Comments on the European Commission’s Draft Technology Transfer Block Exemption Regulation and Guidelines

The Business Software Alliance (“BSA”) welcomes the opportunity to comment on the European Commission’s draft of a revised Technology Transfer Block Exemption Regulation (“TTBER”) and associated draft Guidelines (“Guidelines”).

The BSA supports the Commission’s decision to take a less formalistic approach to the TTBER that is more in line with contemporary economic analysis. The BSA also commends the Commission on improving the clarity of the TTBER and for producing the Guidelines, which will provide helpful direction to companies assessing whether a particular agreement qualifies for exemption under Article 81(3) and to national competition authorities and courts. Finally, the Commission’s decision to bring technology licensing (where appropriate) into line with the Commission’s recent reforms of the rules on horizontal and vertical agreements will help harmonize competition law and provide greater flexibility in technology licensing transactions. In sum, the BSA believes that these changes will enhance the flexibility of businesses operating in the European Union without sacrificing competition law principles.

The draft TTBER reflects the convergence of competition rules internationally. As companies are increasingly responding to customer demand for global licensing arrangements, such convergence takes on more importance. To the extent that the draft TTBER and the Guidelines move the European Union closer to the approaches that other jurisdictions such as the United States and Canada take to intellectual property licensing, such convergence in competition laws will help reduce the transaction costs of doing business across international borders and encourage the dissemination of new technologies.

At the outset, we address certain intellectual property licensing issues that have broad ramifications across the technology industries. First, we express concern about how low the Commission has set its market share thresholds. Second, we support the Commission’s block exemption of certain types of grant-backs of improvements. We are concerned, however, that the Commission has not gone far enough in recognizing the need for exclusive grant-backs of improvements in order to encourage licensing in the first place. Finally, we believe that the treatment of cross licenses is too strict and, accordingly, we make recommendations concerning the treatment of these licenses that are based on the assumption that they are generally pro-competitive.

We also comment on issues specific to software licensing. We endorse the inclusion of software copyright licenses within the scope of the TTBER. We would appreciate further discussion in the Guidelines of certain issues relating to software.
First, we would encourage the Commission to explicitly reference the Software Directive and indicate its intent to apply Article 81 to software in a manner consistent with the Software Directive. Second, we make several recommendations concerning the clarification of the scope of the TTBER with respect to software licenses. Third, we would encourage the Commission to include recognize designated-machine clauses as legitimate tools for protecting intellectual property rights and to list them among those provisions the Commission views as not likely to result in anti-competitive harm. Finally, we emphasize the need for exclusive grant-back clauses in the context of license agreements that allow the licensee to debug the licensor’s software.

In conclusion, we would like to commend the Commission on its thoughtful efforts in revising the TTBER and drafting the accompanying Guidelines. We submit our comments in support of the Commission’s efforts and in hopes that they will assist the Commission in its preparation of the new TTBER.

I. General Comments

A. Market Share Thresholds

The draft TTBER introduces market share thresholds above which the block exemption does not apply. For agreements between competitors, this threshold is exceeded if the combined market share of the parties is above 20% on either the relevant technology or product market. For agreements between non-competitors, this threshold is exceeded if the market share of either of the parties is above 30%. Although the BSA supports the benefits that these thresholds afford to low-market-share companies, they create a significant degree of uncertainty for the parties where the thresholds are exceeded. This uncertainty is exacerbated by the fact that the Commission has indicated that, where the thresholds are exceeded so that an agreement falls outside of the block exemption, it may assess market share on the technology market based on (1) the sales of products incorporating the licensed technology in the downstream market and/or (2) the technology’s share of the market for technology licenses. This approach gives the Commission two ways in which to demonstrate high market share and thereby increases uncertainty for parties reliant on the Commission’s application of Article 81(3) outside the block exemption.

The BSA would encourage the Commission to reduce uncertainty by raising or eliminating the market share thresholds, particularly with respect to any assessments of new products in rapidly-evolving high-tech markets. Where there is a product that creates a completely new demand, the entity creating the new demand has, by definition, a market share of 100%. Under such circumstances, however, natural market forces will typically cause the high market share of the initial market entrant to drop as competitors enter the new market. Thus, treating the initial entrant the same as a company with a high-market share in a stable market is inappropriate and may discourage the initial entrant and slow the development of new products and technologies.
Although the draft TTBER allows for a grace period of one year where market share increases rapidly, this grace period may be insufficient in the case of the introduction of new markets where it may take some time for competitors to begin offering competing products or technologies. To address this concern, the BSA would recommend an alternate approach that would grant a two-year grace period for all technology transfer agreements designed to create new markets. In addition, BSA would recommend a seven-year grace period for such agreements where there are four or more independently controlled poles of research relating to the development of products or technologies that would compete in the new market. This approach would encourage the development of new products and technologies. This approach is also consistent with the Commission’s approach to market definition in the context of R&D agreements as discussed in its Horizontal Guidelines.

