C L I P
European Max-Planck Group for
Conflict of Laws in Intellectual Property

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Comments on the European Commission's Proposal for a Regulation on the Law Applicable to Contractual Obligations („Rome I") of December 15, 2005 and the European Parliament Committee on Legal Affairs' Draft Report on the Proposal of August 22, 2006

I. Introduction

CLIP is a group of scholars in the fields of intellectual property and private international law. It was established in 2004 and meets regularly to discuss issues of intellectual property, private international law and jurisdiction. The Group's goal is to draft a set of principles for conflict of laws in intellectual property and to provide independent advice to European and national law makers. The Group is funded by the Max-Planck Society.

In December 2005, the European Commission has published the "Proposal for a Regulation of the European Parliament and the Council on the law applicable to contractual obligations (Rome I)" (hereinafter "Rome I-Proposal") which contains in Art. 4 special rules for contracts relating to intellectual property rights. The Rome I-Proposal was transmitted to the European Parliament and the Council in December 2005. In August 2006, the European Parliament Committee on Legal Affairs published a Draft Report on the Proposal (hereinafter "Rome I-Draft Report") which modified the proposed rules in Art. 4 relating to intellectual property rights.

The Group submits comments on the Rome I-Proposal and the Rome I-Draft Report as far as it differs from the Rome I-Proposal and summarizes the comments at the end of this document.

II. Comments on the Commission's Rome I-Proposal

1. Exclusion of Issues Concerning the Intellectual Property Right

The conflict of laws rules governing the transfer of intellectual property rights and license agreements are not very clear under the Rome Convention. The Convention neither contains an explicit provision about these contracts, nor are they excluded from the scope of the Convention in Art. 1. The Convention is tacit on this type of contracts. To the contrary, the *Guiliano/Lagarde* Report[1] addresses the applicable conflict rules:

"Since the Convention is concerned only with the law applicable to contractual obligations, property rights and intellectual property are not covered by these provisions. An Article in the original preliminary draft had expressly so provided. However, the Group considered that such a provision would be superfluous in the present text, especially as this would have involved the need to recapitulate the differences existing as between the various legal systems of the Member States of the Community."

One can conclude from these remarks that non-contractual questions are not governed by the lex contractus but by the law governing the intellectual property right itself. However, there is no doubt that license agreements and contractual transfer of intellectual property rights fall within the scope of the convention as far as contractual matters are concerned.

The Rome I-Proposal wants to change the approach of the Rome Convention by inserting an explicit rule on the law applicable to contracts relating to intellectual property rights in Article 4 (1) Rome I Proposal. The implementation of such a rule would automatically bring up questions of characterisation: Which aspects of a contract relating to intellectual property right are contractual by nature and thus fall under the scope of the lex contractus? Which issues are on the other hand governed by the law that governs the intellectual property right itself and are these issues still outside the scope of the instrument? These questions are of particular importance when it comes to issues which concern the intellectual property right itself but which are closely linked to the respective contracts like the transferability of the right, the conditions under which licenses can be granted and whether the transfer or license can be invoked against third parties. These issues do not fall under the lex contractus; they are governed by the law that governs the intellectual property right. Courts should be careful in considering these questions of characterisation.

2. Applicable Law in the Absence of Choice

Art. 4 of the Rome I-Proposals provides for contracts in the field of intellectual property rights and for related contracts (franchise and distribution):

"Article 4 – Applicable law in the absence of choice

1. To the extent that the law applicable to the contract has not been chosen in accordance with Article 3, the contract shall be governed by the law determined as follows:

(…)

(f) a contract relating to intellectual or industrial property rights shall be governed by the law of the country in which the person who transfers or assigns the rights has his habitual residence;

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[1] *Giuliano/Lagarde,* Report on the Convention on the law applicable to contractual obligations: O.J. EC 1980 C 282/1 (1).

