INTELLECTUAL PROPERTY LAWYERS' ASSOCIATION

Response to the EC’s Questionnaire to Stakeholders in relation to the Revision of the Rules for the Assessment of Licensing Agreements for the Transfer of Technology under EU Competition Law

Submitted on behalf of

Intellectual Property Lawyers' Association

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This response is submitted on behalf of the Intellectual Property Lawyers’ Association, in consultation with The Law Society of England and Wales.

Introduction

The Intellectual Property Lawyer’s Association (“IPLA”) act as a representative body for law firms in England and Wales with Intellectual Property practices, who wish to lobby for improvements in IP law and practice. Some 64 firms are members of IPLA, and they are responsible for a substantial amount of the transactional work in England and Wales relating to technology transfer: a significant volume of the technology transfer agreements which member firms handle have effect across the European Union. Member firms act for a wide range of clients, from major multi-national groups and companies to SMEs and technology start-up companies, as well as universities and private inventors and investors. IPLA has provided comments to DG Competition on previous Technology Transfer Block Exemption Regulations (and the earlier regulations on patent and know-how licensing) since the 1980s.

The Law Society of England and Wales is the representative body for solicitors in England and Wales.

General approach

We support the introduction of a new block exemption regulation (“regulation”) for technology transfer agreements when the current regulation expires in 2014. We believe that industry (both licensors and licensees) would benefit from the introduction of a new regulation which provides greater simplicity and certainty. Importantly, this would ensure that industry benefits from a reduction in the transaction costs associated with disseminating and exploiting technology.

In our view:

(a) **Greater recognition of pro-competitive effects.** The European Commission (“Commission”) should give greater recognition to the pro-competitive or benign competitive effects of most exclusive licensing and other technology transfer agreements. Ideally, this would be done by recognising that such agreements are not caught by Article 101(1), but we recognise that this is not consistent with the Commission’s position over many years, dating back to *Davidson Rubber* in 1972. If that approach is not possible, there should be greater recognition of the pro-competitive benefits of technology transfer agreements and of the efficiencies that result from the standard provisions in such agreements when it comes to assessment under Article 101(3). Specifically, many of the terms that are encountered in practice in technology transfer agreements should be treated as *prima facie* acceptable under Article 101(3) unless a clear competition problem can be demonstrated. Examples of
such benign terms include grant-back, no-challenge and non-compete clauses. This *prima facie* assumption should be articulated in both the regulation and the Commission’s guidelines for technology transfer, both of which should make clear that the underlying aim of the regime is that technology is disseminated and exploited effectively so as to enhance access to innovation. It should also be clarified that any proportionate obligations necessary to ensure effective exploitation of the licensed technology should be justifiable under Article 101(3).

(b) **New regulation required.** Having a well-drafted regulation is extremely useful and provides a level of legal certainty for businesses that no set of guidelines (with all of their caveats and qualifications) can provide. Business executives want to know, in simple terms, whether they are allowed to include certain terms in their technology transfer agreements and how those terms should be drafted to avoid competition law concerns.

(c) **New regulation should give increased clearance based on simple criteria.** The general approach of any new regulation should be to provide a clear “safe harbour” for most technology transfer agreements that are encountered in practice, based on criteria that can be readily applied by any commercial lawyer or business executive, without the need to consult an economist. The current regulation requires too much economic analysis and is therefore much too uncertain to provide a reliable safe harbour. This applies both to the question as to whether the parties are competitors (particularly potential competitors) in any market, and determining their respective market shares. These requirements are inherently difficult and expensive to assess in technology transfer agreements, and become particularly difficult when they must be assessed by reference to “technology markets”. Business people generally understand product markets but do not understand technology markets. Technology markets are a theoretical and impractical concept and should not be part of the assessment as to whether the safe harbour is available.

Replies to questionnaire

1. **Is your company primarily a licensor or licensee of technology? In which sector(s) or broad product groups?**

   Our members act for both licensors and licensees across all technology sectors. Clients include SMEs, large national and multi-national companies, investors in technology-based companies, individual inventors, universities, research-based organisations and Government bodies.

