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COMMISSION STAFF WORKING DOCUMENT

EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Accompanying the document

COMMISSION REGULATION

on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of technology transfer agreements

and

COMMUNICATION FROM THE COMMISSION

Guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to technology transfer agreements

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1. BACKGROUND

1.1. Context

The EU aims to achieve a more competitive, connected, greener, knowledge based and inclusive society. In particular, innovation and competitiveness are fundamental to the Commission's Europe 2020 strategy.[1] Innovation often results in greater prosperity and a more efficient use of scarce resources, with knowledge as the key input. Efficiency enhancing technology transfer agreements between competitors or non-competitors can further promote innovation and competitiveness in Europe.

Guidance for the assessment of technology transfer agreements under the EU competition rules is currently given by two instruments, namely the Commission Regulation (EC) No 772/2004 of 27 April 2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements ("TTBER") and the accompanying Guidelines on the application of Article 81 of the EC Treaty to Technology Transfer agreements ("Guidelines"). The TTBER creates a safe harbour (in other words it gives an automatic exemption from competition law) for certain categories of technology transfer agreements whereas the Guidelines provide guidance both on the application of the TTBER and on the application of Article 101 to agreements that cannot benefit from the safe harbour in the TTBER (for example because they exceed the market share thresholds).

1.2. Technology transfer agreements and substantive competition rules

Technology transfer agreements are agreements entered into between two parties, by which one party (licensor) authorises another (licensee) to use its technology for the production of goods and services. In general, a simple transfer by way of sale is not covered by the TTBER. Rather, the term "technology transfer agreement" refers to an agreement which licenses the use of patents, know-how, software copyrights or other types of intellectual property rights covered by TTBER for the purposes of producing goods or services.

[1] http://ec.europa.eu/eu2020/pdf/COMPLET%20EN%20BARROSO%20%20%20007%20-%20Europe%202020%20-%20EN%20version.pdf

Most licensing agreements do not restrict competitition. On the contrary, technology transfer agreements will often have positive effects, as they will give rise to substantial efficiencies by strengthening the incentives to innovate, reduce duplication of research and development ("R&D") and promote innovation by allowing innovators to earn returns to cover their R&D costs, lead to dissemination of technology, lower production costs, result in improved products, facilitate diffusion of innovation and generate product market competition. Licensing agreements are also capable of removing obstacles to the development and exploitation of the licensee's own technology, creating design freedom and removing the risk of infringement claims by the licensor. The efficiencies often stem from the combination of the complementary assets and technologies of the licensor and licensee.

On the other hand, as recognized by the agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS agreement")[2], licensing agreements can also result in negative effects on competition on the market. Technology transfer agreements might facilitate collusion, foreclose competitors from the market by raising barriers to entry, e.g. by restricting their access to essential inputs or raising their costs, or reduce inter- or intra-technology competition between companies thereby creating obstacles to market integration and harming consumers by leading to higher prices, lower output, less product variety, lower product quality or less innovation.

However, even those licensing agreements that restrict competition may give rise to pro-competitive efficiencies, and therefore be exempted under Article 101(3) TFEU, provided that they create objective economic benefits for consumers and that their pro-competitive effects outweigh the restrictive effects that the agreements have on competition.

The TTBER block exempts those licensing agreements that fulfil the conditions set out in it. The block exemption applies to certain categories of technology transfer agreements on the presumption that such agreements, to the extent they are caught by Article 101(1) TFEU, fulfil the conditions laid down in Article 101(3) TFEU.

The TTBER applies to a wide range of agreements: it covers both agreements entered into by actual or potential competitors and agreements between non-competitors. The TTBER applies different exemption criteria based on whether the parties to the agreement are competitors or non-competitors. The TTBER block exempts technology licensing agreements i) between competitors which do not possess a combined market share in excess of 20 % and non-competitors where the market share of each of the parties does not exceed 30 % on the affected relevant technology and product markets and ii) where the agreements do not include so-called "hardcore" restrictions of competition such as price-fixing, the limitation of output or the allocation of markets or customers.

An individual assessment is required in order to evaluate the licensing agreements concluded by companies whose market shares fall outside the safe harbour created by the above mentioned market share thresholds. The Guidelines provide guidance in making this assessment.

2. ISSUES TO BE ADDRESSED: – THE "WHY"

The goal of this revision is to verify that the Commission's competition policy as regards technology transfer agreements still reflects the right balance between providing effective incentives for competitors and non-competitors to enter into technology transfer agreements

[2] Article 40 TRIPS.

while ensuring that the technology transfer agreements contribute to economic welfare without, at the same time, distorting competition.

