NEW RULES ON TECHNOLOGY LICENSING

Dr. Bernd Allekotte

On April 7, 2004, the European Commission adopted a new Technology Transfer Block Exemption Regulation ("TTBE")[1]. The new TTBE replaces the TTBE of 1996[2] ("TTBE 1996") and brings with it important changes to the technology licensing rules. It is part of a fundamental reform of the enforcement rules for antitrust which came into force on May 1, 2004. Entities licensing technology need to be aware of the TTBE. Not only should they note the changes when negotiating new licenses. Rather, entities need to review their licensing Agreements taking effect before May 1, 2004, as they will fall under the TTBE as of April 1, 2006.

Background

According to Art. 81 (1) of the EC Treaty, agreements that prevent, restrict or distort competition are prohibited. Agreements violating Art. 81 (1) are void and the parties to such agreements may face severe fines. Art. 81 (3) of the EC Treaty contains an exception in that agreements that meet certain criteria may fall outside the scope of Art. 81 (1).

The European Union has passed several so-called *block exemption regulations* (like the TTBE). If the criteria of these block exemptions are met, the agreements are considered not to violate Art. 81 (1) (i.e., they are block exempted).

Also, agreements between parties that only have a relatively *low market share* may be exempted under the De-Minimis-Notice of the Commission[3].

So far, the Commission has also granted *individual exemptions* to agreements that would not meet the requirements of a block exemption regulation if, nevertheless, they met the criteria of Art. 81 (1) of the EC Treaty. As per May 1, 2004, however, the Commission will no longer grant such individual exemptions. Rather, the parties themselves have to assess whether they Agreement meets the criteria of Art. 81 (3).

TTBE and Guidelines – An Overview

Compared to the TTBE 1996, the TTBE brings about important changes. In particular,

- the TTBE introduces a *market share test*;
- distinguishes between *competitors* and *non-competitors*;
- also covers licenses of copyright in *software* and of *design rights*
- does not contain any "*white classes*" (that are, in any case, permitted)

The Commission also enacted Guidelines as regards application of Art. 81 (1) of the EC Treaty to Technology Transfer Agreements ("Guidelines")[4]. The Guidelines,

[1] OJ L 123, 27.04.2004, pages 11-17
[2] Commission Regulation (EC) 240/96 of January 31, 1996, on the application of Article 81 (3) of the Treaty to certain categories of technology transfer agreements, OJ L 31, 09.02.1996, p. 2
[3] OJ C 368, 22.12.2001, page 13
[4] OJ C 101, 27.04.2004, pages 2 - 42

although not binding for the Courts, lay down the view of the Commission as regards, in particular

- *interpretation* of the TTBE;
- antitrust concerns as regards certain clauses contained in agreements that do not fall under the TTBE because the *market thresholds are exceeded*;
- *technology pools.*

Technology Transfer Agreements

The TTBE applies to technology license agreements entered into between *two undertakings* for the manufacture or provision of goods/services that are manufactured or provided with the *licensed technology*. As opposed to the TTBE 1996, it does not only cover patents and know how, but also extends to the licensing of designs and software copyright.

The TTBE does not deal with setting up patent pooling arrangements, yet such agreements are dealt with in the Guidelines which provide the parties to such an agreement with an idea on how the Commission evaluates them.

Safe Harbour established by Market Share Thresholds

In comparison to the TTBE 1996, one of the most crucial changes brought about in the TTBE is the introduction of a market share test. Depending on whether the agreements are entered into between competitors or non-competitors, a certain market share may not be exceeded to qualify for automatic exemption under the TTBE:

- Agreements between competitors which have a combined market share not exceeding 20 % of the relevant technology and product markets, and
- Agreements between non-competitors, none of whose (individual) market share exceeds 30 %

qualify for automatic exemption under the TTBE.

The *definition of the relevant market*, be it product market or technology market, will play a major role in the future because it is only when the market thresholds defined in the TTBE are not exceeded that an agreement qualifies for automatic exemption.

The Commission's approach to defining the relevant *product market* is laid down in its Market Definition Guidelines[5]. Product markets comprise products and services incorporating the licensed technology as well as their substitutes. *Technology markets*, on the other hand, consist of the licensed technology and its substitutes (i.e., other technologies which customers could use as substitutes).

Once relevant markets have been defined, the *market shares* of the parties to the agreement need to be determined. The applicable thresholds depend on whether the agreement is concluded between competitors or between non-competitors. For the purposes of the TTBE, parties are considered competitors on the relevant technology market if they license competing technologies to third parties. Parties are competitors on the relevant product market where both are active on the market on which the products incorporating the licensed technology are sold (actual competitors). They are also considered competitors if they undertook additional investments to enter the

[5] Commission Notice on the definition of the relevant market for the purposes of Community Competition Law, OJ 1997 C 372, page 1

relevant market in response to a small and permanent increase in relative prices (potential competitors).

As regards technology markets, the licensor's market share is calculated on the basis of *all sales* by the *licensor and its licensees* of products incorporating the licensor's technology. In case the parties are competitors on the technology market, the sales of products incorporating the *licensee's* technology must be added to the sales of the products incorporating the licensor's technology.