2. **Do you, overall, consider that the Block Exemption Regulation and the Guidelines have proven to be a well-functioning system for assessing technology transfer agreements?**

   The guidelines are a useful summary of the Commission’s current criteria for assessment. The regulation is moderately useful as a general guide to acceptability of terms, but it is not as useful as earlier regulations for technology transfer, when it comes to providing a definite “safe harbour” for technology transfer agreements (which is the ostensible purpose of the regulation). The reason why the latest regulation is less useful than its predecessors is because of the shift from a set of “black and white” rules to a largely economics-based approach to the application of the safe harbour in
the latest regulation. It is much more difficult to give concrete (or clear) advice on the application of the economics-based approach.

3. Can you give an indication of the impact (positive and negative) of the current competition rules on the business of your company? What would be the impact on your business if there were no Block Exemption Regulation and Guidelines?

Such impacts will be felt by our clients rather than by our members. Removing the regulation and guidelines would increase legal uncertainty for undertakings that engage in technology transfer activities. It would also significantly raise their transaction costs by leading to delays in the licensing of technology, adding difficulties to the negotiation process and increasing the need for expert lawyers and economists to be engaged.

4. Please report any problems raised by the application of the Block Exemption Regulation and/or the Guidelines. Please indicate also the sector/broad product group(s) in which such problems were encountered and the type of solution found, if any, to address the problems and results obtained.

It has been difficult for business executives to understand the scope of the exemption provided by the regulation. As explained in more detail at paragraph 11, it is difficult to establish with any certainty the relevant markets and market shares for “technology markets”. This is compounded by the increasing tendency for the Commission and national competition authorities to find very narrow product markets in the context of Article 102.

One of the most difficult features of the regulation for businesses has been the need to navigate the long list of exceptions to the exemption provided for at Articles 4(1) and 4(2), i.e. the hardcore restrictions. It is confusing enough to have exceptions to the exemption, but these are made very difficult to follow by including further exceptions and a number of double-negatives. The clarity of the regulation would be greatly improved if the hardcore restrictions were simplified.

5. Do you have any suggestions as to how one could clarify either the concepts or terminology used in the two instruments?

Where appropriate we have made some suggestions elsewhere in this document.

6. According to your experience, do you consider that some of the provisions in the current Block Exemption Regulation and/or parts of the text of the Guidelines have become unsatisfactory or need to be updated due to developments (in particular developments after 2004 when the current system was put in place) that have taken place at the national and European level either generally or in a particular industry? Please provide reasons for your response.

Our comments are generally not based on developments since 2004, other than the greater, cumulative experience that the Commission has of technology transfer agreements since that date, which we hope will encourage the Commission to view most technology transfer agreements as inherently pro-competitive. However, as mentioned above, in recent years there has been an increasing tendency for the Commission and national competition authorities to find very narrow product markets in an Article 102 context. This approach, if taken in the context of licensing agreements, would exacerbate many of the difficulties outlined in this submission, in particular the difficulties surrounding the application of the market share thresholds. The increased
lack of certainty surrounding the approach to market definition leads to serious difficulties also in identifying which hardcore list to apply: it can be difficult to advise clients whether a narrow market definition will be appropriate (meaning that the parties are not dealt with as competitors and can rely on Article 4(2) – but the market share threshold is more likely to be exceeded) or a broader market definition (meaning that the parties must apply Article 4(1) – but have more prospect of satisfying the market share threshold).

7. Do you believe that there are any specific competition "issues" related to technology transfer agreements not currently addressed by the current Block Exemption Regulation or Guidelines and that should be considered in the review? For example should the scope of the Block Exemption Regulation and/or the Guidelines cover other types of production related agreements such as agreements, where trademarks are licensed for display on consumer goods but there is no licensed technology? In addition, are there new contractual arrangements or clauses in technology transfer agreements which could have an impact on competition and which are not explicitly dealt with in the Block Exemption Regulation and/or the Guidelines? Please provide reasons for your response.

