# UK COMPETITION LAW ASSOCIATION

## Consultation Response

## European Commission: Draft proposal for a revised block exemption for technology transfer agreements and for revised guidelines

**17 May 2013**

## 1. Introduction and Overview

1.1 This document is submitted on behalf of the UK Competition Law Association ("**CLA**") in response to the consultation launched by the European Commission on its "Draft proposal for a revised block exemption for technology transfer agreements and for revised guidelines" (the "**Consultation**") on 20 February 2013.

1.2 The CLA is affiliated to the Ligue International du Droit de la Concurrence. The members of the CLA include barristers, solicitors, in-house lawyers, academics, and other professionals, including economists, patent agents, and trade mark agents. The main object of the CLA is to promote the freedom of competition and to combat unfair competition.[1]

1.3 The CLA broadly welcomes the draft proposal. However, it has some specific points as follows, first in relation to the Articles of the draft Regulation and then in relation to the draft guidelines on settlement agreements.

## 2. ARTICLE 1 - DEFINITIONS

2.1 We suggest the following changes:

(a) Article 1(1)(i)(ii), remove phrase "substantial, that is to say," as this wording is redundant

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[1] Further details on the CLA can be found on our website at: http://www.competitionlawassociation.org.uk/.

(b) Article 1(1)(j)&(k), change from “are regarded as interchangeable or substitutable” to “would reasonably be regarded as interchangeable or substitutable” to provide an objective test

(c) Article 1(2)(a): add additional: "iv) or who has effective control of the undertaking’s affairs"

## 3. ARTICLE 3 - MARKET SHARE THRESHOLDS

3.1 Where a licensee has technology that is competitive with that of the licensor but is not actively licensing that technology, nor using it to manufacture for external use, the market share threshold should remain 30% and not be reduced to 20%.

3.2 Proposed new Article 3(2) applies the lower 20% market share threshold to a situation "*where the undertakings party to the agreement are not competing undertakings but the licensee owns a technology which it uses only for in-house production and which is substitutable for the licensed technology*". Similarly, paragraph 72 of the draft Guidelines suggests that the licensee should be treated as "*already (potentially) active on that market without the technology transfer agreement in question*".

3.3 Market share thresholds are used in the TTBER to confer cost-effective legal certainty under self-assessment whilst applying economics-based criteria. However, relevant technology markets are difficult to determine, particularly in the context of fast-moving technology-based industries. This will be even more difficult if undertakings need to consider whether any technology used only for in-house production could be used to produce competing products. Use of technology by an undertaking for its in-house production is very different from an undertaking engaging in the business of manufacturing for external use or of licensing that technology, and so its substitutability is very unlikely to have been analysed previously.

3.4 Also, the Commission is considering use of the simplified procedure for notification of certain horizontal mergers (treating them as equivalent to a merger between non-competitors) provided the combined market share is up to 50% and the increase is low (a

Herfindahl-Hirschman Index ("HHI") increment of less than 150).[2] Similarly, a technology transfer agreement between parties with a combined market share up to 30% could be made subject to the regime for technology transfer agreements between non-competitors where the comparable HHI "increment" is less than 150 (i.e. the HHI treating licensor and licensee as one entity less the HHI treating licensor and licensee as separate entities).

## 4. ARTICLE 4 - HARDCORE RESTRICTIONS

4.1 We welcome the softening of the guidance on whether hardcore restrictions can be individually exempted (in paragraphs 84, 85 and 116 of the draft Guidance).

4.2 However, we do not agree that Article 4(2)(b)(ii) should be amended with the effect that a restriction on passive sales into the exclusive territory or exclusive customer group of another licensee is now a hardcore restriction. In the previous TTBER, such a restriction was exempted for two years.

4.3 Paragraph 116 of the draft Guidelines (like paragraph 101 of the existing Guidelines) explains that sunk costs of entry may mean that a licensee would not enter the licence without such a restriction, and so depending on the facts such a restriction falls outside of Article 101(1) for up to two years. The difference now is that if on later analysis it does not fall outside of Article 101(1), or only for a shorter period, parties will lose the protection of the block exemption entirely.

4.4 We do not understand the reason behind this change, particularly given that licensors can still restrict passive sales into their own territory without any time limitation under Article 4(2)(b)(i). This provides licensors with an even greater incentive to try to enter territories themselves (and never open them up to passive sales) rather than entering into more pro-competitive licensing arrangements (whereby the territories will be opened after two years).

[2] Draft Commission Notice on a simplified procedure for treatment of certain concentrations under Council Regulation (EC) No 139/2004, http://ec.europa.eu/competition/consultations/2013_merger_regulation/draft_revised_simplified_procedure_en.pdf.

