Draft proposal for a revised block exemption for technology transfer agreements and guidelines

The consultation

The European Commission launched on 20 February 2013 a public consultation on anti-trust rules on technology licensing. The objective of the consultation was stated as follows:

> In the meaning of the EU competition rules, a technology transfer agreement is a licensing agreement where one party (the licensor) authorises another party or parties, the licensee(s), to use its technology (patent, know-how, software license) for the production of goods and services.
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> The rules on how to assess technology transfer agreements are set out in two instruments, the technology transfer block exemption regulation ("TTBER") and accompanying Guidelines. The TTBER exempts certain categories of licensing agreements concluded between companies that have limited market power and that respect certain conditions set out in the TTBER. Such agreements are deemed to have no anticompetitive effects or, if they do, the positive effects outweigh the negative ones. The Guidelines provide guidance on the application of the TTBER as well as on the application of EU competition law to technology transfer agreements that fall outside the safe harbour of the TTBER.
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> These instruments will expire on 30 April 2014. The Commission has now drafted a proposal for a revised TTBER and Guidelines. The current consultation is seeking stakeholders' views on this proposal.

The consultation closed on 17 May 2013. It followed on from the earlier consultation, to which the IP Federation had responded with policy paper PP5/12.

IP Federation response

The Federation responded to the 2013 consultation with policy paper PP5/13, as follows:

Section I: background and overview

1. The Federation has made a careful comparison of the draft Regulation with the Regulation currently in force (772/2004). *In what follows, "old" refers to 772/2004 and "new" to the draft Regulation.*

2. The Federation welcomes the replacement of old Article 1.1(j)(i) and 1.1(j)(ii) with new Article 1.1(j), (k), (l), (m), to the extent that they improve clarity in the terminology used in the new Regulation. The Federation believes that the greater delineation of application of the new Regulation and the Specialisation and R&D Block Exemption regulations in new Article 9 adds to legal certainty.

3. However, the Federation urges the Commission to reconsider some of the changes that have been made compared with the old Regulation, each of which, the Federation considers, makes for increased legal uncertainty and limits the value of the Regulation. We discuss these changes in detail below in -

   - Section II of this paper, addressing new Article 3;
   - Section III of this paper, addressing new Article 5.1(a); and
   - Section IV of this paper, addressing new Article 5.1(b).

4. So far as the *Guidelines* are concerned, the Federation has two suggestions to make concerning new paragraphs 219-227 in Part 3 entitled “Settlement Agreements” (see Section V below).

Section II: market share thresholds, new Article 3

5. The market share thresholds included at new Article 3 are the same as those included in the old Regulation (see following paragraph as to the proposed introduction of new Article 3.2). As noted in the Federation’s response to the Commission’s initial consultation on the revision of the rules for the assessment of licensing agreements for the transfer of technology under EU competition law (Policy Paper 5/12), it is the Federation’s view that the market share test under the old Regulation is a major problem in the application of the technology transfer regime. The Federation has urged the Commission to consider raising the market share thresholds such that the block exemption would be easier to apply and of more practical relevance to businesses. Unfortunately, the absence of change will mean that opportunity to create greater legal certainty for businesses will be missed. The Federation would urge the Commission to consider substantially raising the market share thresholds in new Article 3 from their current levels.

6. It is proposed to introduce new Article 3.2, which has no counterpart in the old Regulation, and reads as follows:

    > 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 exemption provided for in Article 2 shall apply on condition that [the combined market share of the parties does not exceed 20%] on any relevant market.

7. New Article 3.2 adds a further degree of complexity to the market share test and is particularly difficult to apply in practice because a non-competing licensee may not be aware whether its in-house technology could be substitutable for the licensed technology if that is not the focus of its business. The rationale for the introduction of new Article 3.2 appears to be the concern that the licensee will be precluded from licensing its in-house technology to third parties. If this concern is so great that it merits introducing increased complexity in the market share test, then the IP Federation would urge the Commission to consider limiting the applicability of new Article 3.2 to exclusive licence agreements.

