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## RESPONSE OF LICENCING EXECUTIVES SOCIETY INTERNATIONAL TO EUROPEAN COMMISSION'S PUBLIC CONSULTATION ON THE DRAFT REVISED RULES FOR THE ASSESSMENT OF HORIZONTAL CO- OPERATION AGREEMENTS UNDER EU COMPETITION LAW (IP/10/489)

### 1. Introduction

The Licensing Executives Society International (LESI) has issued a first reaction to the European Commission review of Regulation 2658/2000 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of specialisation agreements (**Specialisation BER**) and Regulation 2659/2000 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of research and development agreements (**RDBE**) through its response dated January 30, 2009. A copy of that earlier document is attached for your reference. It includes a background chapter on LESI.

Following the publication by the European Commission of the draft Regulations and Guidelines for the assessment of horizontal cooperation agreements on May 4, 2010 for public consultation, LESI hereby wishes to comment on some of the provisions laid down in the draft RDBE.

Like in our response of January 30, 2009 LESI's submission will remain focused on RDBE. Also, having regard to the tight deadline that was provided in the Commission notice inviting stakeholders to address comments to the Commission before June 25, 2010, the below comments should be seen as the summary of the preliminary views of the LESI practice groups on some of the provisions laid down in the RDBE, but we nevertheless hope that the Commission will find them constructive and helpful.

### 2. Specific Comments on the RDBE and Suggested Amendments

#### 2.1 Definitions

LESI welcomes the initiative of the Commission to define more precisely what needs to be understood by "specialisation in research and development" on the one hand and "specialisation in exploitation" on the other hand (articles 1.12 and 1.13 RDBE).

While LESI shares the position of the Commission with respect to the general definition of both terms, it does not share its vision on the issue of the excluded scenarios in both definitions.



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Joint research and development programs represent a very heterogeneous group of possible collaborative structures, the contractual organization of which may vary in accordance with (without limitation):

- a) the subject of the research, ranging from thematic collaborations on scientific issues of general interest that may assemble a multitude of participants (cf. the EU framework programs to which in general more than thirty parties of various horizons - industry, universities, research centres - participate), to subject-specific collaborations on industrial issues of direct interest to the parties that will assemble in general not more than five parties,
- b) the staffing of the research, ranging from collaborations where each party has a specific competency and where the various work programs are allocated to each respective party in accordance with its particular skills and experience, to collaborations where one party brings the required research resources and the other party brings the operational resources (e.g. input data that are necessary for the performance of the R&D project),
- c) the financing of the research, e.g. collaborations where depending upon the level of interest of each party in the field of research, budget affectations may vary from a mere symbolical financial participation under which a party will gain a mere right of access to the results ("quick look") without rights of exploitation, to an important financial participation where a party expects to gain a competitive advantage whenever the results of the R&D project prove to be promising, and
- d) the position of the parties, e.g. industrial parties that have a direct interest in the commercial exploitation of the results, against academic and research oriented parties that have a mere indirect interest in the exploitation of the results, principally through licensing activities.

In such a context where R&D collaborations represent such a heterogeneous field of activities, LESI is of the opinion that the scenarios identified by the Commission in articles 1.12 and 1.13 of the RDBE should not be excluded "ab initio" from the definitions of specialisation.

With respect to article 1.12, an optimal allocation of financial and human resources between the parties may justify a collaborative structure under which one party (in particular when that party has a specific or unique R&D expertise) will carry out all the research and development, and where the other party (in particular when that other party has no internal R&D resources, or has affected its R&D staff to other ongoing projects) merely participates to the financing of these activities in exchange of a right to exploit the results.

With respect to article 1.13, in accordance with the financial contributions that each party brings to the R&D project, the parties may have a legitimate interest to designate one party (in principle the industrial partner) as the exclusive licensee of the R&D results who will be responsible for the production and distribution of the contract products, in consideration of a fair and equitable remuneration to the other partners who do not personally work the R&D results.

It seems to us that the present wording of articles 1.12 and 1.13 unfairly excludes from the benefit of the block exemption those research programs that, for reasons described above, have structured their collaborative framework in such a way as to suitably fit their respective business interests and research objectives. Moreover, we see a risk that the general wording of the excluded scenarios in articles 1.12 and 1.13 would create some kind of "safe harbours" to which the parties may artificially decide to have recourse for the sole purpose of bringing their collaboration within the scope of the block exemption.