B. Grant-Backs

The parties to technology licensing agreements, including software licensing agreements, often allocate ownership of and/or license improvements arising out of the use of the licensed technology by the licensee. In particular, such agreements may include grant-back clauses that require the licensee to grant back to the licensor a license to any improvements made to the licensed technology. Such grant-back clauses may be exclusive or non-exclusive, and, in the case of cross-licensing, may be reciprocal or non-reciprocal.

We welcome the Commission’s decision to exempt non-exclusive grant-back clauses below the market share thresholds, regardless of whether or not they are reciprocal. These clauses promote the licensing of existing technologies by encouraging licensors to license their technologies without fear that one of their licensees would improve the licensed technology and obtain intellectual property rights that would lock the licensor out of the market of next-generation products. Non-exclusive grant-back clauses also encourage the broad dissemination of improved technology. While the exemption of non-exclusive grant-back clauses under the TTBER implies that they normally would qualify for exemption under Article 81(3) in cases where the market-share thresholds are exceeded, it would be helpful if the Guidelines made this clear.

We are concerned that the Commission remains overly restrictive with respect to exclusive grant-back clauses, which are exempted only if the improvements are non-severable (which presumably means that the improvement cannot be practiced independent of the underlying technology) and the market-share thresholds are not exceeded. Exclusive grant-backs can encourage licensors to license their technology in an efficient manner, avoid fragmented ownership of technology that could raise the transaction costs getting products to market, and thereby promote innovation and product development. As discussed below in Section II(D) of these comments, exclusive grant-backs in the context of license agreements for debugging are pro-competitive. Accordingly, we would urge the Commission not to include exclusive grant-back clauses in the conditions listed in Article 5, but rather to make it clear in the
Guidelines that the eligibility of such clauses for exemption under Article 81(3) must be decided on a case-by-case basis.

We are particularly concerned about the Commission’s approach in the case of subcontracting situations. For example, a software publisher may grant a license to allow a subcontractor to further develop its product rather than conducting this activity in-house. Through the use of an exclusive grant-back clause (for severable or non-severable improvements), the licensor retains full control over its software and related improvements, and prevents the licensee from free-riding on the licensor’s initial investments in the licensed technology. Concerns about reducing the licensee’s incentives to innovate are specious in this context because, but for the licensor’s desire to obtain the improvements, no license would have been offered and the licensee would have had no opportunity to have the benefit of the licensor’s technology to aid its innovative efforts. In this case, greater freedom to structure licenses leads to more innovation, not less.

Thus, for licenses granted in the context of subcontracting arrangements, we encourage the Commission to make it clear in the Guidelines that exclusive grant-backs are generally eligible for exemption under Article 81(3). This approach will provide licensors with the flexibility to outsource software development without losing control over improvements developed under the license.

Relatedly, many of the terms that the Commission uses in its treatment of grant-back clauses, including “improvements” and “severable,” are undefined and derive from the patent context. Particularly given that the block exemption will now cover software copyright licenses, we encourage the Commission to define these terms either in the TTBER itself or in the Guidelines. As a practical matter, if licensors had greater certainty concerning what is “severable” technology, they would be less reluctant to license their technology for fear that they would not be unable to control future developments.

C. Cross-Licenses

The draft TTBER’s and Guidelines’ treatment of cross licenses is too restrictive because they fail to recognize that that such licenses may be pro-competitive. It is common in the software industry for companies to have broad cross licenses with one another designed to clear the field of patents and to thereby increase each company’s freedom to operate, which enhances competition in product markets. These cross licenses reduce transaction costs because, by licensing portfolios of patents, the parties are able to avoid having to engage in complex analyses regarding the validity of individual patents and potential infringements with respect to a wide range of different products offered by each company.

We are particularly concerned with the treatment of cross licenses used to settle patent disputes, and the treatment of reciprocal royalty obligations and field-of-use restrictions in the context of cross licenses.
1. Patent Settlements

The BSA commends the Commission on its recognition of the value and importance of settling disputes involving blocking patents, which may hold up product development and distribution and thereby reduce consumer choice and benefit. We would encourage the Commission to establish a more flexible test on which parties may rely with respect to establishing the existence of blocking patents rather than requiring the parties to avail themselves of an independent expert or to await the resolution of litigation. We believe unduly high evidentiary thresholds for the proof of blocking positions could result in unnecessarily high transaction costs and discourage settlements that are pro-competitive.