While both the current TTBER and the Guidelines are perceived by stakeholders to have been working well in practice, some issues have surfaced which require minor revision of the rules. These issues pertain to **exclusive grant-backs** and **termination clauses** and concern the question whether they should continue to be covered by the safe harbour of the TTBER as well as the question how to foster the creation of pro-competitive **patent pools**.

3. OBJECTIVES – THE "WHAT"

3.1. General objectives of the review

One of the overarching goals of the revision is to contribute to the Commission's Europe 2020 strategy. Technology transfer agreements play a significant role in fostering further innovation and competitiveness. The Commission aims to leave companies maximum flexibility when entering into technology licensing agreements in order to increase the competitiveness of the European economy while at the same time ensuring effective competition for the benefit of European businesses and consumers. The technology transfer regime aims at providing guidance to companies as to what business actions they can undertake without a risk of infringing competition law. Finally, the TTBER and the Guidelines also aim to further simplify administrative supervision by providing a technology transfer agreements' assessment framework for the Commission, NCAs of the Member States and national courts.

3.2. Specific objectives of the review

The specific objective of the review of the treatment of exclusive grant-backs is to incorporate recent industrial economic arguments concerning the potential effects of exclusive grant-back obligations and to reassess the reasons for and practical difficulties with the current difference in the EU competition policy approach towards such obligations for severable and non-severable improvements of the licensed technology.

The specific objective of the review of the treatment of termination clauses is to ensure that on the one hand invalid IPR is not unduly protected by contractual arrangements and does not remain a barrier to innovation and on the other hand that a stricter approach might lead to less pro-competitive licensing and/or less incentive to innovate.

The specific objective as regards patent pools is to foster the establishment of pro-competitive patent pools as an effective market-driven instrument to mitigate the risks of lessened competition due to the increasing number of patent thickets.

4. POLICY OPTIONS – THE "HOW"

The **baseline scenario** is the continuation of the current policy without any change, i.e. without any new or additional EU intervention.

4.1.1. Options concerning exclusive grant-backs

– Status quo i.e. to keep exclusive grant-backs of non-severable improvements in the safe harbour (the baseline scenario) (Option 1);

– All exclusive grant-backs to be treated as excluded restrictions (Option 2);

– Consider exclusive grant-backs as hardcore restrictions (Option 3).

4.1.2. Options concerning termination clauses

– Status quo, i.e. termination clauses benefit from the safe harbour of the TTBER (the baseline scenario) (Option 1);

– Termination clauses will be considered as an excluded restriction (Option 2);

– Only termination clauses in non-exclusive agreements to be considered as an excluded restriction (Option 3);

– Consider termination clauses (and non-challenge clauses) as hardcore restrictions (Option 4).

4.1.3. Options concerning patent pools

– Keeping the current text of the Guidelines (the baseline scenario) (Option 1);

– Bringing patent pools under the safe harbour of the TTBER (Option 2);

– Introducing soft law safe harbour in Guidelines (Option 3).

5. IMPACT ASSESSMENT OF THE POLICY OPTIONS

5.1. Exclusive grant-backs

5.1.1. Economic impact

Obliging stakeholders to assess whether a certain improvement is severable or non-severable, Option 1, risks creating extra compliance costs and uncertainty while this would not seem to be justified by sufficient reasons to differentiate the treatment of such grant-backs.

Option 2 and Option 3 take away the direct need to make this distinction between severable and non-severable improvements. As regards in particular SMEs the fact of not having to distinguish between severable and non-severable improvements could be an advantage in itself.

Option 3 gives the clearest message and may thus further reduce compliance costs. However, in view of the serious consequences of including a hardcore restriction in an agreement, it will also force firms to scrutinise current agreements and temporarily increase compliance costs.

Grant-back clauses can be expected, in general, to reduce the incentive of licensees to innovate. Exclusivity strengthens the negative effects as the licensee loses the possibility to use its own improvements and to license it to third parties. A reduction in the incentives to innovate will also lead to a negative effect on competition and, in the long run, to a reduction in consumer choice and therefore also to a direct negative impact on consumers. However, in certain scenarios where the licensor might not be willing to license out or only license out against higher royalties without an (exclusive) grant-back, such a clause could lead to positive effects. In addition grant-backs can allow the licensor to ensure that there is a one stop shop for all its licensees and future improvements. Option 1 provides a safe harbour for certain exclusive grant-back clauses while these clauses can be expected in general to lower the incentive of the licensee(s) to innovate and will have countervailing efficiency benefits only

in certain circumstances. Option 3 could lead to companies not including exclusive grant-backs even in scenarios where this would be beneficial for the European consumer. Option 2 is most likely to have the best impact on competition and consumers.

