{165. Id.}
\footnotetext{166. Id. at 9899-11.}
\footnotetext{167. Comm’n Notice on Subcontracting Agreements, 22 O.J. Eur. Comm. (No. C 1) 12 (1979), [1978-81 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 10,103, at 10,359 [hereinafter Subcontracting Notice]. A subcontracting agreement is defined by the Commission as an agreement where one firm supplies goods, work, or services for another firm in accordance with the latter's specifications. Subcontracting Notice, id. at 10,359.}
\footnotetext{168. Id.}
\footnotetext{169. See Comment, supra note 146, at 187.}
\footnotetext{170. See supra the text accompanying notes 161-66 (discussion of freedom of seller of business to compete by means of innovations to technology transferred as part of sale).}
\footnotetext{171. Patent Licensing Regulation, supra note 147, ¶ 2747, at 1951.}
\footnotetext{172. Id. at 1956-58.}
\end{footnotes}
formulating field-of-application restrictions. Nevertheless, a licensee may gain five years of lead time through noncompetition covenants. Further, the licensee can maintain increased control of the knowhow’s development by reserving fields of application for independent exploitation.

4. Research and Development Agreements

Joint ventures and research and development (R & D) cooperation agreements also implicate technology transfer issues. In a 1985 regulation, the Commission addressed complications arising when the parties to the knowhow transfer occupy large market shares. The regulation does not prohibit firms with large market shares from collaborating in research and development. However, when the firms’ market share exceeds twenty percent, the parties must terminate all restrictive obligations. The parties, therefore, must be in a position to compete with each other once their combined market share exceeds twenty percent.

Here, the Commission’s analysis of whether a term is restrictive within the meaning of article 85 becomes critical. Not all obligations connected to knowhow transfer agreements are within the scope of article 85. If the Commission follows its position with regard to franchising agreements, contractual obligations preserving the value of the knowhow fall outside the scope of article 85. Consequently, dominant competitors may transfer knowhow through agreements which create nondisclosure and, possibly, field-of-application restrictions.

B. The 1987 Knowhow Licensing Regulation

The Commission promulgated the 1987 draft knowhow regulation (knowhow regulation) to prevent adverse effects from the large
number of knowhow licensing agreements between Community firms. Certain terms in these agreements tend to inhibit economic progress by impeding technological development. Other obligations influence competition in Community markets. The following paragraphs explore the Commission's position with respect to these terms from the differing perspectives of the licensor and the licensee.

1. Obligations Protecting the Licensor's Interest

Prior to the technology transfer, the licensor possesses a natural monopoly over the exploitation of the technology. As long as the knowhow remains undisclosed, another firm will be willing to pay royalties to exploit the technology. Even after disclosure to the public, the knowhow continues to possess value. This value lies in the technological lead time associated with the knowhow—the period required for competitors to imitate the technology through reverse engineering. Up until this reverse engineering period ends, therefore, the knowhow possesses value which can be realized by the licensor. Throughout this period, the licensor may collect royalties for the licensee's use of the knowhow.

The knowhow regulation also recognizes the licensor's right to transfer knowhow for a limited purpose. This permits the licensor to limit exploitation of the licensed knowhow to certain products and services. For each new field of application exploited by the licensee, the licensor may collect additional royalties.

2. Obligations Promoting the Licensee's Interest

The regulation grants a licensee wide freedom to exploit innovations to the licensed technology. A licensor cannot prohibit the licensee

182. See, e.g., Knowhow Regulation, supra note 144, ¶ 10,911, at 12,195 (describing obligation on licensee to transfer title to improvements as inhibiting licensee's incentive to develop innovations).
183. See, e.g., id. at 12,193 (discussing noncompetition obligations within the context of knowhow licenses).
184. See Comment, supra note 146, at 189.
185. Knowhow Regulation, supra note 144, ¶ 10,911, at 12,195 (permitting payment of royalties to extend after public disclosure of knowhow).
186. Id.
187. Id.
188. Id. at 12,196.
189. Id.
from exploiting innovations developed by the licensee. This position reflects the Commission’s effort to promote technological development through economic incentives. Further, by prohibiting an obligation to transfer a license to use improvements which extends longer than the period of the original license, the Commission enhances the licensees bargaining position upon the termination of the agreement. A licensee interested in further development of the knowhow may bargain for further use of the knowhow by offering the licensor a license to exploit improvements developed by the licensee.

The licensee may also benefit from the establishment of a territorially-based production network. The regulation allows the parties to refrain from active and passive competition in another licensee’s contract territory: In the Commission’s view, the major investment required for technologically new or improved products creates a greater need to offer a licensee security to develop a market within the contract territory. Therefore, licensees can develop a territorial market completely free from competition by firms using the licensor’s technology.

C. Implications of the Knowhow Regulation for Technology Transfers in the Community

The knowhow regulation addresses the interests of both purchasers and sellers of technology exploitation rights. Under the regulation, licensees purchasing rights to exploit knowhow benefit from limitations on the licensor’s power to prevent application of innovations. As well, the licensee profits from the Commission’s approval of bans on competition in the licensee’s contract territory. The licensor, however, may exert a high degree of control over the exploitation of the knowhow and realize significant economic benefit from knowhow

190. Id. at 12,194. The licensee must, however, refrain from disseminating improvements when disclosure would destroy the value of the knowhow which is the subject of the original license. Id.
191. Id.
192. Id.
193. Id.
194. Id. at 12,193.
195. Id.
196. See supra the text accompanying notes 190-93 (text examining licensee’s rights to exploit innovations).
197. See supra the text accompanying notes 194-96 (discussion of noncompetition obligations).
licensing. By limiting fields of application, the licensor can grant exploitation rights to firms best adapted to improving particular applications and increase the prospects for development of successful innovations. For each new application, the licensor can collect additional royalties. Further, the regulation extends protection to the licensor's investment interest by permitting the payment of royalties throughout the period the knowhow remains secret and for a limited time after the knowhow enters the public domain. When combined with the existing support structure for technological innovation, the legal certainty provided by the regulation creates an attractive Community market for the purchase and sale of rights to exploit technology.

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198. See supra the text accompanying notes 188-89 (analysis of licensor's ability to control exploitation by limiting fields of application).
199. Id.
200. See supra the text accompanying notes 184-87 (explanation of economic value of knowhow after disclosure).