

Consultation Response

LIDC *ad hoc* Committee

on

the Revision of the Technology Transfer Block Exemption Regulation¹

17 May 2013

The International League of Competition Law (LIDC) is a long standing association focusing on the study of competition (antitrust) law, intellectual property law and unfair competition law both at the national and international levels. The LIDC welcomes the opportunity to comment on the draft Technology Transfer Block Exemption Regulation ("Draft TTBER") and the draft Technology Transfer Guidelines ("Draft Guidelines"). We respectfully ask the European Commission to consider our below observations on the draft texts.

1. Summary

The LIDC welcomes the intention of the Commission to maintain a special regime for technology transfer agreements following the expiry of the current technology transfer block exemption regulation ("TTBER").² We are of the view that in order to maximize the incentives for innovation and the dissemination of technology, the new regime should provide adequate legal certainty and should also strike a fair balance between open competition and the need to protect the interests of IP owners and licensees. Our below observations aim to achieve certain improvements to the draft texts in light of these objectives.

2. Specific observations on the Draft TTBER and the Draft Guidelines

2.1. Market share threshold in case of in-house production

Pursuant to Art. 3(2) of the Draft TTBER where the undertakings party to the agreement are not competing undertakings but the licensee owns a technology which it uses only for in-house production and which is substitutable for the licensed technology, the lower 20% combined market share should apply as a condition for the block exemption.

The above proposal to take into account for the purposes of the market share thresholds substitutable technology used exclusively for in-house production raises, however, practical problems, as it is unlikely that the licensee would be willing to disclose the existence (and the market share) of any substitutable technology to the other party. Accordingly, there is a realistic risk that the licensor will not be in the position to decide which of the two market share thresholds are applicable to the agreement and whether the 20% combined market share threshold is exceeded or not. We recommend therefore reconsidering the need to amend the currently applicable rules.

¹ Chair: Zoltán Hegymegi-Barakonyi and Márton Horányi (Hungary); members: Dr. Florian Neumayr and Dr. Anna Maria Baumgartner (Austria); Carmen Verdonck (Belgium); Dr. Michele Giannino (Italy); Gusztáv Bacher (Hungary); Dr. Christopher Stothers (United Kingdom).

² Commission Regulation (EC) No 772/2004 of 27 April 2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements (OJ 2004 L123/11).

2.2. Temporary passive sales restrictions protecting exclusive licensees

Art. 4(2)(b)(ii) of the current TTBER permits for agreements between non-competitors the restriction of passive sales into an exclusive territory or to an exclusive customer group allocated by the licensor to another licensee during the first two years that this other licensee is selling the contract products in that territory or to that customer group.

The Draft TTBER removes such passive sales restrictions from the scope of block exemption. Paragraph 116 of the Draft Guidelines indicates, however, that restrictions on passive sales by licensees into an exclusive territory or to an exclusive customer group allocated to another licensee may fall outside of Art. 101(1) for a certain period if the restraints are objectively necessary for the protected licensee to penetrate a new market.

The above changes harmonize the rules applicable to technology transfer agreements with the rules on vertical distribution agreements, where passive sales restrictions are not block exempted either, but may nonetheless be considered to fall outside of Art. 101(1) for an initial two year start-up period if they are objectively necessary to allow the distributor to enter the market.³

The LIDC is of the view that there are fundamental differences between simple distribution arrangements and technology transfer arrangements, and consequently it is not appropriate to harmonize the rules applicable to them. In case of distribution agreements, it is less common for distributors to incur substantial costs due to the investments necessary to enter or develop a new market that would objectively justify a (temporary) absolute territorial protection. However, in case of technology transfer agreements entered into between a licensor and a licensee for the purpose of producing products that incorporate the licensed technology or are produced with such technology, it is the rule rather than the exception that the licensee incurs substantial sunk costs. These result not only from promotional activities, but (and more importantly) from the need to invest in the assets required to produce on the basis of the licensed technology.

With regard to the above, the possibility to grant licensees a temporary absolute territorial protection should, in our view, remain within the scope of the TTBER's safe harbor as opposed to merely referring to the possibility of such restrictions in the Guidelines. We emphasize that maintaining the possibility of a block exemption in the TTBER would not lead to a more lenient treatment of such restrictions: under either solution passive sales restrictions are accepted only in case of significant investments by the protected licensee and if they are limited in duration. Although from a policy point of view the substance of the rule would remain the same irrespective of whether it is included in the TTBER or in the Guidelines, from a practical point of view it would considerably increase legal certainty for both licensors and licensees if the rule was incorporated in the legally binding block exemption regulation as opposed to the Guidelines. This is particularly so given the binding effect of the block exemption regulation on national courts and competition authorities, which may very well deviate from the informal guidance provided in the Commission's Guidelines.