For instance, with respect to article 1.12, we do not see why one should consider that competition will not be adversely affected when each party carries out part of the R&D, while competition



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would well be adversely affected when only one party carries out the research, and the other party financially supports part of the cost of the program. As explained above, such structuring is generally merely the result of an internal organization of the R&D between the parties in order to optimize the use of their internal resources, whether human, material or financial. In addition, the open-ended wording of article 1.12 last paragraph would entice the parties, with the mere objective of artificially bringing their R&D project within the safe harbour of the block exemption, to reserve a minor and symbolical research contribution to the other party in order to justify that "each of the parties carries out some of the research and development activities".

Similarly, regarding article 1.13, we do not see why one should consider that competition will not be adversely affected when each party is contractually authorized to exploit the results, while competition would be adversely affected when only one party produces and distributes the contract products on the basis of an exclusive license granted by the other parties. As the Commission recognizes itself in paragraph 86 of the Guidelines on the application of article 81 of the EC Treaty to technology transfer agreements, "the purpose of (exclusive licenses) may be to give the licensee an incentive to invest in and develop the licensed technology. The object of the agreement is therefore not necessarily to share markets". This is even more so under joint R&D projects where the exclusive license is often justified by the fact that the exclusive licensee takes an important stake in the orientation of the R&D project, contributes human and material resources during the project performance and assumes a financial risk in its successful outcome. In most cases, there would be no incentive for the industrial partner to financially invest in a joint R&D project and to dedicate human and material resources to its performance, when in the event of a successful outcome, a third party could get a "free ride" on the research results (without said third party having participated itself in the risk of a negative outcome of the research project) through a license that such third party would be granted from one of the other research partners. Moreover, it is LESI members' experience that exclusivity rights are always granted on the condition that the licensed technology is effectively exploited by the exclusive licensee, and may be revoked when certain diligence obligations are not met. In addition, exclusivity rights are often acquired indirectly, either under a contractual structure where each party fully owns the results that it has developed or co-developed during the R&D project, or through later cross-licensing arrangements where following the achievement of the R&D project, the partners grant each other the required license rights in order to effectively exploit the results in their respective markets.

As a practical example, LESI refers to a case where an industrial partner identifies an operational hurdle for which it seeks a cost-effective technological solution, and for which it thus wishes to set up an R&D project with a partner having the required in-house research resources. The research partner will perform 100% of the work, but both parties will finance the work on a 50:50 basis, in accordance with the budget that has been defined in relation with the project. In consideration of each party having co-financed the work, the industrial partner will have the royalty-free right to exploit the results for its industrial needs, while the research partner will have the right to license out the results to third parties and thus earn royalty income (situation that seems currently excluded under article 1.12). Likewise, it may be agreed that the industrial partner has an exclusive right to exploit the results, in consideration of which the industrial partner will agree to pay a royalty to the research partner (situation that seems currently excluded under article 1.13). Both arrangements appear to be pro-competitive since they are based on a classic "risk and reward" approach: each party assumes a research risk by funding 50% of the research work without a successful outcome being guaranteed, and in return each party negotiates a reasonable reward when the results prove to be successful and are fit for commercial exploitation.

Finally, the Commission itself has developed an example where it considers that a specialisation in exploitation under which a small research company A grants an exclusive license to a large pharmaceutical producer B for the exclusive production and distribution of the contract products



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likely meets the conditions of article 101(3) of the TFEU (example 2 cited at page 39 of the Commission Guidelines on the applicability of article 101 of TFEU to horizontal cooperation agreements).

LESI also refers to its comments in paragraph 4.2 of its response dated January 30, 2009 to the Commission, where it held that in general, specialisation in research and development and specialisation in exploitation do not raise any particular anticompetitive concerns below the market thresholds defined in article 4 of the RDBE.

