

European Union: Assessment of IP Licensing Agreements under EU Competition Law

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Introduction

In recent years there has been a remarkable expansion of antitrust enforcement in the area of intellectual property (IP). This trend is illustrated by an increasing willingness of the European Commission (the Commission) and other antitrust enforcement agencies to challenge IP-related transactions, often on the basis of novel theories of competitive harm. This is particularly true where intellectual property rights (IPRs) are of strategic importance, as is the case in the high-tech and pharmaceutical sectors.

The fact that IP laws grant exclusive rights of exploitation does not imply that IPRs are immune from competition law intervention. On the contrary, articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU), as well as equivalent provisions in national competition law, are fully applicable to unilateral conduct of IP owners and agreements whereby the holder of IP licenses another firm to use its IPRs. In fact, over the past few years, the use of IPRs has given rise to an increasing number of highly visible and hotly debated cases in EU competition law.

For instance, in the *Microsoft* case, the Commission concluded that Microsoft had abused its dominant position by deliberately refusing to provide interoperability information to competitors. As a result, the Commission imposed a fine of €497 million and obliged Microsoft to disclose complete and accurate interface information to allow developers to compete efficiently. However, as Microsoft did not comply with the Commission's 2004 decision, the Commission imposed additional periodic penalties on Microsoft, which, in June 2012, the General Court eventually fixed at €860 million.

Similarly in *AstraZeneca*, in December 2012 the European Court of Justice upheld the judgment of the General Court, which found that AstraZeneca had abused its dominant position by misleading patent offices and misusing the patent system in order to prevent generic competition against its anti-ulcer medicine, Losec. In that case the Commission had established that AstraZeneca had provided misleading information to several national patent offices in the EU resulting in AstraZeneca gaining extended patent protection for Losec, and that it had selectively deregistered market authorisations for Losec capsules in certain member states, in violation of article 102 TFEU. The Commission imposed a fine of €52.5 million.

In the pharmaceutical sector, the Commission is currently challenging settlement agreements involving 'pay-for-delay' and reverse payment arrangements whereby patent holders make payments to generic companies that may delay or impede the market entry of generic medicinal products.

In addition, with regard to the smartphone and other high-tech sectors, the Commission takes the view that holders of standard essential patents (SEPs) are required under EU competition law to license those patents on fair, reasonable and non-discriminatory (FRAND) terms, an issue that has also come to the forefront in EU merger control. Indeed, in the *Google/Motorola Mobility* case (2012), the Commission examined whether the acquisition of a portfolio of SEPs by Google would create an economic incentive on

Google's part to (i) raise the royalty levels of Motorola Mobility's SEPs, (ii) force potential licensees to enter into cross-licences on terms that they would otherwise not agree to, and (iii) exclude competitors from the market. The Commission conducted a similar analysis in the *Microsoft/Nokia* case (2013), which involved the acquisition of Nokia's devices and services business by Microsoft. This transaction was approved in December 2013.

EU competition law generally takes account of the fact that the creation of IPRs enhances economic efficiency, entails substantial investment and that it is often a risky endeavour. As a result, it is felt that the innovator must not be unduly restricted in the exploitation of valuable IPRs and that licensing as such is pro-competitive as it leads to dissemination of technology and spurs innovation. However, licence agreements may also contain provisions that are restricting competition by virtue of their object or effect and that may, as a consequence, be in violation of articles 101 and 102 TFEU. In this respect, it is recalled that article 101(1) TFEU prohibits agreements that restrict competition, which are automatically void pursuant to article 101(2) TFEU. Article 101(3) TFEU provides for an exemption from the prohibition of article 101(1) TFEU if, on balance, the agreement produces positive welfare effects. Article 102 TFEU seeks to control anti-competitive unilateral conduct and prohibits abuse by one or more firms of a dominant position.

Competition law seeks to strike a balance between rewarding the holder of IPRs by allowing many forms of legitimate exploitation of those rights, while at the same time safeguarding competition. Thus, price fixing or other restrictions of a licensee's ability to determine its prices when selling products to third parties, certain field of use of restrictions, resale restrictions, grant-back clauses and cross-licensing arrangements are examples of the types of provisions that may be in violation of EU competition law.