The scope of the block exemption should be broadened to make it generally applicable to intellectual property licensing (including licensing of books and other copyright works, trade mark licensing, etc). Technical restrictions on the application of the block exemption should therefore be removed, such as the requirement that the licensee must manufacture the licensed products.

The current regulation only covers bilateral agreements, thereby excluding licensing agreements to set up technology/patent pools. Although some guidance for technology/patent pools is provided in the accompanying guidelines, a limited exemption in the regulation for certain benign categories of technology/patent pools would provide a greater degree of certainty. Although an assessment of technology/patent pools would not necessarily fit into the current structure of the regulation, dependent as it is on market share thresholds, there is no reason that a limited “safe harbour” could not be provided in a new regulation with separate criteria for block exemption.

8. Have you been involved in litigation and/or competition investigations concerning the Block Exemption Regulation and/or the Guidelines? Or are you aware of national cases and/or arbitration awards that could be relevant for the Commission’s review. Please specify.

Some of our members are large, multi-national firms. It is possible that individual lawyers in some member firms may have been involved in litigation and/or competition investigations where the regulation or guidelines were at issue. However, the principal authors of these replies are not aware of any such involvement.

9. Do you consider that there is a need to keep a Block Exemption Regulation in this field or would it be enough to merely give guidance (including relevant safe-harbours) in the Guidelines?

The regulation should be maintained so as to provide legal certainty to undertakings that wish to come within a “safe harbour” for their technology transfer agreements. No set of guidelines (with all of their caveats and qualifications) can provide sufficient legal certainty.
10. **Do you have any particular comments on the list of hardcore restrictions in Article 4 and/or the list of excluded restrictions in Article 5 of the Block Exemption Regulation?** In particular, should the lists include also other type of restrictions or should, on the contrary, certain restrictions be removed from them? We would welcome comments as to whether you consider the balance right as regards the Commission's policy toward territorial restrictions, field of use restrictions and possibilities of exclusive and non-exclusive grant-backs.

Any new regulation should be more liberal than the current regulation. In particular:

(i) **Allocating markets and customers.** The Commission’s broad statement treating “the allocation of markets or customers” as a hardcore restriction (both in the regulation and in other Commission materials, eg the Notice on Agreements of Minor Importance) is misleading. There is nothing inherently anti-competitive about granting rights to commercialise IP in respect of different technical fields, territories, markets or customers. Each method is just another way of ensuring efficient exploitation, and is entirely normal and uncontroversial at a commercial level. Such dividing-up is a key feature of the exercise of IP rights. As the Commission recognises that licensing in different fields and territories is acceptable, it should make clear that licensing in different markets or with different customers is also often acceptable – as is already partially accepted in the exceptions to Articles 4(1)(c) and 4(2)(b). It should make no difference to the competition law analysis whether the licensee is granted rights in a technical field (eg use of aspirin for blood thinning rather than for headaches) or for a particular customer set (eg private hospitals rather than public hospitals or family doctors).

One of the most difficult features of the regulation for businesses is the long list of exceptions to the prohibition on allocating markets or customers under Article 4(1)(c), and the similar list in Article 4(2)(b). These are, in effect, double-negatives – exceptions to prohibitions, which by implication are acceptable. It would improve the clarity of the document, and the underlying legal position, and simplify the analysis of the safe harbour, if Article 4(1)(c) were deleted in its entirety, or the categories of prohibited clause were narrowed to some specific types of allocation of markets or customers. The hardcore restrictions could be simplified by including positive statements as to what would not (normally) give rise to competition concerns.

Similarly, we suggest that the Commission should consider extending any such clarification of "allocation of markets or customers" in the case of IP licensing, to Article 11 of the Notice on Agreements of Minor Importance.