(g) a franchise contract shall be governed by the law of the country in which the franchised person has his habitual residence;

(h) a distribution contract shall be governed by the law of the country in which the distributor has his habitual residence.

2. Contracts not specified in paragraph 1 shall be governed by the law of the country in which the party who is required to perform the service characterising the contract has his habitual residence at the time of conclusion of the contract. Where that service cannot be identified, the contract shall be governed by the law of the country with which it is most closely connected."

Article 4 Rome I-Proposal constitutes one of the most significant departures from the law as it stands under the Rome Convention. The Commission proposes to enhance certainty by adopting a list of fixed connection points for certain contracts enumerated in Article 4 (1) Rome I Proposal. The flexible criterion of the closest connection is only retained in the exceptional case where no contract on the list of Article 4 (1) Rome I-Proposal is concerned and the service characterising the contract cannot be identified (Article 4 (2) 2nd sentence Rome I-Proposal). This change of standard has been thoroughly criticised from a general point of view by many of the comments the Commission has received on its Proposal, among them the comments submitted by the Hamburg Max-Planck Institute for Comparative and International Private Law.[2] The following remarks are focusing on the specific rule for contracts relating to intellectual property and the related contracts of Article 4 (1) (f-h) Rome I-Proposal.

a) Inconsistencies in Franchise and Distribution Agreements

The proposed regime of a strict rule for intellectual property related contracts in Article 4 (1) (f) Rome I-Proposal is particularly unsuited to the needs of commercial and judicial practise in this field. This is due to the wide variety of contracts related to intellectual property rights. Some of these contracts might have as their main object a franchise, distribution, research cooperation or joint venture agreement and deal with the transfer or license of intellectual property rights only in ancillary provisions. As the wording of Article 4 (1) (f) Rome I-Proposal does not specify what is meant by "contracts relating to intellectual or industrial property rights", it is quite unclear whether in the situation described above (franchise, distribution or joint venture contract with ancillary license of intellectual property rights) the strict rule of Article 4 (1) (f) Rome I-Proposal would submit the whole franchise, distribution, research cooperation or joint venture agreement to the law of the transferor or assignor of the intellectual property rights or whether Article 4 (1) (f) Rome I-Proposal would apply only to the part of the contract dealing with intellectual property transfers or licenses (thus resulting in a dépeçage which may raise serious problems of coordination) or whether contracts which include transfers or licenses of intellectual property rights only as ancillary provisions would be excluded from the scope of Article 4 (1) (f) Rome I-Proposal altogether.
This is a particular problem in franchise and distribution contracts which according to Article 4 (1) (g) and (h) Rome I-Proposal would be governed by the law of the country where the franchisee or the distributor is habitually resident whereas Article 4 (1) (f) Rome I-Proposal would call for the application of the law of the franchisor or contracting partner of the distributor as licensor of the intellectual property rights. The Group thus proposes to clarify the ambit of Article 4 (1) (f) Rome I-Proposal. This could be done by including a "notwithstanding point (f)" in those provisions which might conflict with Article 4 (1) (f) Rome I-Proposal, in particular Article 4 (1) (g) and (h) Rome I-Proposal. Another solution

[2] http://ec.europa.eu/justice_home/news/consulting_public/rome_i/news_summary_rome1_en.htm.

would be to narrow the wording of Article 4 (1) (f) Rome I-Proposal from "a contract relating to intellectual or industrial property rights" to "a contract having as its main subject matter the transfer or license of an intellectual or industrial property right".