The consequences of not complying with EU competition law can be severe. IP licences may be held unenforceable and give rise to private actions for damages based on violations of EU law. Moreover, the Commission can fine companies up to 10 per cent of their group worldwide turnover. National competition agencies in the EU also have the power to impose fines for violation of EU competition law (or equivalent provisions of national competition law).

This chapter provides an overview of the general regime of EU competition law applicable to IP licensing agreements. It sets out the basic principles under the two key provisions of articles 101 and 102 TFEU and it discusses the general scheme of the Technology Transfer Block Exemption Regulation (TTBER), Regulation 772/2004 on technology transfer agreements, which defines the terms and conditions under which restrictive licence agreements automatically benefit from the exemption under article 101(3) TFEU. The 'safe harbour' embodied in the TTBER is of significant practical importance to licensees and licensors.

In addition, we briefly discuss the assessment of licence agreements outside the TTBER, as well as the circumstances in which the refusal by a dominant company to grant a licence under its IP

to a third party can be considered to be an abuse under article 102 TFEU and when those firms are, as a consequence, required to offer a compulsory licence.

Finally, this chapter offers insights into the application of EU competition law to a number of specific practices involving IPRs, in particular pay-for-delay arrangements and reverse payments, cross-licensing, licensing on FRAND-terms and pool licensing.

The safe harbour of Regulation 772/2004

While many technology licensing agreements are of minor importance, or can be deemed not to be capable of affecting trade to an appreciable extent and are therefore not caught by the prohibition of article 101(1) TFEU, many other licensing agreements are quite likely to fall under article 101 TFEU. This applies both to agreements that may restrict intra-technology competition and inter-technology competition. Inter-technology competition refers to competition between firms that license or produce on the basis of substitutable technologies, whereas intra-technology competition relates to competition between firms that produce on the basis of the same technology.

Restrictive licence agreements that fall within the terms of the TTBER are automatically exempted from the article 101(1) TFEU prohibition.

The TTBER provides for an exemption 'by category' for certain types of IP licensing agreements. The regulation applies generally to patent licensing, know-how, software copyright and 'mixed' licensing agreements that are entered into between two firms and that permit the manufacture of products produced with the licensed technology. However, the safe harbour of the TTBER is narrowly defined and only applies if the parties' market shares do not exceed certain thresholds and the agreement does not contain 'hard-core' or 'blacklisted' restrictions of competition. Significantly, the scope of the exemption differs depending on whether the parties to the agreement must be deemed competitors in the affected relevant technology and product market. This distinction reflects the Commission's view that technology transfer agreements between competitors generally give rise to greater risks to competition than licence agreements between non-competitors.

If the parties are not considered competitors, the exemption is in principle available if the market share of each of the parties does not exceed 30 per cent on the affected technology and product market. Article 4(2) provides that in that case, the exemption is not applicable if the agreement restricts a party's ability to determine its prices when selling products to third parties (price fixing), or provides for certain customer or market allocation restrictions. The list of hard-core restrictions of article 4(2) of the TTBER mirrors to a large extent those of article 4 of Regulation 330/2010 on vertical restraints. This reflects the Commission's view that technology transfer agreements between non-competitors are essentially of a vertical nature.

The list of hard-core restrictions of article 4(2) is, however, carefully conditioned. For instance, while customer and market allocation generally qualify as hard-core restrictions, article 4(2)(b)(ii) provides that the licensor is allowed to restrict passive sales 'into an exclusive territory or to an exclusive customer group allocated by the licensor to another licensee during the first two years that this other licensee is selling the contract products in that territory or to that customer group'. Similarly, an obligation to produce the contract products only for the licensee's own use (provided it is not restricted in selling the contract products as spare parts for its own products) and the obligation to produce the contract products only for a particular customer (where the licence was granted in order to create an alternative source of supply for that customer) are permitted under article 4.