(ii) **Calculating royalties by reference to the net sales price of combination products.** There are many situations in which a licensed product is used in combination with other products or services that are supplied by the licensee or the licensed product is incorporated into a larger product. It may be commercially sensible and convenient to base royalties on the sale price of the other products. Usually there is no anti-competitive intent behind such an arrangement, but it is an issue on which the parties’ legal advisers may have to think carefully about the competition law implications, not least because of the comment in paragraph 81 of the guidelines that: “The hardcore restriction contained in Article 4(1)(a) also covers agreements whereby royalties are calculated on the basis of all product sales irrespective of whether the licensed technology is being used.” The Commission should therefore explicitly recognise that royalties on combination products are not in themselves anti-competitive. We understand that the
underlying concern in paragraph 81 is that royalties are charged when the product does not even contain or rely upon the licensed technology (as in the Microsoft/Novell case), thereby dis-incentivising the use of alternative products. On this point, see our comments on non-compete provisions generally at paragraph (iv) below. In the absence of dominance it is unclear that such provisions should be regarded as hardcore, and much less indirect restrictions of the type referred to in paragraph 81 of the guidelines.

We understand that no significant concern arises simply from the fact that royalties are calculated on the basis of all product sales if that is the most convenient way of assessing royalties for complex products (as is reflected in the second half of paragraph 81). The difficulty is with the balance of the paragraph which appears to place an onerous burden on the parties to show that the royalty arrangements they have selected are pro-competitive and certainly gives the impression that such arrangements are both unusual and problematic. As the concern about the licensee paying royalties on products where only his own technology is used is repeated (more clearly) in paragraph 95 of the guidelines, the rather misleading comment in paragraph 81 could be removed and replaced with a more positive statement that calculating royalties by reference to the net sales price of combination products is not in itself a hardcore restriction (even when entered into between competitors). Notably, although the equivalent language of Article 4(2)(a) is very similar, the guidelines do not express the same concern. It would be better not to squeeze this concern in the hardcore list by cross referring to Article 4(1)(a) at all, but to deal with it more explicitly in the guidelines (as in paragraph 95).

Take the example of a small company that designs semiconductor devices. The company licenses its designs to semiconductor manufacturers. Initially calculation of the royalties is very straightforward: they are simply calculated on the net sales price of each interface chip sold by the manufacturer. However, to reduce costs and power consumption and save space, the trend in the semiconductor sector is to combine the functionality of previously separate chips onto a single chip. As a consequence it becomes necessary to calculate the royalties by reference to the net sales price of the combination chip. The royalty rate is reduced to take account of the fact that the combination chip contains units that are not licensed by the licensor, but it is still necessary to calculate the royalties by reference to the net sales price of the combination chip.

In this case, the parties should be able to take comfort from an explicit recognition in the regulation and guidelines that the setting of the royalty rate by reference to the net sales price of the combination product is not anti-competitive and this should apply whether or not they are competitors.

(iii) Excluded restrictions. We note that certain restrictions (eg on assignment back) were moved to the list of excluded restrictions in Article 5, whereas in the previous (1996) regulation they had been black-listed in Article 3. In our view the Commission should take this one stage further by removing the list of excluded restrictions altogether (or further limiting it) and recognising that these restrictions do not generally cause competition problems: where they do, the withdrawal mechanism provides a safeguard.

Take the example of a patent licence agreement in respect of a pharmaceutical drug, where the licensor is a small biotech company and the licensee is a large pharmaceutical company. If the licence is terminated due to the licensee’s non-
performance, the licensor wants to take back both the originally licensed IP and any new developments or improvements of that IP, even if those improvements are severable. This is pro-competitive, as it enables a motivated licensor to find a new licensee without losing several years of developments made by the original licensee, and the original licensee is almost certainly no longer interested in developing the improvements.

We suspect that the Commission’s original suspicion of grant-back clauses may have been based partly on an older model of large licensors licensing small licensees, whereas in our experience in many sectors most licensees are larger than licensors and perfectly capable of looking after their own interests at a commercial level.

See also comments in paragraph 12 below.

(iv) Developing competing products. The guidelines and regulation should state that it is permissible for a licensor to require an exclusive licensee not to commercialise products that compete with the licensed products.