2.3. Exclusive grant backs

Art. 5(1)(a)-(b) of the current TTBER only exclude exclusive grant back clauses for severable improvements from the scope of the block exemption, as a result of which exclusive grant back clauses for *non-severable* improvements currently fall within the safe harbor of block exemption.

The Draft TTBER no longer distinguishes between severable and non-severable improvements. Consequently, an obligation on the licensee to grant an exclusive license of its rights in non-severable improvements or new applications to the licensor or to assign those rights to the licensor is not block exempted.

³ Commission Guidelines on Vertical Restraints (OJ 2010 C130/1), paragraph 61.

We are of the view that this change to the current regime unduly restricts the rights of IP owners. Non-severable improvements are improvements which cannot be exploited without infringing the licensed technology. Since non-severable improvements cannot be exploited by the licensee without the licensor's permission, we agree with the approach of the current TTBER and Guidelines that exclusive grant backs and obligations to assign non-severable improvements are not restrictive of competition within the meaning of Art. 101(1).⁴ We therefore respectfully ask the Commission to reconsider the need to amend the currently applicable rules.

2.4. Termination upon challenge clauses

Pursuant to Art. 5(1)(c) of the existing TTBER, non-challenge clauses are covered by the block exemption insofar as they only provide for a termination right of the licensor upon challenge of the underlying IP rights by the licensee.

The Draft TTBER and the Draft Guidelines aim to introduce a stricter approach to non-challenge clauses. A termination right upon challenge by the licensee is now expressly specified as an excluded restriction which does not fall under the scope of block exemption.

The LIDC recommends retaining the current regime which permits termination upon challenge. Non-challenge clauses providing for a termination right of the licensor upon challenge by the licensee are widely used in license agreements. Such clauses are also critical for a majority of IP owners to grant a license, as a licensor will rightly feel uncomfortable agreeing to a license which it cannot terminate if the licensed IP is subsequently challenged.

As a motivation to the amendment, paragraph 125 of the Draft Guidelines refers to the "*public interest to eliminate any obstacle to economic activity which may arise where an intellectual property right was granted in error*", and states that "*a termination right can have the same effect as a non-challenge clause, in particular where the licensee has already incurred significant sunk costs...*"

We are of the view, however, that a mere reference to the licensees' potential sunk costs cannot justify introducing a general expectation that companies should be prepared to deal with third parties even where they launch legal proceedings against them (in particular if we consider that it is not the general rule but rather an exception for IPR to be granted in error). In fact, such an obligation would even go beyond the special obligations that dominant companies have towards their customers. However, the Draft TTBER and the Draft Guidelines apparently require even non-dominant licensors to maintain relations with a licensee which challenges the validity of the licensed IP.

In our view, this obligation would put an unjustified burden on IP owners. A diligent licensee can be expected to assess the value and validity of a license before entering into it. If the licensee genuinely believes an IP right to be invalid, it may then decide to operate without a license and commence invalidity proceedings. If termination upon challenge clauses were to be excluded from the scope of block exemption, this could in our view easily generate false incentives for licensees to challenge underlying IP rights, possibly even unmeritoriously. Consequently, due to the fear that a licensee intends to enter into the license agreement only in order to protect itself from infringement actions and to prepare a challenge to the validity of the licensor's IP, the licensor may decide not to grant a license at the first place. This would appear to be a realistic risk, even if a licensor is convinced about the validity of its IP rights, as protracted litigation can result in costs and risks which by far outweigh the benefits of granting a license to a licensee.

⁴ Commission Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements (OJ 2004 C101/2) para 109.

Notwithstanding the above, should the Commission maintain its position concerning the anti-competitive nature of terminate on challenge clauses, we respectfully ask the Commission to include in the Draft Guidelines further clarification on the conditions under which a termination may nonetheless be acceptable, despite the licensee's challenge of the underlying IP. Although paragraph 125 of the Draft Guidelines suggests that the licensor will be entitled to terminate the license despite a challenge if there is some other breach of the agreement (e.g. non payment of the royalty), it would significantly contribute to legal certainty if the Commission would elaborate on the potential causes of termination.

2.5. Art. 9 of the Draft TTBER

The LIDC agrees with the Commission's approach that the Draft TTBER should not apply to the types of agreements covered by the R&D and the Specialisation BERs.⁵ However, the wording of Art. 9, in particular the reference to the "*subject matter*" of licensing agreements appears to leave room for legal uncertainty as to the interpretation of the new Art. 9.