In contrast, if the parties to a technology transfer agreement must be considered competitors, article 4(1) provides that in addition to price fixing and a number of specific market and customer

allocation provisions, clauses that limit a party's output or restrict the licensee's ability to exploit its own technology or that restrict the parties' ability to carry out research and development (unless that is indispensable to prevent the disclosure of the licensed know-how to third parties) make the exemption inapplicable. Again, each of the hard-core restrictions of article 4(1) is conditioned. For example, provided the agreement is non-reciprocal, article 4(1)(c)(v) exempts 'a restriction of active sales by the licensee into the exclusive territory or to the exclusive customer group allocated by the licensor to another licensee provided the latter was not a competing undertaking at the time of the conclusion of its own licence'.

Finally, article 5 of the TTBER lists a number of 'excluded restrictions' that do not benefit from the block exemption. However, in contrast with the hard-core restrictions of article 4, these restrictions do not cause the entire agreement to fall outside the block exemption. Excluded restrictions require individual assessment under articles 101(1) and (3) TFEU. Article 5 mentions in particular 'hard grant-back clauses' in relation to severable technologies: 'any direct or indirect obligation on the licensee to grant an exclusive licence to the licensor or to a third party designated by the licensor in respect of its own severable improvements to or its own new applications of the licensed technology'. Similarly, obligations imposed on the licensee to assign rights to that technology and certain no-challenge provisions are excluded from the scope of the block exemption. Also, if the parties to the agreement are not competitors, the exemption does not apply to limitations on the licensee's ability to exploit its own technology or the provisions that limit either party's ability to carry out research and development (see article 5(2) TTBER). The restrictions mentioned under article 5(2) TTBER may, however, benefit from the exemption if they are indispensable to prevent the disclosure of the licensed know-how to third parties.

The benefit of the block exemption is that agreements that fall within the safe harbour are permitted under article 101 TFEU. While Regulation 772/2004 remains sometimes difficult to apply in practice, for instance, when examining the 'primary object' of the agreement at hand to determine whether the agreement is, in fact, governed by the TTBER, or when distinguishing between (blacklisted) customer and market allocation arrangements on the one hand, and (permitted) field-of-use restrictions on the other, the block exemption is of significant practical effect. This is true despite the fact that the scope of the exemption is limited to patent licensing, know-how licensing, software copyright licensing agreements and 'mixed' agreements, and does not cover 'non-ancillary' trademarks and copyrighted material other than software, and despite the fact that multiparty agreements, settlement agreements and master licence agreements are not covered.

Assessment of licensing agreements outside the TTBER

Agreements that fall outside the exemption because the market share thresholds are exceeded are not necessarily illegal; they may, upon individual assessment, be in compliance with article 101(1) and (3) TFEU. In contrast, the Commission takes the view that the hard-core restrictions of article 4 are almost always anti-competitive. As a result, it considers that in the context of individual assessment those restrictions will only exceptionally fulfil the conditions of article 101(3) TFEU and, on balance, not be restrictive of competition.

The individual assessment of licensing agreements under article 101(1) and (3) TFEU outside the safe harbour of the TTBER is to be conducted on the basis of the Technology Transfer Guidelines (2004) (the TT Guidelines) and the Commission Notice on Article 101(3) (2004).

The TT Guidelines explain the methodology that the Commission applies to assess the effects of particular types of licensing agreements. The basic assumption underlying the analytical framework contained in the TT Guidelines is that licensing agreements can bring about important efficiencies. For instance, where the licensee already has access to the necessary production assets, the

licence agreement may allow the licensee to gain access to a technology that can be combined with these assets, allowing the licensee to exploit new or improved technologies (TT Guidelines, paragraph 148). Also, an exclusive licence may be necessary in order to induce the licensee to invest in the licensed technology and to bring the products to market in a timely manner. However, the Guidelines also specify that licence agreements may result in negative effects on competition, in particular by: (i) reducing inter-technology competition between the companies operating on a technology market or a market incorporating the technologies, including through explicit and tacit collusion, (ii) foreclosing competitors by raising their costs, or restricting access to essential inputs, and (iii) reducing intra-technology competition between firms that produce products on the basis of the same technology. For instance, the Commission states that it will only exceptionally intervene against exclusive licensing between non-competitors, irrespective of the territorial scope of the licence and that the main situation in which intervention is warranted is where a dominant licensee obtains an exclusive licence to one or more competing technologies and entry into the technology market is difficult and the licensed technology constitutes a real source of competition on the market (TT Guidelines, paragraphs 165 and 166).