As regards product markets, the licensee's market share is to be calculated on the basis of its *sales* of products incorporating the *licensed technology* as well as *competing (i.e., substitute) products*. Where the licensor is also a supplier of products on the relevant market, the licensor's sales on the product market also need to be taken into account.

The market shares must be calculated on the basis of market sales value data for the *preceding* calendar year. Where such data are not available, *estimates* based on other reliable market information might be used though.

If the parties initially fall under the market share thresholds but exceed them later, they benefit from the exemption for another two calendar years.

It is pretty safe to assume that the market share test will cause difficulties when applied by the parties to a technology licensing agreement. Often, no reliable data will be available, and in some instances it may not even be an option to estimate the market shares. Further, the definition of the relevant markets will cause difficulties as it is rather often arguable how the relevant market(s) need(s) to be defined. In particular, SMEs that operate in niche markets may be hit as they will often have rather high market shares, without having the means to seriously limit competition. In any case, parties to a technology licensing agreement may need to spend considerable amounts in an effort to assess their position in the market.

Hardcore Restrictions

Assuming that the parties do not exceed the market share thresholds, they must avoid agreeing on any of the TTBE's hardcore restrictions as defined in Art. 4. Imposing any of the hardcore restrictions will *invalidate* the *whole agreement*. As is true for the definition of the relevant market share threshold, the hardcore restrictions differentiate between competitors and non-competitors.

As regards agreements between *competitors*, the following provisions are banned (cf. Art. 4 (1) TTBE):

- Restriction on prices.
- Limitations of output (other than a limitation on output imposed on the licensee in a non-reciprocal agreement or one of the licensees in a reciprocal agreement).
- Allocation of markets or customers other than the following provisions:
    - obligation on the licensee(s) to produce with the licensed technology only within one or more technical fields of use or one or more product markets;
    - obligation on the licensor and/or the licensee (in a non-reciprocal agreement) not to produce with the licensed technology within one or more technical fields of use or one

or more product markets or one or more exclusive territories reserved for the other party;

- obligation on the licensor not to license the technology to another licensee in a particular territory (sole license);

- restriction (in a non-reciprocal agreement) of active and/or passive sales by the licensee and/or the licensor into the exclusive territory or to the exclusive customer group reserved for the other party;

- restriction (in a non-reciprocal agreement) of active sales by the licensee to the exclusive territory or to the exclusive customer group allocated by the licensor to another licensee provided the latter was not a competing undertaking of the licensor;

- obligation on the licensee to produce the contract products only for its own use provided that the licensee is not restricted in selling the contract products actively and passively as spare parts for its own product;

- obligation on the licensee (in a non-reciprocal agreement) to produce the contract products only for a particular customer, where the license was granted in order to create an alternative source of supply for that customer;

- Restrictions on the licensee's ability to exploit its own technology or the restriction of the parties to carry out R & D (unless indispensable to prevent the disclosure of the licensed know-how to third parties).

The Guidelines offer further help on what kind of provisions qualify as one of the aforementioned hardcore restrictions. They also offer guidance as regards anticompetitive concerns of certain provisions if the market thresholds are exceeded.

For *non-competitors*, the following provisions are banned (cf. Art. 4 (2) TTBE):

- Restrictions on prices (other than imposing a maximum price or a recommended resale price).

- Restrictions of either the territory into which, or of the customers to whom, the licensee may passively sell, except:

  - restriction of passive sales into the exclusive territory or to an exclusive customer group reserved for sales by the licensor;

  - restrictions of passive sales into the exclusive territory or to an exclusive customer group reserved for another licensee (for two years only);

  - limitation of manufacturing only for the licensee's own use (provided the licensee is not restricted to sell the contract products as spare parts for its own products);

  - obligation to produce the contract products only for a particular customer (where the license was granted in order to create an alternative source of supply for that customer);

  - restriction of sales to end-users by a licensee at the wholesale level of trade;

  - restriction of sales to un-authorized distributors by the

members of a selective distribution system.

- Restrictions of active or passive sales to end-users by a licensee which is a member of a selective distribution system operating at the retail level (other than prohibiting a member of such selective distribution system from operating out of an unauthorized place of establishment).

As compared with the TTBE 1996, the TTBE is relatively straight forward and seems to be less complex. This is true, at least, where the market thresholds are not exceeded.

In practice, it may turn out that when a technology licensing agreement was entered into, the parties were not competing with each other, yet turn out to be competing parties after execution of the agreement. In this case, the hardcore restrictions as regards non-competitors (Art. 4 (2) TTBE) apply for the full life of the agreement unless the agreement is subsequently amended in any material respect.

Excluded Restrictions

The TTBE also contains a list of the following provisions that are not block exempted and which, therefore, require *individual assessment* as regards antitrust concerns (Art. 5 TTBE). In any case, though, if such provisions find their way into technology licensing agreements and turn out to be anti-competitive, this will not invalidate the whole licensing agreement, but rather only the respective provision.