4.5 Therefore, we suggest that this change is not adopted. If this change is to be adopted, though, it should be done by moving such restrictions to Article 5, so that if the restriction does fall within Article 101(1) it can be severed from the rest of the agreement rather than undermining legal certainty of the entire agreement.

## 5. ARTICLE 5 - EXCLUDED RESTRICTIONS

5.1 The licensor should not need to justify individually the right to terminate a licence if the licensee challenges the validity of the underlying intellectual property rights.

5.2 The exclusion of any restriction from the scope of the block exemption puts additional analytical and risk costs on industry, and is likely to alter significantly the negotiation of licensing agreements and to prevent some otherwise pro-competitive licences. Such an exclusion is only justified if those costs are merited by a resultant improvement in effective competition. In the case of Article 5(1)(b), it is not justified, in particular because:

(a) When negotiating a licence, the parties should be free to decide the extent to which they wish to resolve possible disputes under the intellectual property rights licensed, including as to validity. The licensor may be unwilling to give up its exclusive rights (ultimately enforceable by injunctive relief, which must be made available under the Enforcement Directive) where the licensee reserves the right to challenge the validity (and potentially avoid future royalties) but continue paying royalties and avoid the risk of termination of the licence and injunctive relief even if the challenge fails. This is particularly the case if the licensor believes the licensee may use the licence cynically and strategically (gamesmanship), to avoid the risk of injunctive relief before challenging validity of the rights. By reducing the certainty that a no-challenge or termination-upon-challenge clause will be enforceable, some pro-competitive licences will be discouraged and instead cost-wasteful litigation encouraged.

(b) No new market developments or case law have been presented to justify the extension of the excluded restrictions to include rights to terminate upon challenge. In new paragraph 61, the only case law cited dated back to 1986.

(c) If the rights being challenged are invalid, termination of the licence does not raise any issues for the licensee (indeed, it may be beneficial, because in many licences past royalties are not recoverable if intellectual property rights are later revoked). In reality, of course, it is not known whether the rights will be held valid in a particular jurisdiction until the judgment of a court or patent office, often on appeal. It is not agreed that such disputes should be encouraged by providing licensees with a risk-free opportunity that is not afforded to other market players to challenge the rights while continuing to benefit from protection under a licence. We believe that it is disproportionate to pursue the policy objective of eliminating invalid intellectual property rights by requiring private parties (which in the majority of cases will not be dominant) to continue dealing with each other in circumstances where there is a significant dispute between them.

(d) The enforceability of existing termination-upon-challenge clauses will be brought into question by the proposed change. It is unclear whether this will be from 1 May 2014, when the new Regulation enters into force, or from 1 May 2015 under the transitional provisions in Article 10 (which do not clearly cover excluded restrictions). In either case, technology licences are often for the life of the patent (up to 20 years). Therefore, many existing and stable contractual agreements will be undermined by giving the licensee a new right to object to any termination upon challenge, on the basis that the clause might now be regarded as anti-competitive although it was block exempted when originally agreed.

## 6. ARTICLE 9 - RELATIONSHIP WITH OTHER BLOCK EXEMPTION REGULATIONS

6.1 We support the principle of making it clear that the TTBER should not apply to the types of agreements covered by the other two block exemptions. However, the wording “the subject matter of which” is not particularly clear. We would welcome clarification, for instance as suggested by the LIDC, to ensure that it operates as described in the Draft Guidelines.

## 7. ARTICLE 10 - TRANSITIONAL PERIOD

7.1 The transitional period for undertakings to review and amend existing agreements has been reduced from 23 months in the last Regulation to 12 months. Given some of the significant changes being introduced, this is too short. It should be 23 or 24 months as before. It should also clearly cover existing termination-upon-challenge clauses as identified above.

## 8. GUIDELINES PART 3 - SETTLEMENT AGREEMENTS

8.1 We strongly support the attempt to expand the guidance on settlement agreements. The current enforcement activity and the Commission's monitoring of pharmaceutical patent settlements has given rise to considerable uncertainty for companies which wish to settle litigation, in particular where one party or the other makes a concession of some kind, or where the parties enter into another agreement at the same time as settling a dispute.

8.2 However, we also believe that the Commission should be cautious in providing too extensive guidance at this stage, given that it is currently conducting three antitrust investigations regarding settlement agreements in the pharmaceutical sector. Such guidance may turn out to be premature and unhelpful, and it would not be a good use of the Commission's resources to have to revisit the guidelines before they expire.

8.3 In particular, we have the following concerns with specific aspects of the draft guidance:

(a) Paragraph 219, footnote 81 appears to exclude non-assertion agreements from the scope of the guidance, limiting it to agreements where there is a licence. This increases uncertainty when using a common tool to resolve disputes. The footnote should be deleted.

