Kluwer Competition Law Blog

Commission consults on tighter rules on technology transfer agreements

Tom Jenkins (Baker & McKenzie) · Thursday, March 14th, 2013

Introduction

The European Commission has published its long-awaited proposals to overhaul the Technology Transfer Block Exemption Regulation,[1] which provides a competition law safe harbour for agreements that license patents and know-how to licensees for the production of goods and services. This safe harbour applies so long as the agreement does not contain certain blacklisted restrictions and the parties' market shares do not exceed the following thresholds in respect of either the relevant technology or the contract products or services to be produced pursuant to the licence:

- 20% combined, where the parties to the agreement are either actual competitors in relation to the licensed technology, or actual or potential competitors with regard to the contract products or services; and
- 30% on the part of each party, where they are non-competitors.

While no fundamental changes are being proposed to the regulation, the Commission has proposed to tighten the rules in a number of ways that will leave businesses with less flexibility in how they agree to license the fruits of their innovation and investment, and will reduce legal certainty for these types of agreement.

The block exemption is accompanied by guidelines on how the Commission will approach the assessment of technology licensing agreements for competition law purposes, both under and outside the block exemption. The Commission has also published proposals to amend these guidelines, with revisions covering, in particular, software distribution, patent settlement agreements and technology pools.

Businesses active in licensing technology (both licensors and licensees) should actively engage with this consultation to protect against any tightening of the competition law regime. Stakeholders are invited to submit their comments on these proposals by May 17 2013. New rules must be adopted by May 1 2014.

- **Rolling back the regulation**

The Commission is proposing a number of revisions that will limit the protection currently

afforded to technology licensing agreements under the Technology Transfer Block Exemption Regulation. On the whole, the revisions are unwelcome suggestions that reduce flexibility and do not appear to be supported by real-world experience.

- **Passive sales restrictions no longer permitted**

Under the current technology transfer block exemption, a licensor may restrict not only active sales and marketing, but also passive sales (responding to unsolicited orders from customers) to a territory or customer group reserved exclusively either to the licensor, or to a single licensee for an initial two-year period. Passive sales restraints are not typically permitted in the general rules applicable to distribution (the vertical agreements block exemption),[2] unless they are justified by substantial investments made by the first distributor to sell into a new market – a very limited exception in practice. The Commission has proposed to harmonise the two regimes, by removing the protection previously afforded to passive sales restraints in favour of exclusive licensees under the technology transfer block exemption, and revising the technology transfer guidelines to suggest that such passive sales restraints may be justified only in the context of the new market entry. This attempt at harmonisation makes the law significantly more restrictive in practice and ignores the differences between technology licensing and general distribution. The more permissive approach in the current technology transfer block exemption recognises the fact that absolute protection is justified by the pro-competitive effects of technology dissemination and is necessary to protect the substantial investment needed for IP development. The stated desire to ensure consistency with other block exemptions ignores the particular features of technology licensing over other forms of distribution agreement. This revision is therefore detrimental to the dissemination of technology in Europe and runs contrary to the purpose of the regulation.

- **Termination on challenge provisions**

At present, provisions in technology licensing agreements that permit a licensor to terminate a licence in the event that the licensee challenges the validity of the underlying intellectual property fall within the safe harbour. The Commission is proposing to change this, with the result that such provisions must be individually assessed as to their anti-competitive and pro-competitive effects. This appears to be motivated by concerns that such clauses operate in the same way as provisions which prevent a licensee from claiming invalidity (currently excluded). That aside, such clauses are common in patent licensing agreements, and their removal from the block exemption risks decreasing legal certainty as to when a licensor will be in a position to rely on its contractual right to terminate in the event of a challenge to the validity of a patent and when such a clause may be invalid under Article 101 of the Treaty on the Functioning of the European Union.