b) Significant Obligation of the License

The wide variety of contracts relating to intellectual property rights also calls for a differentiated solution instead of one strict, clear-cut rule. Even though the application of the law of the assignor or transferor of the intellectual property right might be appropriate in simple contracts which resemble an outright sale – such as an assignment or license for consideration in the form of a lump sum payment –, this does not hold true as a general rule. More complex intellectual property transactions often include an explicit or implicit duty of the licensee to exploit the intellectual property right, sometimes supplemented by clauses indicating quantities of production or modalities of use, while the licensor does not accept any commitment beyond the toleration of use of his rights. This casts doubt on the proposition that it is the licensor who effects the performance characteristic of the contract (as it is the licensee who accepts the commercial risks linked to the exploitation). It may also be the case that the intellectual property rights licensed or assigned are mainly exercised in the country of the licensee's or transferee's habitual residence or principal place of business. Another example of an intellectual property contract where the performances of both parties are essential and characteristic is a contract to publish and distribute a book.

c) Two Alternative Proposals

For these reasons it is not surprising that many national courts have refused to always regard the assignment or license of an intellectual property right as the performance characteristic of the contract and instead stressed the importance of an individual assessment of the license or transfer contract. The Group thus proposes to delete Article 4 (1) (f) Rome I-Proposal altogether and instead submit contracts relating to intellectual property rights to the general rule of characteristic performance in order to make it clear that it is left to the judges' appraisal of the circumstances of the case whether there is a characteristic performance and which party has promised it.

If the legislator nevertheless prefers a special rule for contracts relating to intellectual property rights, the Group proposes to change Article 4 (1) (f) Rome I-Proposal into a presumption in favor of the law of the transferor or licensor which, however, excludes contracts in which the transferee or licensee has accepted an explicit or implicit duty to exploit the rights. The wording should be amended in order to reflect that not only transfers, but also licenses of intellectual property rights are covered. Accordingly, a modified wording of Article 4 (1) (f) Rome I-Proposal could be drafted as follows:

"(f) a contract having as its main object the transfer or license of an intellectual or industrial property right shall be presumed to be most closely connected with the law of the country in which the person who transfers or licenses the rights has his habitual residence, unless the transferee or licensee has accepted a duty to exploit the rights."

III. Comments on the European Parliament Committee on Legal Affairs' Draft Report

In its Draft Report, the European Parliament Committee on Legal Affairs has proposed significant changes to the Commission's Proposal, especially with regard to Art. 4 and the rules on contracts in the field of intellectual property. The Rome I-Draft Report suggests the following rules:

"Article 4 – Applicable law in the absence of choice

1. To the extent that the law applicable to the contract has not been chosen in accordance with Article 3, the contract shall be governed by the law of the country with which it is most closely connected.

1a. It shall be presumed that the contract is most closely connected with the country in which the party who is to effect the performance which is characteristic of the contract has his habitual residence at the time when the contract is concluded.

1b. In particular, a contract shall be presumed to be most closely connected as follows:

(…)

(f) a contract relating to intellectual or industrial property rights shall be presumed to be most closely connected with the country in which the person who transfers or assigns the rights has his habitual residence;

(g) a distribution contract shall be presumed to be most closely connected with the country in which the distributor has his habitual residence.

2. By way of exception, the presumptions set out in paragraphs 1a and 1b may be disregarded if it is clear from all the circumstances of the case that the contract is manifestly more closely connected with another country."

The Group welcomes the suggested system of presumptions which basically preserves the current approach of Art. 4 Rome I-Convention. The Group also endorses the proposed amendment of the basic rules by a set of more specific presumptions for certain types of contracts in Art. 4 (1b) Rome I-Draft Report and the narrowly drafted rebuttal rule in Art. 4 (2) Rome I-Draft Report.

The practical experience with the closest connection test and the characteristic performance presumption of Art. 4 Rome I-Convention has been essentially positive in the course of the last 15 years. In addition, the presumptions of Art. 4 Rome I-Convention reflect what has been legal practice in most European countries prior to the enactment of the Rome Convention.[3] However, the flexibility of the presumptions of Art. 4 Rome I-Convention has been criticised because it has led to different interpretations in the Member States which has impaired the foreseeability of the applicable law. The Group thus welcomes the basic approach of Art. 4 Rome I-Draft Report to supplement the closest connection test with a system of presumptions and a narrowly drafted exception clause because it implements a reasonable compromise between enhanced certainty of application and retained judicial flexibility in individual cases.

