Commission adopts new safe harbour for licensing of patents, know-how and software copyright

Luc PEEPHERKORN, Lars KJOLBYE and Donncadh WOODS, Directorate-General Competition, units A-1 and A-3

The European Commission has adopted on the 7th of April new rules for applying competition policy to the licensing of patents, know-how and software copyright. The new block exemption regulation, Commission Regulation (EC) No 772/2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements (the TTBER), was adopted together with a set of guidelines, Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements (the Guidelines) (1). These new rules facilitate licensing. From the 1st of May licensing agreements benefit from an improved safe harbour, saving many agreements from individual scrutiny. The new rules reduce the regulatory burden for companies, while ensuring an effective control of licensing between companies holding significant market power. The new rules will contribute to the dissemination of technology within the EU and thereby contribute to the Lisbon targets. The new policy is part of the fundamental reform of the European Union's enforcement rules for antitrust which has entered into force on the 1st of May 2004.

Licensing is important for economic development and consumer welfare as it helps disseminate innovations and allows companies to integrate and use complementary technologies and capabilities. However, licensing agreements can also be used for anti-competitive purposes. For instance, when two competitors use a license agreement to divide markets between them, or when an important licensor excludes competing technologies from the market. As competition is one of the main driving forces of innovation and competitiveness, it is important to find the right balance between protecting competition and protecting intellectual property rights.

Licensing agreements that restrict competition are caught by Article 81(1) of the Treaty. However, in the vast majority of cases licensing agreements also produce positive effects. These positive effects may in many cases outweigh the possible restrictive effects. The TTBER creates a safe harbour for a good deal of such licensing agreements where the balance is positive. For agreements not covered by the safe harbour the Guidelines explain the application of Article 81 to individual cases.

Background

Article 81 (1) of the EC Treaty prohibits agreements which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market. Under Article 81(3) an anti-competitive agreement may be exempted from the prohibition of Article 81(1) if the positive effects brought about by the agreement outweigh its negative effects. The Commission can 'block exempt' categories of agreements of the same nature and did so in 1996 for the licensing of patents and know-how with the technology transfer block exemption Regulation n° 240/96. (2) The new rules replace Regulation 240/96 which has been criticised for its narrow scope of application and its formalistic character and that many have said has contributed to a ‘strait-jacket’ effect. In December 2001 the Commission adopted a mid-term Evaluation Report as required by this Regulation. This was taken as an opportunity to start a thorough review of our policy towards intellectual property licensing agreements.

Most of 2002 was spent consulting stakeholders on the Evaluation Report. This consultation showed that many considered the 1996 Regulation to be too narrow in scope, too prescriptive and too legalistic. The Commission then worked out the details of a new block exemption regulation and a set of guidelines, which were adopted by the Commission for consultation purposes just before the summer break of 2003. These texts were discussed

(1) Published respectively in OJ L 123 and OJ C 101, both of 27.4.2004. Also available on the website of the Directorate-General for Competition at: http://europa.eu.int/comm/competition/antitrust/legislation/entente3_en.html#technology
with Member States in September 2003 and were published for consultation of industry and consumer organisations and other interested third parties on the 1st of October 2003.

The public consultation took place during the months of October and November 2003. Industry and others showed a keen interest and the Commission received over 70 submissions, in general of a high quality and often providing detailed comments on the proposals. Submissions were received from industry and trade associations, from law and IP societies, from individual law firms, from national authorities, from individual companies, from universities and from consultants. While in general welcoming the replacement of the 1996 Regulation with a more economic and flexible approach, the comments were critical on a number of important aspects of the proposals. The Commission carefully read and analysed all comments and made substantial revisions to the draft proposals. The revisions remedied a good deal of the concerns expressed and helped to improve the resulting level of legal certainty, one of the concerns often expressed. The revised proposals were discussed with and supported by Member State authorities in a meeting in February 2004.