5.1.2. Innovation and research

Option 1 provides a safe harbour for certain exclusive grant-back clauses while these clauses can be expected in general to lower the incentive of the licensee(s) to innovate and will have countervailing efficiency benefits only in certain circumstances.

Option 2, by allowing an individual assessment of the possible negative and positive effects, is most likely to have the better impact on innovation as compared to Option 1, while allowing for taking into account the incentives for original and follow-on innovation.

Option 3 might only have a limited positive effect on innovation because of its negative effect on the incentives to license and therewith both on the incentives for the original innovation and follow-on innovation.

5.1.3. Legal certainty / Flexibility

Option 1 reduces the flexibility for authorities and courts to apply Article 101 in cases where exclusive grant-backs would prove to have negative effects.

Option 2 combines a reasonable measure of legal certainty, by treating all exclusive clauses in the same way under the TTBER, with a high degree of flexibility to take account of the effects in a particular case.

Option 3 creates more legal certainty for firms, but does so at the cost of reducing their commercial freedom. In addition, it will also reduce the flexibility of competition authorities and courts.

5.2. Termination clauses

5.2.1. Economic impact

In Option 2 and 3 the parties' incentive to revisit past agreements (thus creating compliance costs) would be limited compared to the baseline scenario since the rest of the agreement would still benefit from the safe harbour of the TTBER. In addition, in Option 3 only termination clauses in non-exclusive licence agreement would have to be reviewed.

Compared to the baseline scenario (Option 1), the temporary increase in compliance cost would be significant in Option 4 where the effect of including a termination clause would lead to the removal of the whole technology transfer agreement from the safe harbour of the TTBER. For future licence agreements Option 4 would, however, rather lower compliance costs, since the qualification as hardcore restriction would send a clear signal not to incorporate such clause in agreements.

Since licensees that have made substantial investments in a licensed technology may hesitate to challenge the validity of the licensed IPR if the sanction would be termination of the agreement, termination clauses can have the same negative effect as a non-challenge clause. Option 4 would thus contribute further to challenge weak or invalid IPR removing barriers to follow-on innovation. However, it does not take into account that a termination clause does

not always have a comparable effect to a non-challenge clause and that there may be specific situations where a termination clause may be necessary to protect the incentives of the licensor to innovate and license-out, e.g. where a small innovator is exclusively licensing its innovation to a large licensee and, absent a termination possibility for the licensor, the licensee may, after obtaining the licence, threaten to challenge the IPR with the sole intention to renegotiate the royalties or otherwise undermine the position of the innovator. Such an innovator firm may be particularly vulnerable in an exclusive licence relationship as it cannot switch to another licensee or produce itself without a prior termination of the agreement. Not allowing for termination clauses in these scenarios could risk giving a disincentive for innovation which in the long run could lead to less competition.

Implementing Option 2 and Option 3 would, in most relevant cases, remove the negative effect on challenging IPRs. That Option 3 would not remove the negative effect for exclusive licence agreements seems to be justified as in most cases a licensee who has an exclusive licence will anyhow have a very limited incentive to eliminate the licenced IPR. On the other hand, the companies which do not have access to this exclusively licensed-out IPR have a strong incentive to challenge the IPR if they consider it valuable and potentially invalid.

Option 2 allows for a case by case assessment. However, since it will not always be easy to assess if such a clause is necessary to protect the licensor's incentives, this creates uncertainty that in very specific situations might lead to a disincentive to licence.

Option 3 allows keeping the safe harbour for termination clauses in an exclusive licence agreement scenario. It is thus more targeted and gives a positive message to the use of termination clauses in the scenario where the licensor is dependent on one licensee.

5.2.2. Innovation and research

Option 2, 3 and 4 could increase the incentive to apply for patents on substantial innovations as they are less likely to be successfully challenged. Patents on substantial innovations would thus become more valuable than patents on non-substantial improvements.

Compared with the baseline scenario, Option 2 and Option 3 contribute to removing barriers to follow-on innovation by facilitating the removal of invalid IPR. The removal of invalid IPR would reduce costs for innovation in the respective areas.