- **Exclusive grant-backs**

An exclusive grant-back clause obliges the licensee to give back to the licensor (by way of either assignment or exclusive licence) improvements which the licensee makes to the intellectual property during the licence term. The current regime distinguishes between improvements which are severable (i.e., which can be exploited without the underlying intellectual property) and non-severable. Only exclusive grant-back clauses relating to severable improvements are outside the scope of the block exemption. The Commission has proposed to change this, so that an exclusive grant-back clause will be outside the safe harbour and require individual assessment whether the improvements are severable or not. This approach seems to miss the point that since a rights holder can logically prohibit the use of non-severable improvements by licensees or third parties by virtue

of its underlying IP rights, a grant-back of non-severable improvements goes no further than the scope of the licensor's underlying IP protection. In other words (as acknowledged by the current guidelines), grant-backs and obligations to assign non-severable improvements are not restrictive of competition, since non-severable improvements cannot be exploited by the licensee without the licensor's permission. Non-exclusive grant-backs will remain within the safe harbour under the proposals.

- **In-house production**

Under the current block exemption, a licensee that owns a technology which competes with that of a licensor, but which the licensee uses only for in-house production, is not treated as a competitor of the licensor (with the effect that the 30% market share cap will apply). The Commission is proposing to change this. In this situation, the proposals suggest that the block exemption should apply only where the market share of the licensor and licensee combined does not exceed 20% on the relevant technology or product market.

Software licensing

The Commission has proposed to revise the guidelines to expressly carve out from the block exemption the licensing of software copyright for the purposes of distribution (e.g., licensing the copyright to a distributor to distribute via physical media or via online downloading). The result of the proposal would be that this form of licensing would fall under the general distribution rules or vertical agreements block exemption, whereas at present it is assessed under the transfer of technology regime. This matters because some of the provisions of the transfer of technology block exemption are more generous in certain respects than the vertical agreements block exemption. For example, imposing an active sales restraint under the technology transfer block exemption does not require the licensor to reserve exclusively a territory or customer group to either itself or a single licensee (unlike under the vertical agreements block exemption). In addition, indefinite non-compete obligations (between non-competitors) are permitted under the technology transfer block exemption, but such clauses must have a five-year limit under the vertical agreements block exemption. This proposal will therefore limit the flexibility which 'pure distribution' software licensors currently enjoy and is something that such businesses should resist. Under the proposed amendment, the licensing of software for the inclusion in a product (e.g., where the licensee incorporates the software into a device with which the software interacts) will still be covered by the technology transfer block exemption.

Settlement agreements

A settlement agreement typically involves an agreement to resolve a dispute as to the infringement or validity of an IP right, such as a patent. Such settlements typically contain, as a matter of course, an agreement not to challenge the validity of the patent.

While the proposed revisions to the guidelines indicate that such settlement agreements are, in principle, a legitimate means of settling commercial disputes (since parties to such agreements may want to avoid the time, cost and uncertainties of litigation), the proposals go on to suggest that a settlement agreement involving a no-challenge clause may attract competition law scrutiny where:

- the licensor knows, or could reasonably be expected to know, that the relevant technology does not meet the criteria for IP protection – for example, where the patent was granted following the provision of incorrect, misleading or incomplete information; or

- where a financial inducement (reverse payment) is involved.

These provisions are primarily targeted at the pharmaceutical sector, where settlement agreements and reverse payments are currently a hot topic on both sides of the Atlantic. In the United States, the courts have consistently resisted attempts by the Federal Trade Commission (FTC) to attack such settlements, finding that in the absence of sham litigation – or fraud in obtaining the patent – patent settlement agreements are immune from antitrust attack, provided that the agreement does not go beyond the scope of the patent (regardless of the existence or amount of any reverse payment).[3] The US Supreme Court is set to hear oral arguments on this point on March 25 2013 in Watson. The European Commission has been monitoring such agreements since its pharmaceutical sector inquiry in 2009 and has commenced proceedings against Servier and Lundbeck in respect of settlement agreements concluded with generic producers (oral hearings in both cases are expected to take place shortly).

The approach taken in the proposed revisions to the guidelines is unhelpfully broad and impractical to apply. For so long as the underlying patent is valid, in the absence of fraud, a settlement agreement which goes no further than the patent will not in principle be capable of having anti-competitive effects. Put another way, it is the originator's patent that excludes the generic producer and not any anti-competitive agreement between the two.