We therefore recommend reconsidering the wording of Art. 9 of the Draft TTBER in order to ensure that it is interpreted in conformity with the principles described in the Draft Guidelines, i.e. the TTBER does not apply to R&D and specialisation agreements as defined in the respective BERs, except to R&D and specialization agreements which are excluded from the scope of the R&D and Specialization BERs by virtue of Art. 2(2) of these regulations.

2.6. Patent settlements

The LIDC welcomes the inclusion of an expanded section on settlement agreements in the Draft Guidelines, as currently there is considerable legal uncertainty relating to patent settlements. We also welcome the fact that the Draft Guidelines indicate that patent settlements are, in principle, a legitimate means of settling commercial disputes. However, we are of the view that certain parts of the new text require improvement for the following reasons:

Paragraph 220 of the Draft Guidelines refers to the "*general public interest to remove invalid intellectual property rights as an unmerited barrier to innovation and economic activity*". As settlement agreements do not prevent third parties from starting future invalidity proceedings, we are of the view that the general public interest to remove invalid IP rights has no part to play in the competition law assessment of settlement agreements. Competition law cannot be used to force a private party to pursue litigation as opposed to entering into a settlement. In fact, we are of the view that competition law should not play any role in encouraging patent litigation.

Paragraph 223 of the Draft Guidelines provides that "*settlement agreements between competitors which include a licence for the technology and market concerned by the litigation but which lead to a delayed or otherwise limited ability for the licensee to launch the product on this market may under certain circumstance be caught by Article 101(1)*". Pursuant to the Draft Guidelines "*scrutiny is necessary in particular if the licensor provides an inducement, financially or otherwise, for the licensee to accept more restrictive settlement terms than would otherwise have been accepted based on the merits of the licensor's technology*". Insofar as the Commission interprets the concept of "delayed" or "limited" market entry to mean a delay or limitation exceeding the scope of the IP

⁵ Commission Regulation No 1218/2010 of 14 December 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of specialisation agreements (OJ 2010 L335/43); Commission Regulation No 1217/2010 of 14 December 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of research and development agreements (OJ 2010 L 335/36).

protection available to the licensor (as opposed to a delay or limit determined by reference to the potential revocation of the licensed IP), we agree that the agreement may raise competition law issues. The appropriate point of reference should, however, be clarified.

The concepts of "*inducement*" and "*more restrictive terms*" also give rise to considerable legal uncertainty. As regards the concept of "*inducement*", we are of the view that a payment or any other incentive (inducement) will not, in itself, alter the effect of the settlement on competition. Therefore, on the face of it, the existence of an inducement seems irrelevant to assessing the nature of the agreement. As regards the concept of "*more restrictive terms*", it is completely unclear what the Commission intends to consider as the reference point against which the agreement could be assessed. We are nonetheless of the view that an agreement can only have anti-competitive effects if it extends beyond the scope of the disputed IP rights. We recommend clarifying this principle in the Draft Guidelines.

Paragraph 227 of the Draft Guidelines provides that "*non-challenge clauses in settlement agreements can under specific circumstances be anti-competitive and may be caught by Article 101(1). ... For instance, this is the case where the licensor knows or could reasonably be expected to know that the licensed technology does not meet the respective legal criteria to receive intellectual property protection, for example where a patent was granted following the provision of incorrect, misleading or incomplete information.*"

We agree that a non-challenge clause concerning a patent which was granted on the basis of "*incorrect, misleading or incomplete*" information provided by the licensor to the patent authority may indeed raise competition concerns if the licensor is aware of the patent fraud. However, in the absence of patent fraud it is completely unclear when a licensor "*could reasonably be expected to know that the licensed technology does not meet the respective legal criteria to meet patent protection*". Insofar as the Commission considers that, not only the manner in which an IPR was acquired (e.g. via the submission of incorrect or false information), but also the strength or weakness of the IPR (e.g. based on the novelty of a patent), should be considered under this rule, the rule would imply a second-guessing of the validity of IPRs on the merits of patentability, which we consider to be unacceptable.

In addition, the last sentence of paragraph 227 provides that "*Scrutiny of such [non-challenge] clauses is also necessary if the licensor induces, financially or otherwise, the licensee to agree not to challenge the validity of the technology*". We emphasize again that the effect of a non-challenge clause (as an inherent element of a settlement agreement) is the same, regardless of the existence or the size of any "*inducement*". It is therefore unclear why, in the Commission's view, a financial inducement would give rise to suspicion of anticompetitive effects. Given that the rule also creates considerable legal uncertainty (e.g. what constitutes an inducement for a non-challenge clause?), we recommend that the Commission considers removing it from the Draft Guidelines.