Section III: excluded clause: exclusive grant / assign back, new Article 5.1(a)

8. New Article 5.1(a) replaces old Article 5.1(a) and (b). Under the old Regulation a distinction was drawn in the treatment of grant backs (and assign backs) of severable and non-severable improvements. Only grant backs and assign backs of severable improvements were treated as excluded clauses. The change proposed here is to remove this distinction so that all exclusive grant back and assign back clauses are excluded clauses.

9. As the new Guidelines no longer address the concept of severable / non-severable improvements, the rationale for this change of stance by the Commission is unclear.

10. The IP Federation takes the view that agreements containing clauses permitting exclusive grant-backs and assignments of non-severable improvements should remain block exempted. As was noted in paragraph 109 of the old Guidelines: “Exclusive grant backs and obligations to assign non-severable improvements are not restrictive of competition within the meaning of [Article 101(1)] since non-severable improvements cannot be exploited by the licensee without the licensor's permission.” This statement was correct in 2004 and remains correct today.

11. Exclusive grant back and assign back clauses are of considerable importance to licensors and fundamental to the willingness of business to consider technology transfer agreements. The proposal to make all exclusive grant backs / assign backs excluded

terms will considerably increase uncertainty in the application of competition law to technology transfer agreements and may in many cases lead to licensors declining to license out their technology, preferring to maintain control over improvements by using the technology in-house only. Rather than removing the distinction between the treatment of severable and non-severable improvements, the review of the technology transfer block exemption would more effectively be used to provide clear guidance as to the interpretation of the concepts.

Section IV: excluded clause: non-challenge, new Article 5.1(b)

12. New Article 5.1(b) reads as follows (underlining indicating the changes compared to the old Article 5.1(c)) -

> any direct or indirect obligation on the licensee not to challenge the validity of intellectual property rights which the licensor holds in the European Union, including any right for a party to terminate the technology transfer agreement in the event that the other party challenges the validity of any of the intellectual property rights which a party to the agreement holds in the European Union.

13. Under the old Regulation, agreements containing termination on challenge clauses could fall within the block exemption. The rationale for this change is set out at paragraph 125 of the new Guidelines: "The interest of the licensor not to be forced to continue dealing with a licensee that challenges the very subject matter of the licence agreement has to be balanced against the public interest to eliminate any obstacle to economic activity which may arise where an intellectual property right was granted in error." The final sentence of this paragraph indicates that: "In balancing those interests it should be taken into account of whether the licensee fulfils all the obligations under the agreement at the time of the challenge, in particular the obligation to pay the agreed royalties."

14. The Federation is highly concerned by this proposal. First, the proposed new article would be open to cynical exploitation by licensees, which would likely discourage pro-competitive technology transfer. Second, the proposed change is in any event unlikely to lead to the increased elimination of invalid intellectual property rights where licence agreements are entered into.

15. The proposed change might make sense in a world where: (i) undertakings invariably entered into good faith negotiations to take licences before practising patented technology; (ii) participants in licensing negotiations ignored the possibility of invalidity or non-infringement of the intellectual property rights in question; and (iii) any undertaking which chose not to take a licence could be immediately and inexpensively prohibited from infringing irrespective of the merits of the intellectual property right in question. In such a world, a potential licensee would have no realistic choice other than to pay for invalid rights and a right to challenge in such circumstances may be justifiable. The reality is very different: undertakings generally do not take licences if they can avoid them; there is some degree of uncertainty as to the validity / infringement of most IPR which is routinely taken into account during licensing discussions and frequently results in favourable adjustments to licensees including discounted royalty terms; a licensee who challenges a patent can in most jurisdictions (with the possible exceptions of Germany and Austria) continue to practise the technology, even if the technology transfer agreement is terminated, until the licensor has proven its IPR is valid and infringed.