Option 3 would, in addition, cater for the fact that in an exclusive licensing relationship, the licensor is more dependent on the licensee. In particular for SME's, a termination clause might be necessary to balance the economic need of a licensee of an exclusive licensing relationship while safeguarding the licensor's interest in getting a fair value for its research.

Option 4 could also have a negative impact as it does not allow for termination clauses even in the specific circumstances where the innovator might need such a clause to protect itself against efforts from the licensee to only renegotiate the royalty level or where such a clause is necessary to reach a genuine settlement.

5.2.3. Legal certainty / Flexibility

Option 1 could be seen to provide a too wide general blessing of termination clauses, even when the agreement falls outside the safe harbour provided by the TTBER. Stakeholders could be led into the perception that these clauses never cause competition concerns.

Option 2 and 3 remove this uncertainty as non-challenge clauses and termination clauses would both be treated as excluded restrictions. They would also leave enough flexibility for a

more lenient treatment of those cases where the termination clause does not have the same effect as a non-challenge clause or creates efficiencies.

Option 4 would increase legal certainty, however, would also remove most of the flexibility.

5.3. Patent pools

5.3.1. Economic impact

Compared to the baseline scenario, Option 2 and Option 3 have positive effects on competition and consumers by giving a stronger incentive to the creation of pro-competitive patent pools by giving certain guidance and legal security on their creation.

Option 1 implies relatively high compliance costs for companies by making it necessary for them to enter into a comparatively complicated self-assessment of whether the pool would risk infringing competition law or not. The self-assessment would be significantly easier and less costly in many cases in Option 2 and Option 3.

As the current enabling regulation (Regulation 19/65) only delegates the power to deal with bilateral agreements, Option 2 would require amending the enabling regulation and involving the Parliament and Council and therefore have a long lead-time.

Considering that many patent pools today already contain many of the features set out in the proposed safe harbour and the elements of the safe harbour (see section 4.1 above) are based on the classical criteria developed by antitrust regulators both in Europe and in other parts of the world, for example the US., Option 3 would not oblige these patent pools to any significant changes in their set-up and therefore not lead to significant compliance costs.

5.3.2. Innovation and research

By not providing for an easy "check-list approach" and by not giving a clear safe harbour for patent pools, it would seem that Option 1 gives less incentives for the creation of pro-competitive patent pools and therefore less follow-on innovation than Options 2 and 3. It seems likely that the positive effects between Option 2 and Option 3 would be largely the same, but possibly higher for Option 3 as it gives more flexibility.

5.3.3. Legal certainty / Flexibility

Option 1 provides for a certain degree of legal certainty, by giving guidance on the factors which would be important for assessing whether a certain patent pool arrangement is in compliance with competition law. However, the individual assessment of arrangements setting up a pool remains complex. In addition, since the licensing out from the pool may easily fall outside the TTBER, these licenses may also have to be assessed individually, which adds to the complexity of assessing pool arrangements.

Extending the safe harbour of the TTBER to cover also patent-pools under Option 2 could for a limited number of pool arrangements provide more legal certainty and would also be binding on national courts.

On the other hand, an assessment under the Guidelines (Option 3) could provide for the necessary structured flexibility.

5.4. Summary of the overall conclusions

Concerning **exclusive grant-backs**, Option 2 would seem to be, on balance, the preferable option. Option 2 leads to the most positive effects on competition and consumers while at the same time reducing legal uncertainty and compliance costs.

Regarding **termination clauses**, by keeping the safe harbour for termination clauses in an exclusive licence agreement scenario where the licensor is likely to be dependent on one licensee while removing the possible negative effect of termination clauses where relevant, Option 3 would seem to be the option with the most positive impact.

Regarding **patent pools**, in light of the assessed impacts, Option 3 is the preferred policy option, in particular as it gives a stronger incentive to the creation of pro-competitive patent pools.

6. MONITORING AND EVALUATION

The Commission will continue to monitor the operation of the TTBER and the Guidelines based on market information from the stakeholders and the Member States. This will provide the Commission with opportunities to receive feedback from, amongst others, industry representatives, consumer associations, law firms and economic consultants. The proposed TTBER will expire 12 years after its entry into force. However, as with all its competition law instruments, the Commission will amend or repeal the TTBER before its expiry should it no longer respond to the market conditions in the EU or lead to block exempting anticompetitive practices with no significant efficiencies.