The new rules

The new rules are firmly aligned on the Commission's new generation of block exemption regulations and guidelines for distribution agreements and horizontal co-operation agreements, while not ignoring the differences that obviously exist between licensing and distribution or licensing and R&D agreements. This was also requested by many of those who commented on the Evaluation Report of December 2001. The new rules therefore have the following general characteristics:

— The new block exemption Regulation is based on having a back list only. By doing away with the white and grey lists of the 1996 Regulation, the strait jacket effect is avoided: whatever is not explicitly excluded from the block exemption is now exempted. This leaves companies more freedom to devise their licensing agreements according to their commercial needs;

— The scope of the new rules is extended by covering all types of technology transfer agreements for the production of goods or services. The new Regulation covers not only patent and know-how licensing but also designs and software copyright licensing, as requested by many of those who commented on the Evaluation Report. Where the Commission does not have the powers to adopt a block exemption regulation, as for patent pools and for copyright licensing in general, the Guidelines give clear guidance as to future enforcement policy (1);

— The new rules make a clear distinction between licensing between competitors and licensing between non-competitors. In particular the applicable hardcore list should differ. Competition problems are more likely to arise in licensing between competitors than in licensing between non-competitors;

— The TTBER provides the safe harbour only below certain market share thresholds, 20% cumulative for licensing agreements between competitors and 30% each for agreements between non-competitors (see articles 3 and 8). Market shares need to be calculated both for the relevant affected product market(s) and technology market. The market share on the technology market is, however, defined in terms of the market share of products produced with the licensed technology and thus based also on the product market. For market share calculation normally sales value data of the preceding calendar year are to be used and a 2 year grace period is foreseen in case the relevant threshold is exceeded;

— A licence agreement can not benefit from the block exemption if it contains a so-called hardcore restriction of competition (see below);

— Some restrictions are excluded from the benefit of the block exemption while the remainder of the agreement can continue to benefit from the block exemption (see article 5). This concerns in particular obligations on the licensee to exclusively grant back or assign severable improvements to or new applications of the licensed technology and no-challenge clauses.

The hardcore list

The hardcore list in article 4 of the TTBER specifies the restraints which are considered very serious restrictions of competition. If such a hardcore restriction is found in a licence agreement, this denies the benefit of the block exemption to the whole agreement and also makes individual application of Article 81(3) unlikely. The list makes a distinction between licensing between competitors and between non-competitors.

(1) Council Regulation No 19/65/EEC, the enabling regulation, only allows adoption of block exemption regulations for transfer of technology agreements between two parties and concerning industrial property rights.
As for licensing between competitors the following are hardcore restrictions (see article 4(1)):

— Price fixing;
— Output limitation;
— Allocation of markets or customers;
— Restricting the licensee to exploit its own technology;
— Restricting the parties to carry out R&D, unless such is indispensable to prevent disclosure of licensed know-how.

As for licensing between non-competitors the following are hardcore restrictions (see article 4(2)):

— Vertical price fixing;
— Restriction of the licensee's passive sales;
— Restriction of the licensee's active and passive sales inside a selective distribution system.

Both for licensing between competitors as for licensing between non-competitors article 4 contains specific exceptions to the hardcore list. This extends the scope of the block exemption to cover a number of commonly used restrictions such as field of use restrictions, active and passive sale restrictions between licensor and licensee to protect their exclusive territories, captive use restrictions and others.

The Guidelines

The Guidelines provide guidance on the application of the TTBER and on the application of Article 81 outside the scope of the block exemption. The Guidelines make it very clear, as is also done in the recitals of the Regulation, that there is no presumption of illegality outside the safe harbour of the block exemption provided that the agreement does not contain a hardcore restriction of competition. In particular, there is no presumption that Article 81(1) applies merely because the market share thresholds are exceeded. Individual assessment based on the principles described in the Guidelines is required.

In order to promote predictability beyond the application of the TTBER and to confine detailed analysis to cases that are likely to present real competition concerns, the Commission has created a second safe harbour within the Guidelines. It takes the view that outside the area of hardcore restrictions Article 81 is unlikely to be infringed where there are four or more independently controlled technologies, in addition to the technologies controlled by the parties to the agreement, that may be substitutable for the licensed technology at a comparable cost to the user.

The Guidelines provide not only a general framework for analysing licence agreements, but also contain specific sections on the application of Article 81 to various types of licensing restraints, in particular royalty obligations, exclusive licensing and sales restrictions, output restrictions, field of use restrictions, captive use restrictions, tying and bundling and non-compete obligations. The Guidelines also contain a section on the assessment of technology pools, that is arrangements whereby two or more parties assemble a package of technology which is licensed not only to contributors to the pool but also to third parties. Agreements establishing technology pools and setting out the terms and conditions for their operation are not — irrespective of the number of parties — covered by the block exemption but are addressed in that section of the Guidelines.

Conclusion

These new rules represent an important improvement compared to the 1996 Regulation in terms of clarity and scope. While providing more freedom to companies to draw up licence agreements according to their commercial needs, they will also enhance the protection of competition and thereby with innovation. The new rules in addition bring about an important degree of convergence between the application of competition policy to licence agreements in the EU and US.