16. The effect of New Article 5.1(b) would be to change the commercial dynamic in licensing negotiations, with a likely negative impact on economic activity. Under the proposals, long duration agreements with running royalties would become less attractive to licensors. This is because a licensor would face the risk of agreeing a rate with a licensee (potentially discounted to reflect the risk of invalidity of the IPR) only subsequently to be faced with a spurious challenge to its IPR by a licensee shielded from any real negative consequences (e.g. an injunction). In such a situation the licensor might feel compelled to agree a further discount to avoid the risks and costs of litigation. Faced with such a possibility, a rational licensor would either demand significantly higher

royalties when entering into long duration agreements with running royalties to account for these increased risks or maintain its existing royalty level but structure its agreement such that a challenge to its IPR would be unattractive: e.g. by proposing a short fixed term agreement with royalties to be paid on a non-refundable up front lump sum basis. Under such a structure the licence need not be renewed if the IPR challenge were unsuccessful (which would be in effect similar to a termination on challenge clause) and the licensee would have little incentive to challenge the IPR as it would have no prospect of reducing its royalty burden during the term of the agreement.

17. This change in licensing dynamic brought about by the New Article 5.1(b) would increase transaction costs and/or royalty demands of licensors, which may reduce the overall level of technology transfer. The Federation's view is that the existing regime, which permits termination on challenge, adequately balances the interests of licensors and licensees and maintains the possibility for licensees to challenge IPR they genuinely believe to be invalid. The Federation strongly urges the Commission not to make this change.

Section V: settlement agreements, Guidelines Part 3

18. The Commission has proposed considerable changes to the section of the new Guidelines which deal with the treatment of settlement agreements. It appears that these proposed changes are a result of the Commission's experience in its *AstraZeneca* investigation and its Pharma sector inquiry. However, the changes proposed would affect not just the Pharma sector but all other technology sectors as well. Certain critical changes are at paragraphs 223, 226 and 227 of the new Guidelines (of these paragraphs 223 and 227 are entirely new):

> *Pay-for-restriction in settlement agreements*
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> 223. 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). 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.
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> *Non-challenge clauses in settlement agreements*
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> 226. In the context of a bona-fide settlement agreement, non-challenge clauses are generally considered to fall outside Article 101(1). It is inherent in such agreements that the parties agree not to challenge *ex post* the intellectual property rights which were the centre of the dispute. Indeed, the very purpose of the agreement is to settle existing disputes and/or to avoid future disputes.
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> 227. However, non-challenge clauses in settlement agreements can under specific circumstances be anti-competitive and may be caught by Article 101(1). Such clauses are not part of the specific subject-matter of a patent and may restrict competition within Article 101. 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. Scrutiny of such clauses is also necessary if the licensor induces, financially or otherwise, the licensee to agree not to challenge the validity of the technology.

19. The IP Federation is of the view that this section of the guidelines is highly ambiguous and overly broad. For example, paragraphs 223 and 227 both deal with the concept of the licensor "inducing" the licensee "financially or otherwise" to accept certain restrictions. It is very unclear how this concept is to be understood. Is the threat of litigation an 'inducement'? Is the opportunity to enter a licence under a settlement agreement itself an 'inducement'? Is the offering of a compromise deal – i.e. the offer of terms more favourable than would be offered if the licensor succeeds at trial an 'inducement'? Is a licensor even allowed to initiate settlement negotiations? How is a licensor to achieve a pre-trial settlement without providing some form of incentive to the licensee to end the litigation?

20. Clearly it is not the fact that some form of 'inducement' has led to a settlement being entered into which raises competition concerns, rather the concern arises if the settlement is a sham. The guidelines should therefore be drafted to recognise this and a settlement agreement should only be considered anticompetitive where there is strong evidence (e.g. court decision) establishing that the licensor had misled the patent office and knew that its IPR was invalid.

Conclusion

21. The Federation urges the Commission to reconsider the changes that have been proposed in new Articles 3, 5.1(a) and (b) and paragraphs 219–227 of the new Guidelines. These proposals have the potential to substantially reduce legal certainty to businesses entering into licensing arrangements, with resultant chilling effect on technology transfer, economic efficiency, and innovation in the EU.

Outcome of the consultation

Once stakeholders' submissions have been reviewed, a revised draft may be issued and the new regime will be adopted, in April 2014 (with a brief transitional period).

David England, 13 November 2013