- Obligation on the licensee to exclusively license-back to the licensor any severable improvements or new applications of the licensed technology;

- obligation on the licensee to assign to the licensor any severable improvements to or new applications of the licensed technology;

- no-challenge clauses (i.e., obligations not to challenge the validity of intellectual property rights of the licensor), without limiting the possibility of the parties to provide for termination of the technology transfer agreement if the licensee challenges the validity of the licensed intellectual property rights;

- obligation limiting the licensee's ability to exploit its own technology or limiting the ability of the parties to carry out R & D (unless this is indispensable to prevent the disclosure of the licensed know-how to third parties), in an agreement between non-competitors.

Exceeding the market share thresholds

It is recalled that as long as the market share thresholds are not exceeded and no hardcore restriction are contained, the technology licensing agreement is automatically exempted under the TTBE. By contrast, if the market share thresholds are exceeded, there is *no presumption of illegality*. Rather, such agreements need to be assessed individually in the light of Art. 81 (3) of the EC Treaty. In this respect, the following is of particular importance:

The former Regulation (EC No. 17/1962) will be replaced by Commission Regulation (EC) No. 1/2003[6]. Under Regulation (EC) No. 17/1962, the parties to a technology license agreement had the

[6] OJ 2003 L 1, page 1

opportunity to apply for individual exemption. The Commission would evaluate the respective agreement and either exempt it or declare it to violate EU Competition Rules, in particular in view of Art. 81 (1) of the EC Treaty.

Regulation (EC) No. 1/2003, which takes effect as per May 1, 2004, *abolishes* the opportunity to request *individual exemption*. Rather, if the technology licensing agreement qualifies for exemption under Art. 81 (3) of the EC Treaty in that

- the agreement contributes to improving the production or distribution of goods or to promoting technical or economic progress,
- while allowing consumers a fair share of the resulting benefits,
- and does not impose on the parties' restrictions which are not indispensable to the attainment of these objectives,
- nor affords such parties the possibilities of eliminating competition in respect of a substantial part of the products in question

it is exempt. According to Art. 2 Regulation (EC) No. 1/2003, the burden of proof for an agreement meeting the requirements of Art. 81 (3) is with the parties to the technology licensing agreement, though. That is, as of May 1, 2004, parties to a technology licensing agreements exceeding the market thresholds have the burden of proof to show that the agreement does not violate Art. 81 (1) of the EC Treaty, without the opportunity to have this declared by the Commission by way of a binding decision (individual exemption) prior to entering into the agreement.

To assess whether a provision violates Art. 81 (1) of the EC Treaty, the parties need to consult the Guidelines. There, the Commission lays down its concerns as regards certain provisions in rather great detail. Nevertheless, the Guidelines are in some respect vague and do not always provide the parties with clear answers. In addition, the views expressed by the Commission are not binding for the antitrust authorities of the Member States nor the Courts. As a result, parties to a technology licensing agreement will more often than before need to consult with their legal and/or economic advises when negotiating such agreement.

Technology Pools

Although technology pools are not covered by the TTBE, the Commission's views on agreements establishing technology pools are laid down in the Guidelines. Technology pools are defined as arrangements whereby two or more parties assemble a package of technology which is not only licensed to the members of the pool, but also licensed to third parties. It is recalled that while the agreements *establishing* technology pools are carved out from the TTBE and are only covered in the Guidelines, the individual *licenses granted* by the pool to third party licensees are, in any case, treated like other license agreements.

The Commission takes the view that to assess the competitive risks and efficiency enhancing potential of technology pools, one needs to distinguish between (1) technological complements and technological substitutes, and (2) essential and non-essential technologies:

Two technologies *complement* each other where they are both required from a technological point of view to

produce a product or carry out a process. In contrast, two technologies will be *substitutes* where the parties to the patent pool may use either of the technologies to produce a product or carry out a process.

A technology is *essential* if there are no substitutes for it inside and outside the pool. As opposed to this, a technology is *non-essential* if there exist substitutes for the technology, be it inside or outside the pool.

The Commission considers the pooling of substitute technologies to restrict competition and to amount to collective tying, therefore violating Art. 81 (1) of the EC Treaty. However, if a pool contains essential technologies (which are by definition also complement technologies), the Commission takes the view that the pool will generally raise no antitrust concern irrespective of the market position of the parties.

Where non-essential but complementary patent are included in the pool, there is a risk of foreclosure of third party technologies. The Commission takes the view that licensees will have little incentive to license-in a competing technology when the royalty paid to the patent pool for the whole package of patents already covers a substitute technology.

Moreover, the inclusion of non-essential technologies also forces licensees to pay for them even though they do not strictly need them. When a pool encompasses non-essential technologies, the agreement is likely to be caught by Art. 81 (1) of the EC Treaty if the pool has a significant position on any relevant market.

Transitional Period

Agreements that have been in force on April 30, 2004, which satisfied the conditions for exemption provided for in the TTBE 1996 will not be caught by the TTBE until March 31, 2006. In effect, parties to such an agreement that shall be in effect after April 30, 2004, need to check whether such agreement violates – or continues to be exempted – under the TTBE as per April 1, 2006.

Should you have any further questions, please feel free to contact us.

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