For the above reasons, LESI recommends to delete the last sentence of both article 1.12 and 1.13 and thus to consider that the scenarios described therein are included (instead of excluded) as a means of specialisation in research and development or in exploitation. Likewise, LESI recommends to delete the sentence in article 1.13 according to which "each of the parties must carry out some of the exploitation of the results in the internal market" and "each party must carry out in the internal market some distribution activities regarding the contract products" – not only are these requirements incompatible with exclusive license arrangements, but they also may be inapplicable in practice since not all parties that are active in an R&D project necessarily deploy and maintain distribution networks.

## 2.2 Article 3.2

Under article 3.2, "the parties must agree that prior to starting the R&D all the parties will disclose all their existing and pending IP rights in as far as they are relevant for the exploitation of the results by the other parties".

LESI raises the question whether it is practically feasible to list *a priori* all IP rights currently possessed by a party with respect to the *a posteriori* exploitation of the R&D results that at the date of signature of the agreement, do not yet exist and (during the performance of the project) may appear to be rather different than those originally anticipated by the parties.

In addition, it is not clear to us what the consequences will be on the R&D Agreement when the IP rights are incompletely disclosed: does the R&D agreement then become null and void? Are the non-disclosed IP rights to be licensed for free? Are the non-disclosed IP rights to be licensed for a reasonable fee?

## 2.3 Article 3.3

Under article 3.3, "the R&D agreement must stipulate that all the parties must have equal access to the results of the joint R&D for the purpose of further research or exploitation". While it is standard practice that each party to the R&D project will have equal access rights to the results of the joint R&D project ("right to see"), user rights to the same results (whether for further research or for exploitation) are not necessarily granted on an equal basis. For example, if the partners to the research project decide to grant exclusive exploitation rights to the industrial partner, this implies by definition that these research partners can no longer freely dispose of those rights, which will thus by definition narrow their margin of manoeuvre both with respect to their future research projects (for which they cannot contribute user rights to the IP for which exclusive rights have been granted to the industrial partner) and with respect to their own exploitation.

In addition, the R&D agreement may provide that each party will own the results that it has itself conceived and developed. Although user rights may then be granted to the other parties for their respective internal research purposes, the same rights do not necessarily extend to the exploitation



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of the research results, which will remain subject to future license negotiations between the proprietor and its R&D partners.

LESI does not share the view that access rights should necessarily be granted on an equal basis, since this principle should only apply if the parties participate on an equal basis to the R&D project. Having regard to the heterogeneous structuring of R&D agreements (see paragraph 2.1 here above), if partners participate in the project under unequal levels of involvement (e.g. one party performing 60% of the budgeted work, one party performing 35% and one party performing 5%), at the same token access rights to the R&D results for the purpose of exploitation could justifiably be granted on an unequal basis, in order to take due account of the unequal investment commitments consented by each party.

As a way to accommodate that issue, LESI recommends that article 2.3 provide that the R&D agreement must stipulate that all the parties must have access (instead of equal access) to the results of the joint R&D.

#### **2.4 Article 4.1**

As was already voiced in our response of January 30, 2009, LESI once again wishes to emphasize that the limitation of the exemption in relation with the joint exploitation of the results to a duration of seven years does not, in many instances, go far enough to ensure that those companies engaged in R&D and investing in subsequent commercialisation of the R&D results have sufficient incentives to recover such investments. The extension of the duration of the exemption for the joint exploitation of the results by non-competing undertakings beyond seven years does not seem to raise particular competition concerns; LESI submits that, in general, joint exploitation regimes are more appropriately viewed as a particular specimen of technology transfer transactions, the particularity being that instead of the transfer taking place "*a posteriori*" with respect to a technology that already exists on the marketplace, the transfer is realized "*a priori*" within the framework of an R&D collaboration program with respect to a technology that yet needs to be developed. Since therefore, the parties' arrangement with respect to the joint exploitation of the R&D results is merely a particular type of technology transfer transaction with respect to a future (anticipated) technology, there are no compelling reasons why the rationale laid down in article 2 of Regulation 772/2004 ("The exemption shall apply for as long as the intellectual property right in the licensed technology has not expired, lapsed or been declared invalid or, in the case of know-how, for as long as the know-how remains secret, except in the event where the know-how becomes publicly known as a result of action by the licensee, in which case the exemption shall apply for the duration of the agreement"), should not likewise apply to the RDBE.