It is clear from the guidelines and the current regulation that the Commission is more concerned about licensing between competitors than between non-competitors. However, the current approach of the Commission does not support the licensor who wishes to ensure that his licensee will not become a competitor (because this will increase the risk that the licensed product is not effectively commercialised). At the very least, Article 5(2) should explicitly provide, in the same way as Article 5(1)(c), that its provisions are without prejudice to the possibility of providing for the termination of the technology transfer agreement in the event that the licensee begins to commercialise a competing product or technology (whether its own or that of a third party). We suggest that this should apply whether the parties are competitors or non-competitors. If a prospective licensee has more faith in his own technology than the technology he has licensed in, then he should devote his resources to developing that technology, and the licensor should be free to seek wholehearted commercial support for his technology from someone else.

For example, consider a patent licence in respect of a new pharmaceutical drug for the treatment of a particular type of cancer. No licensor is going to want to license a pharmaceutical company that is marketing a rival drug, as there is a serious risk that the licensed product will not be commercialised effectively or will be put “on the shelf” by the licensee if he generates more profit from the other product. At a commercial level a restriction on competing is entirely sensible for a licensor who wants to ensure that the licensed technology is commercialised, and this should be viewed as pro-competitive. However, there is a business risk that it would be prohibited under Article 101, as the Commission generally regards restrictions on competition as unacceptable. This is indicated, for example, in Article 5(2) of the current regulation, which excludes from the block exemption a restriction on a licensee developing its own, competing products. In our view, Article 5(2) should not exclude restrictions on a licensee competing, and the guidelines should mention the potentially pro-competitive benefits of such a restriction. Generally, the guidelines should not raise doubts about the legality of contract terms that are aligned with the conventional, commercial expectations of business people. In our view, a restriction on a licensee commercialising competing products falls into this category.
A further example is as follows: a small biotech company grants an exclusive licence to a large pharmaceutical company to develop and sell a new treatment for indication A. The large pharmaceutical company later acquires another company with a set of development programmes that include development of an alternative treatment for indication A. There is a risk that the large pharmaceutical company may put development of one of the two new treatments on a back burner as a fall back, in case development of the other treatment is not successful. To prevent this, the guidelines and regulation should allow the small biotech company to include a provision in the licence agreement whereby the biotech company can in effect force the pharmaceutical company to choose between the two programmes. If it chooses to proceed with the development programme from the acquired company, the biotech company should be able to terminate the pharmaceutical company’s licence and require it to give (or sell) the results of the original development programme to the biotech company, in order that the biotech company can readily find another licensee and not lose time repeating the development work already carried out by the pharmaceutical company. The result of such a provision should be pro-competitive as it may help to ensure that development of a potentially important treatment is not sidelined and is more likely to be commercialised: this would therefore result in greater consumer choice.

As noted above, it would also help if the Commission were to make explicit whether there is an obligation to exploit effectively the technology which is the subject of the licence in order for the exemption to apply. Non-exploitation is currently dealt with only as a possible basis for the withdrawal of the exemption in Article 6(1)(c).

See also comments in paragraph 12 below.

11. Have you encountered practical difficulties in calculating the relevant market shares for the purpose of applying the Block Exemption Regulation (c.f. Article 3(3))? If so, how could this situation be improved?

A number of practical difficulties arise in relation to the calculation of relevant market shares for the purpose of the block exemption. First, it is extremely difficult to calculate market shares with certainty in technology markets, in particular in relation to new/emerging technologies. Second, there can be considerable difficulty in determining whether parties are ‘competing undertakings’ in the relevant technology market. Third, market shares have little relevance in certain high technology sectors, where high market shares can be reached quickly, but also lost quickly on the emergence of newer technologies. Fourth, the assessment of market shares throughout the lifetime of an agreement makes legal certainty difficult; it is especially problematic in sectors where long-term licensing is common and where there may be a long period before products are commercialised. These issues would be compounded if the Commission and national competition authorities followed their increasing tendency to find very narrow product markets in the context of Article 102. These issues render the block exemption worthless in many cases.