The Commission appears to believe that competition law should play a role in encouraging patent litigation – for example, the guidelines now refer to a "general public interest to remove invalid intellectual property rights as an unmerited barrier to innovation and economic activity". However, without evidence of a clear intention to mislead the patent office (addressed in *AstraZeneca*[4] in the context of Article 102), antitrust authorities are not well placed to assess questions of validity, which typically involve complex questions of fact and IP law. By suggesting that a no-challenge agreement as part of a settlement agreement will be invalid where the licensor ought to have known that the patent is invalid, the proposals inadvisably invite the antitrust regulator to second-guess validity.

A more sensible approach would be limit the competition law attack on settlement agreements to just this circumstance. The inclusion of financial inducements as grounds of suspicion should be deleted because these ought to be irrelevant to the analysis of whether a settlement agreement has anticompetitive effects.

Technology pools

A technology pool describes the situation where multiple licensors agree among themselves to collectively license certain IP rights (the pool) to third-party licensees. Many of the issues surrounding pools tend to be similar to those around standardisation, since a standard will often involve the collective licensing of patents essential to the standard by a pool of licensors. Pools of technologies that are complementary and essential to implement a particular standard are generally pro-competitive, in that they reduce licensing costs and royalties avoiding the royalty stacking problem where licensees must separately license individual patents, leading to higher overall licensing costs. Anti-competitive effects arise where pools contain either:

- substitute technologies (i.e., a licensee is forced to pay for or take a licence for competing

technologies, at least one of which it does not need); or
- technologies which are non-essential to implement the standard, as this latter practice risks foreclosing rival licensors of non-essential technologies because of the bundling effect of the pool.

Issues can also arise where competitively sensitive information is shared between competitors participating in the pool.

While pools will remain outside the scope of the transfer of technology block exemption under the proposals, the Commission has substantially revised its guidance on technology pools, building on its experiences in the field of standards. These proposals are likely to be of interest to clients in sectors that rely on this type of arrangement, such as information and communications technology, telecommunications and semiconductor manufacturing.

The Commission has proposed a new safe harbour for pools (similar to that introduced in the 2010 Horizontal Guidelines for Standard Setting), which will apply regardless of the market share of the pool. The conditions are as follows:

- Participation in the standard and pool creation process must be unrestricted;
- There must be sufficient safeguards against the inclusion of non-essential technologies and anti-competitive information exchange (e.g., the involvement of independent experts in assessing which technologies to include);
- Technologies included in the pool must be licensed into the pool on a non-exclusive basis;
- Pooled technologies must be licensed out to third parties on fair, reasonable and non-discriminatory (FRAND) terms;
- Pool participants must be free to challenge the validity and essential-nature of any patents included in the pool; and
- Pool participants must remain free to develop competing products and technology.

On the whole, the new safe harbour is welcome, although it remains to be seen how workable these conditions are in practice, particularly given the inherent difficulties in identifying which technologies are essential to a particular product or standard. The Commission did not use this opportunity to further develop the notion of FRAND licensing, and in particular whether or when a commitment to license on FRAND terms precludes a licensor from seeking an injunction against an (alleged) bona fide licensee. This is a hot topic both in the European Union (with cases against Samsung and Google under Article 102 pending before the Commission) and in the United States (with the FTC recently accepting binding commitments from Google/Motorola Mobility that would preclude such injunctions save for after a mandatory mediation process).

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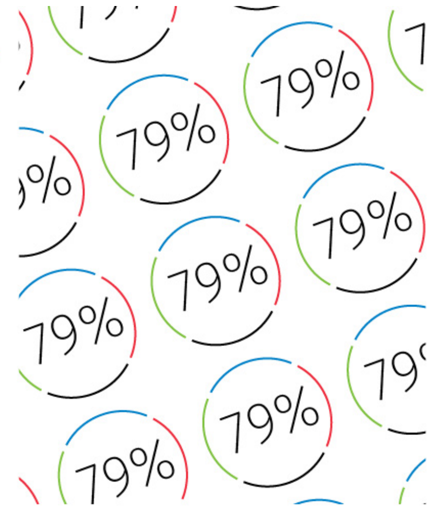

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