2. Reciprocal Royalties

We believe that the treatment of reciprocal royalty payments is too restrictive. The draft Guidelines suggest that the use of ongoing royalty payments in cross-licenses may constitute a hardcore violation. According to Paragraph 77, the Commission will treat such royalty obligations as price fixing in the context of a cross-license “where the parties could reasonably have chosen a less restrictive payment scheme such as lump sum payments or one-way payment of net royalties and where the amount of the royalty is such that it is likely to have a not insignificant impact on prices.” In the context of settlement agreements, the Commission takes a similarly negative attitude towards reciprocal royalty payments, stating in Paragraph 199 that the licenses necessary to settle such disputes “should be royalty-free or, where the objective value of the technologies in question is different, provide for one-way (lump sum) royalties, reflecting the objective difference in value.”

We would favor a more flexible approach to reciprocal royalty obligations. While such obligations may represent a means of supporting an illegal price fixing arrangement, we believe that the vast majority of such arrangements are pro-competitive. In particular, companies can use per-unit royalties to solve the problem of valuing their technologies and to spread the risks associated with a given project over time. In the settlement context, companies holding blocking patents may be unable to determine the value of their respective patent rights ex ante, particularly with respect to new technologies for which the consumer demand is untested. Allowing companies to use per-unit royalties to resolve patent disputes would improve the likelihood that companies will be able to resolve their patent disputes and thereby focus on product development and distribution rather than on litigation.

3. Field-of-Use Restrictions

The BSA commends the Commission on its explicit recognition of the benefits of field-of-use restrictions, the availability of which will encourage licensors to license their technologies to those entities that would most efficiently and effectively exploit the licensed technology in particular markets. We agree with the Commission’s statements in Paragraph 83 to the effect that cross licenses where both parties are granted the
same field of use are never hardcore, because no market has been allocated. We also agree with the Commission’s further statements to the effect that a field-of-use restriction should not be treated as a hardcore restriction if the parties are not actual or potential competitors in the covered product market.

However, we believe that the treatment of field-of-use restrictions in the draft TTBER and Guidelines is too strict, particularly in the context of cross licenses between competitors. In cases involving agreements between competitors, Section 4(1)(c) of the TTBER treats reciprocal field-of-use restrictions in agreements and non-reciprocal field-of-use restrictions imposed on the licensor as hardcore. While we agree that field-of-use restrictions in agreements between competitors can be nothing more than a fig leaf for illegal market sharing agreements, we believe that such situations are very much the exception rather than the rule and that a blanket prohibition on such restrictions as hardcore is not warranted.

Field-of-use restrictions generally serve pro-competitive purposes, even in cross licenses between competitors. In particular, they can allow competitors to exploit their comparative advantages in certain markets, which benefits consumers. Taking the example given in Paragraph 170 of the Guidelines, suppose that Party A has a new molding technology that can be used to make plastic bottles and plastic glasses, and Party B has a new technology for the manufacture of plastic that can be used in bottles and glasses. Party A and Party B are actual or potential competitors on both markets, but that Party A is more specialized in bottles, while Party B is more specialized in glasses. If Party A is able to restrict Party B to using its technology to produce glasses and Party B is able to restrict Party A to using its technology only to produce bottles, this will allow each party to produce more glasses and bottles incorporating the new technologies than would be the case if there were no license at all.

In the context of software licenses, field-of-use restrictions are pro-competitive because they provide a means for a technology to reach smaller, more specialized markets that may be served by licensees. For example, software publishers frequently license software to OEMs and others on the condition that they only distribute the software together with the licensee’s own software. Unless the licensor is able to ensure that the licensee restricts the use of the software to the market where the licensee is active, the licensor will be reluctant to license its software.

Thus, the BSA recommends dropping the reference to field-of-use restrictions in the block exemption itself, and instead providing in the Guidelines that there is no presumption that a field-of-use restriction falls within Section 4(1)(c) or alternatively, that a field-of-use restriction does not fall within Section 4(1)(c) unless it has the effect of excluding one party from a market in which the parties were actual or potential competitors in the absence of the license.
II. Software-Specific Comments

A. Relationship to the Software Directive

Any understanding of software licensing and its interplay with competition law requires an examination of the Software Directive,¹ which aims to harmonize Member State copyright law protecting computer programs. Article 4 establishes a list of exclusive rights composing the subject matter of the copyright for computer programs. These rights are permanent or temporary reproduction (including loading, displaying, running, transmission or storage), translation, adaptation, arrangement or other alteration, and any form of distribution, including rental. Articles 5 and 6 provide for limitations on the exclusive rights. Some of these limitations on exclusive rights can be overridden by specific contractual language.

In particular, the Directive defines the licensor’s exclusive rights in software and marks the boundaries between the “existence” and the “exercise” of those rights. Under this well-established distinction, the existence of an intellectual right is immune from challenge under the competition laws, while the actual exploitation, or exercise, of that right may violate Article 81 or 82. Licensing provisions consistent with the Software Directive represent the normal use of the licensor’s exclusive rights to ensure for the licensor the benefit of the subject matter of those rights. Such normal use is necessary to preserve the existence of the licensor’s exclusive rights and cannot be overridden by the competition laws.