(b) Paragraph 222, the final sentence, is difficult to interpret. It could be expressed more clearly as “In particular, where there is no blocking position (see paragraph (33) above), it remains necessary to assess whether the parties are competitors”.

(c) Paragraph 223 concerns so-called “pay-for-delay” settlements, in relation to which investigations are ongoing in the pharmaceutical sector. The guidance provided is understandably very limited but this provides little assistance to industry. For instance, does “delayed” mean in relation to the date of expiry or a potential date of revocation of the right? Does “limited” means in relation to a hypothethical where the right is valid or where it is revoked? Equally, the proper assessment of when an “inducement” is impermissible in the context of a business negotiation between two parties typically with a range of commercial interests is hotly contested and the guidance only provides uncertainty. Given the early and sensitive stage of the investigations, and their sector-specific nature, we suggest that this paragraph would be better omitted at present and the Commission provide specific guidance on the issue, if necessary in the light of its decisions, at an appropriate later date.

(d) Paragraphs 224-225 address cross-licensing. We agree that cross-licensing agreements can fall under Article 101(1), but do not believe that they raise particular issues which merit separate guidance. The issues discussed in these paragraphs are already addressed elsewhere in the draft Guidelines.

(e) Paragraph 226 restricts no-challenge clauses in settlements to the IP rights which “*were the centre of the dispute*” (the previous guidance said more broadly “*covered by the agreement*”). However, the next sentence (rightly) accepts that “*the very purpose of the agreement is to settle existing disputes and/or to avoid future disputes*”. In practice, litigation normally involves “test case” proceedings of some IP rights in specific countries from a broader international portfolio of IP rights related to the technology. Settlement agreements need to cover the whole portfolio, not just the rights involved in the proceedings, if they are to be effective.

(f) Paragraph 227, the third sentence, appears to be based on the *AstraZeneca* judgment (although it is not cited) but introduces uncertainty as to its scope. That case involved the provision of information about the date of a particular event. In most cases, information will be decidedly more complex and, even if information has been provided which (perhaps with hindsight) is "*incorrect, misleading or complete*", it would not be reasonable to expect the licensor to know whether or not the IP rights are valid, as this is ultimately to be decided following extensive litigation in front of a court or patent office, often on appeal. Indeed, the specialist tribunals often disagree at different levels of appeal and between jurisdictions. That makes it doubly difficult for non-specialists such as the Commission, national competition authorities or national competition courts fairly to evaluate purported validity (or for market participants to anticipate the outcome of such evaluation predictably and cost-effectively). The proposed language introduces particular uncertainty for companies with very large patent portfolios, as in the IT and telecoms industries, which favour the grant of broad and relatively unrestrictive cross-licences which promote competition on the marketplace. Like the "pay-for-delay" section, we think this is premature and should be deleted (or limited to a summary of the *AstraZeneca* judgment with appropriate citation).

## 9. GUIDELINES PART 3 – TECHNOLOGY POOLS

9.1 We strongly support expansion of the guidance on technology pools. The Commission is right to recognise that technology pools can produce pro-competitive effects by facilitating one-stop shop licensing and reducing transaction costs, and we welcome the recognition at paragraph 229 that patent pools can play a beneficial role in the implementation of pro-competitive standards.

9.2 However, although the Commission notes that there are a number of competition risks which arise from pool licensing, to date there has been little practical guidance on the criteria which will be relevant to its assessment. As we expect patent pools to play an increasingly critical role in the dissemination of technology in the period for which the revised guidance would be in force, we suggest that it may be useful for the Commission to use this opportunity to provide additional guidance on a number of issues.

9.3 The focus of the draft guidance is on factors which are relevant to the formation and early stages of technology pools. However, those assessing the benefits and risks of pool licensing should be reminded that the assessment should have regard to the actual legal and economic context in which the pool is operating at any given point in time. Given that most technology pools will have a life stretching from the inception of a certain technology to the expiry of all relevant patents, it is especially important that the competition law assessment of pools is dynamic: changes in the underlying factual context and amendments to agreements may mean that the competition law analysis changes over time.