The situation could be improved by removing the concept of technology markets from the application of the exemption and focussing on product markets for this purpose. Alternatively, if this is not acceptable to the Commission and in view of the difficulties of determining market shares in technology markets, we suggest that in relation to such markets the Commission should consider a significant increase to the maximum percentages under Article 3 of the current regulation. If this alternative approach is
adopted, we also suggest that the maximum percentages under Article 7 of the Notice on Agreements of Minor Importance should be raised significantly for technology markets.

The Commission could also improve the position by approaching technology markets in a similar fashion to innovation markets. In such cases, the guidelines state at paragraph 25 that “it can be analysed whether after the agreement there will be a sufficient number of competing research and development poles left for effective competition in innovation to be maintained”. If a similar approach to technology markets were adopted this may enable parties to gain some comfort where technology market shares are very difficult to come by – if it can be established that there are four alternative technologies available for licensing that might be regarded as sufficient?

12. The Commission has recently commissioned a study on competition law and patent law, available at the webpage of this consultation: http://ec.europa.eu/competition/consultations/2012_technology_transfer/index_en.html. Do you have any comments on this study? We would particularly welcome comments on the specific issues of cross-licensing, patent pools and grant-backs respectively, which are addressed in the study.

In large part the study appeared not to focus on issues particularly relevant to the actual scope of the regulation. However, we disagree with the study’s rather theoretical analysis of grant-back provisions, specifically its consideration of the “but for...” defence of such clauses. By the authors’ own admission, there is a “dearth of literature on the topic”; the economic analysis undertaken in the study has no regard as to how commercial decisions on whether to enter into a technology transfer licence are made. The ability of a licensor to include grant-back provisions is, in our experience, vital to encouraging and ensuring that pro-competitive licensing arrangements are entered into. We agree that the distinction between non-severable and severable improvements needs to be reconsidered, but we draw the opposite conclusion to the study: grant back provisions in relation to severable improvements should be treated at least as favourably as non-severable improvements. As explained above, the Commission should therefore remove the excluded restrictions at Articles 5(1)(a) and (b).

We also do not agree with the study insofar as it suggests that cross-licensing only increases consumer welfare when the inputs that are cross-licensed are essential to the production of a good. Consumer welfare can still be increased when the inputs are complementary but not essential – the study has no regard to the common commercial reasons behind most cross-licensing arrangements: the need for certainty where it is unclear whether or not an input is essential; and the need to avoid potential costly litigation at a future date. The study also does not point to any evidence that cross-licensing can facilitate collusion and affect incentives to innovate.

13. Any other observations or suggestions for improvement of competition policy in this area?

As mentioned earlier, in our view there should be greater recognition that most exclusive technology transfer agreements are pro-competitive or benign, and should be treated as acceptable under Article 101(1). If this is not acceptable to the Commission, there should be an assumption that technology transfer agreements are prima facie acceptable under Article 101(3) unless they are shown to have seriously anti-competitive effects. Wherever possible, the Commission should introduce simple
rules that a non-economist can apply. We suggest that these desirable objectives would be supported by taking the following measures:

(i) reducing and simplifying the list of hardcore clauses, as described above;

(ii) reducing or removing the list of excluded restrictions in Article 5 of the regulation, as described above;

(iii) liberalising the market share provisions, as described above;

(iv) recognising and making explicit that effective dissemination of licensed technology is a core requirement of any technology transfer agreement;

(v) including more commentary in the guidelines about the potentially pro-competitive benefits of provisions in licence agreements that are designed to ensure that the licensed technology is commercialised, including non-compete obligations on the licensee; and

(vi) stating in the guidelines that the Commission would not expect to bring proceedings against parties to a licence agreement for breach of Article 101 in the absence of hardcore restrictions, market dominance, or other stated factors. This would provide comfort in relation to such proceedings, would be of assistance to national courts in dealing with disputes about such agreements and would also provide a context for business people when considering whether it is necessary to invest in an (expensive) Article 101 analysis in relation to the terms of a routine licence agreement.

Intellectual Property Lawyers’ Association

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