The Software Directive strikes a careful balance between the rights of licensors to protect their intellectual property rights and the need for interoperability and competition in the software industry. Thus, it would be helpful if the Commission explicitly referenced the Software Directive in its Guidelines and made it clear that the TTBER and the Guidelines are not intended to alter in any way the rules laid down in the Directive and that any restrictions that might be included in an agreement pursuant to the Software Directive will be permissible under Article 81.

B. Block Exemption for Software Licensing

The draft TTBER explicitly brings within the scope of the block exemption software copyright licensing agreements for the manufacture or provision of products incorporating such software. We agree that the inclusion of software copyright licenses in the TTBER is appropriate and will create greater certainty regarding the enforceability of such software licenses.

Under the current draft TTBER, it is not entirely clear what kinds of software licenses would be included within its scope. The draft TTBER refers to license

agreements “for the manufacture or provision of contract products.” It is unclear whether this definition is intended to cover software used by professionals in providing services. We believe that such licenses should fall within the scope of the TTBER, and would welcome additional clarification on this point in the Guidelines. More generally, we believe that it would be useful to clarify the scope of the TTBER with respect to software products by amending Article 1(1)(c) to specifically refer to “software works.”

As noted in Paragraph 48 of the Guidelines, some license agreements are for the purpose of the reproduction and distribution of the protected work. We believe that it would be helpful if Article 1(1)(b) of the draft TTBER specifically referenced such agreements to make it clear that they are covered. Thus, Article 1(1)(b) would read “… including such agreement containing provisions which relate to the sale, purchase, or license of products …”

Finally, the reference in Paragraph 47 of the Guidelines to “… other than software copyright” is confusing. We would suggest that this sentence be redrafted to read as follows: “The TTBER only covers the licensing of other types of intellectual property such as trademarks and copyrights (other than software copyright, which is covered by the TTBER) …”

C. Designated-Machine Clauses

In a software licensing transaction, the parties may agree that, except under certain conditions, the licensee is restricted to using the licensed software solely on a “designated machine.” Such clauses, known as “designated-machine clauses” are a reasonable way for licensors to link the payment of royalties to use of the licensed software. By limiting software programs to specific hardware, licensors can more easily calculate royalties based on use. Similarly, designated-machine clauses allow licensors to control how many copies of their program are in use and thus help to prevent unlawful copying in a more effective manner. The use of designated-machine clauses allows software licensors to license their software at a lower price to legitimate users and thus such clauses benefit consumers. In addition, in some instances, software makers may use designated-machine clauses to prohibit transfers to incompatible hardware, in which case the inclusion of such clauses is designed to maintain the licensor’s reputation and the integrity of the licensed software, which may not perform well on incompatible hardware.

Designated-machine clauses do not restrict competition within the meaning of Article 81(1). In *Coditel v. Ciné Vog Films*, Case 62/79, 1980 ECR 881 (“*Coditel I*”), the European Court of Justice held that the calculation of royalties based on actual or potential performances fell within the subject matter of the copyright owner’s rights and, thus, outside of the competition rules.

The Commission does not address designated-machine clauses in the Guidelines. BSA would encourage the Commission to list designated-machine clauses in Paragraph 146, which lists certain obligations that it views as not restrictive of competition. Or, alternatively, if it has particular concerns about the use of such
clauses, to discuss designated-machine clauses in a separate paragraph that addresses any particular concerns that the Commission may have about such clauses, and to provide guidance on how to properly structure such clauses so as to avoid raising competitive concerns.

D. Debugging

Software publishers may license their source code to customers to allow them to debug the software. The purpose of the license is to give the licensee the necessary insight into the software’s source code in order to facilitate debugging and end-user support of the licensee’s hardware. As with other types of subcontracting arrangements discussed above in Section I(C) of these comments, we are concerned about the treatment of exclusive grant-back clauses in such license agreements. Licenses for the purpose of debugging typically contain such clauses and, without them, licensors will be very reluctant to license their source code, which is a key asset. The inclusion of an assignment or an exclusive grant-back in such agreements will not affect the licensee’s incentive to innovate because the entire purpose of the agreement is to allow the licensee to develop solutions to problems with the software.

In addition, an exclusive grant-back or assignment clause ensures the licensor that it can control the implementation of solutions to bugs found in the software. Absent such a clause, the licensee could implement the changes, which could result in a “fork” in the software code -- one branch with the solution implemented by the licensor and the other with the solution implemented by the licensee. Such a situation results in significant increase in the cost of maintaining the software by downstream users, including end users, OEMs and independent software vendors. The more such forks occur, the worse the situation becomes, detracting from the value, usefulness, and maintainability of the licensor’s software, and ultimately leading to higher costs and poorer quality.