The joint exploitation arrangement conceived by the Commission under its example 2 cited at page 39 of the Guidelines related to the application of article 101 TFEU to horizontal cooperation agreements also recognizes the compatibility of an exclusive license for the duration of the patent with the requirements of article 101; since it is expected that the product could be brought to market in five to seven years, and since it may supposedly be considered that company B has a market share above 25%, the effective life of the exclusivity arrangement under this example that, in accordance with the Commission's analysis, is considered compatible with article 101, goes beyond a duration of seven years from the time the contract products are first put on the market. On the basis of the Commission's example, supposing that the product is brought to market in six years, the exclusive arrangement is exempted by the Commission for a duration of fourteen years, i.e. the remaining lifetime of the patent.



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### **2.5 Article 5(a)**

One of the hardcore restrictions relates to the restriction of the freedom of the parties to carry out R&D independently or in cooperation with third parties after the completion of the project. LESI would like to obtain a clarification whether a contract clause that provides for a "right of invitation" (during a limited period of time) under which each party undertakes to solicit the other parties to the contract (on a non-exclusive basis) to participate to future R&D projects in the same field undertaken by that party, is compatible with article 5(a). Although in a literal sense, this "right of invitation" may be considered to be a certain restriction on the freedom of the parties to carry out R&D, this "right of invitation" is also a means to nurture a long-term R&D relationship between the parties. Such clarification may be included in the Guidelines related to the application of article 101 TFEU to horizontal cooperation agreements.

### **2.6 Article 5(b)**

The hardcore restriction set forth in article 5b extends to limitations of output or sales. LESI fears that mere exclusivity arrangements entered into by the parties for joint exploitation could be characterised as such limitations. Granting exclusive exploitation rights with respect to the R&D results to one party (whether on territorial markets or product markets) would indeed by definition lead to a limitation of output or sales for the other parties. Under that scenario, those exclusivity arrangements would then not fall under any of the exceptions provided for (the setting of production targets or sales targets for joint exploitation).

A similar concern may arise under the hardcore restrictions set forth under article 5(d) and 5(e).

LESI is confident that such characterisation is not meant by the Commission but believes that clarification in that respect would be very useful.

### **2.7 Article 5(d)**

If article 5(d) is to be read as condemning arrangements under which a party restricts the territory into which ... the parties may ... *passively* licence the contract process or likewise, to restricts the customers "to whom ... the parties may ... *passively* licence the contract process, LESI requests the Commission to provide a practical example explaining the workings of what it considers to be "passive licensing restrictions" under this paragraph (d). While LESI considers that companies can easily identify what type of practices can be considered to be either active or passive sales restrictions, this distinction seems much more difficult to apply in a licensing context to which the "offer and demand" characteristics that are typical of a product sales market cannot be easily extrapolated.

## **3. Conclusion**

LESI welcomes the revision of the RDBE since it considers that the previous Regulation lacked the required transparency and failed to provide adequate legal security to undertakings in order to be really helpful in the autonomous assessment by undertakings whether their R&D collaboration agreements are compliant or not.

At the same time, in order to provide to European undertakings a legal working tool that responds to operational realities and that is shaped in accordance with the legitimate business concerns of those actors that invest in research, whilst ensuring effective protection of competition on the European market, LESI recommends to modify or clarify some of the provisions of the draft RDBE that, in their actual wording, do not fully take into account the particularities deriving



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from the heterogeneous nature of R&D collaborative projects and the resulting variety of contractual structuring of R&D operations.

### **Contact Details**

The LESI European Committee would welcome the opportunity to expand upon any of the points raised in these comments. The Committee can be reached through its chairman, Jean-Christophe Troussel at the following address: c/o Bird & Bird, Avenue d'Auderghem 22-28, 1040 Brussels, Belgium, Telephone: +32 2 282 6000 or E-mail: [jean.christophe.troussel@twobirds.com](mailto:jean.christophe.troussel@twobirds.com).

A handwritten signature in black ink, appearing to read 'Jean-Christophe Troussel'.

Jean-Christophe Troussel  
Chairman, LESI European Committee  
Brussels, 25 June 2010