The Group nevertheless believes that the specific presumption for contracts relating to intellectual property rights as set out in Art. 4 (1b) (f) Rome I-Draft Report is not suited to determine the applicable law in a way that matches a fair balance of interests for all types of contracts in this field. The presumption may work well in simple transfer or license contracts

[3] *Giuliano/Lagarde,* Report on the Convention on the law applicable to contractual obligations: O.J. EC 1980 C 282/1 (20).

in which the licensee has no duty but to pay a certain amount of money. Here, it will often be the case that the transfer of the right or the license grant is the performance which is characteristic of the contract. But for more complex contracts, e.g. publishing or other contracts in which the licensee has the duty to exploit the work, it will often be the performance of the licensee which is characteristic. The contract might also be more closely connected to the country in which the licensee has its habitual residence if the rights are mainly exercised in this country.

Furthermore, the presumption in Art. 4 (1b) (f) Rome I-Draft Report will lead to inappropriate results for contracts that deal with the transfer or license of intellectual property rights only in ancillary provisions and that have as their main object other duties of the parties, e.g. franchise, distribution, research cooperation or joint venture agreements. For these contracts, it is not clear under the suggested set of presumptions whether the rule of Art. 4 (1b) (f) Rome I-Draft Report applies only to the contract provisions relating to the intellectual property right or whether it applies to the entire contract: in the first case, the presumption would result in dépeçage; in the second case the rule would lead to inadequate results because these contract will often be more closely connected to the country where the other party has its habitual residence or main place of business. For distribution contracts which imply a license grant, the presumptions of Article 4 (1b) (f) and (g) Rome I-Draft Report are even contradictory.

The rebuttal in Art. 4 (2) Rome I-Draft Report would be the only resort for all the above mentioned cases because it allows to depart from the presumptions of Art. 4 (1a) and (1b) Rome I-Draft Report in "exceptional cases". However, it should be understood that these cases are not exceptional for the commercial and judicial practice in this field. They rather represent typical contracts relating to intellectual property rights. Hence, it would be inappropriate to provide the transferor or licensor with a strong presumption in favor of the law of the country of its habitual residence or main place of business.

The Group therefore proposes to delete Article 4 (1) (f) Rome I-Draft Report and instead submit contracts relating to intellectual property rights to the general rule of characteristic performance. Should the legislator prefer to provide a specific presumption for contracts relating to intellectual property rights, it should be clear that this presumption does only cover contracts which have the transfer or license grant as their main object. In addition, the presumption should be supplemented by an exception for cases in which the transferee or licensee has a duty to exploit the intellectual property right. Article 4 (1) (f) Rome I-Draft Report could be drafted as follows:

"(f) a contract having as its main object the transfer or license of an intellectual or industrial property right shall be presumed to be most closely connected with the law of the country in which the person who transfers or licenses the rights has his habitual residence, unless the transferee or licensee has accepted a duty to exploit the rights."

SUMMARY

The Group recommends the following approach:

- The European legislator should not introduce a rule on the law applicable to contracts relating to intellectual property rights in Art. 4 of the future Rome I-Regulation.
- Should the European legislator prefer to insert such a rule in Art. 4, this rule should be drafted as a presumption and not as a fixed rule. Therefore, the future Art. 4 (1) (f) should rather be based on the European Parliament's Rome I-Draft Report and not on the

Commission's Rome I-Proposal. The presumption should be refined in this case. Art. 4 (1) (f) should be drafted as follows:

"(f) a contract having as its main object the transfer or license of an intellectual or industrial property right shall be presumed to be most closely connected with the law of the country in which the person who transfers or licenses the rights has his habitual residence, unless the transferee or licensee has accepted a duty to exploit the rights."