9.4 It may also be useful to refer specifically to the fact that the market power of a pool is likely to change over time. Pools which are successful may acquire market power towards the middle/end of their life, at a time when the underlying pooled patents are beginning to expire. This could lead to an unfair windfall for licensors of later expiring patents, at a time when the ageing nature of the technology may be leading to decreases in the prices of the end products incorporating the technology. In such instances, technology pools ought to have regard to the need for a corresponding reduction of royalties to reflect the diminishing value of their patent portfolios – licensees should not have to bear an unreasonably high royalty burden for ageing technology. This is a particular concern where many of the licensees are SMEs. It would be helpful if the guidance explicitly recognised that technology pools should not be profit-maximising entities, but should rather have regard to the likely effect on the markets concerned to ensure the objective of achieving efficiencies in one-stop licensing on a fair and reasonable basis. As such, it may be useful for the draft guidance to refer to the principle articulated in the Commission's Horizontal Guidelines: that the royalties charged for access to IPR within technology pools should bear a reasonable relationship to the actual economic value of the IPR in the patent pool at a given point in time.[3]

9.5 In order to achieve the above, we suggest the following insertions/amendments.

(a) Refer in paragraph 231 to the *"ongoing operation of the pool"*.

(b) Insert the following after paragraph 248: *"Restrictions that go beyond what is necessary to achieve the efficiency gains that can be generated by the technology pool, both at its inception and on an ongoing basis, do not fulfil the criteria of Article 101(3). The assessment of each technology pool must take into account its likely effect on the markets concerned, on the one hand, and the scope of restrictions that possibly go beyond the objective of achieving efficiencies, on the other"*.[4]

(c) Amend paragraph 249 as follows: *"The purpose of this section is to address a certain number of restraints that in one form or another are commonly found in licensing agreements from technology pools and which need to be assessed in the overall context of the pool with regard to the market power of the pool and the underlying patent portfolio at different stages of the pool's life"*.

(d) Add at the end of paragraph 250(a): *"The market position of the pool may change at different stages of the pool's life; a successful pool may in particular benefit from a significant degree of market power towards the end of its life, thereby increasing the risk of anti-competitive effects"*.

(e) Insert a new subsection 250(c) which states: *"the assessment of whether fees charged for access to IPR in the standard-setting context are unfair or*

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3 This would mirror the Commission's approach to standardisation agreements at paragraph 289, which states that *"the assessment of whether fees charged for access to IPR in the standard-setting context are unfair or unreasonable should be based on whether the fees bear a reasonable relationship to the economic value of the IPR"*.

4 This would again mirror the approach of the Commission to standardisation agreements at paragraphs 314-315 of its Horizontal Guidelines.

*unreasonable should be based on whether the fees bear a reasonable relationship to the actual economic value of the IPR remaining in the patent pool at a given point in time"*.[5]

(f) Add as the penultimate sentence of paragraph 251: *"A reasonable royalty rate should broadly reflect the number and value of the underlying pooled patents and under normal circumstances would be expected to fall over time as the number of pooled patents diminishes due to patent expiries".*

(g) Add wording to paragraph 252 recognising that terms which are fair and/or reasonable at one stage of the life of the pool may later become unfair and/or unreasonable.

9.6 We welcome the inclusion of a "safe harbour" in paragraph 244. Paragraph 244 could also refer to the *"creation and ongoing operation of the pool"*, as a reminder that the competition law assessment ought to be dynamic, and that the "safe harbour" does not allow pools to remain protected against the application of the competition rules if they acquire market power. We also have the following suggestions for further guidance on the application of the safe harbour.

(a) It would be helpful if the Commission would make clear whether the process for withdrawing the safe harbour is as per Article 6 of the Technology Transfer Block Exemption. If not, a further explanation on the status of the "safe harbour" would be welcome.

(b) As well as requiring a pool to allow open participation in the standard and pool creation process by all interested parties, pools should allow timely exit in order to benefit from the "safe harbour".

(c) If paragraph 244(f) is to be effective, and to offer any incentive to licensees (in particular) to take such a step, it is also necessary for the pool to commit to adjust

[5] Ditto.

royalty payments in the event that a technology is held to be invalid/inessential, and thus no longer subject to the pool licence.

(d) The Commission acknowledges at paragraph 228 that technology pools can be varied in their structure, *"from simple arrangements between a limited number of parties or elaborate organisational arrangements whereby the organisation of the licensing of the pooled technologies is entrusted to a separate entity"*. The Commission could recognise this diversity by not making it a condition of the safe harbour that the *"pooled technologies are licensed into the pool"* (paragraph 244(d)) which implies that a licensing body acts as a centralised sub-licensor. Although this may be true of some technology pools, many pools operate via joint licences granted on a non-exclusive basis by the licensors directly to licensees.

9.7 Finally, the last sentence of paragraph 241 relating to the functions of experts appears to be purely descriptive. It is not clear whether in assessing the competitive risks and the efficiency of technology pools, regard will be had to whether the expert assessed <u>both</u> validity and essentiality and there is little discussion of the relevance of an assessment of validity. It may therefore be useful to explain what functions of independent experts the Commission will consider to be most relevant to the competition assessment.