The TT Guidelines set out the factors that are particularly relevant for the analysis of each specific type of licensing agreement, such as the nature of the agreement, the market position of the parties and competitors, the presence of buyer power and entry barriers (TT Guidelines, paragraph 132). In general, the Guidelines treat agreements between competitors, especially when reciprocal, more strictly than agreements between non-competitors. Also, the Commission takes the view that exclusive agreements are generally more likely to raise concerns than non-exclusive agreements.

The TT Guidelines provide an overview of nine types of provisions and restraints that are commonly included in licence agreements, including exclusive licensing and sales restrictions, output restrictions, captive-use restrictions, field-of-use restrictions, royalty obligations, non-compete obligations and tying and bundling. The Guidelines also discuss settlement and non-assertion agreements and technology pools. Each of these restraints may, in the Commission's view, raise various concerns.

For example, although the parties to a licence agreement are normally free to determine the royalty payable by the licensee and its mode of payment, the Commission notes that disproportionate running royalties in cross-licence agreements between competitors may be illegal and that in cases where the agreement is between non-competitors, royalties that are also paid on products produced with third-party technology may reduce demand for third-party technology and thus have anti-competitive foreclosure effects. Foreclosure effects may also occur in cases of tying, when the licensor makes the licensing of one technology conditional upon the licensee taking a licence for another technology or purchasing a product from the licensor (provided the licensor has significant market power in the tying product), and in the case of non-compete obligations that oblige the licensee not to use third-party technologies.

As mentioned above, exclusive licences are only likely to raise concerns if the licensee has significant market power. The main competitive concern associated with field-of-use restrictions (restrictions that limit the exploitation of the licensed technology by the licensee to one or more particular fields of use) in agreements between competitors is that the licensee ceases to be a competitive force outside the licensed field of use. The Commission notes that this risk is greater where the agreement provides for asymmetrical field-of-use restrictions and where the licensee's production facility, which is tooled up to use the licensed technology, is also used to produce products outside the licensed field of use with its own technology.

Where settlement and non-assertion agreements are proportionate and used to clear legitimate blocking positions, they may be pro-competitive. This principle also applies to cross-licensing

agreements, provided that the parties do not impose restrictions on the use of their technologies, including restrictions on the licensing to third parties. However, even then, the Commission notes that where under the agreement the parties are entitled to use each other's technology and the agreement extends to future developments, the Commission will assess whether the agreement prevents the parties from gaining a competitive lead over each other. In that case the agreement risks being caught by article 101(1) TFEU and is unlikely to satisfy the conditions of article 101(3) TFEU.

Finally, the TT Guidelines provide guidance on the assessment of technology pools, namely arrangements whereby two or more parties assemble a package of technology that is licensed as a package to third parties. The Commission notes that technology pools can produce pro-competitive effects, in particular by offering a 'one-stop shop', which may lead to reduced transaction costs and lower cumulative royalty rates. However, these positive effects are contingent on a number of important conditions regarding the institutional framework of the technology pool and the nature of the pooled technologies. In particular, the Commission takes the view that when a pool is composed only of technologies that are essential and therefore by necessity also complementary, the creation of the pool as such generally falls outside article 101(1) TFEU, irrespective of the market position of the parties. A technology is considered essential as opposed to non-essential if there are no substitutes for the technology inside or outside the pool and the technology in question constitutes a necessary part of the package of technologies for the purpose of producing the product(s), or carrying out the process(es) to which the pool relates. In contrast, the inclusion in the pool of substitute technologies is generally not permitted, while the inclusion of non-essential but complementary patents may trigger the application of article 101(1) TFEU, in particular where the pool has a significant position in any relevant market.

In many cases technology pools support industry standards. Importantly, however, while the TT Guidelines do not discuss standardisation agreements, the Guidelines on Horizontal Cooperation Agreements (2011) provide guidance on those types of agreements. In particular, for standardisation agreements not to be caught by article 101(1) TFEU, the Commission takes the view that participation in standard-setting should in principle be unrestricted, while the procedure for adopting the standard in question should be transparent. Moreover, standardisation agreements should not contain an obligation to comply with the standard and should provide access to the standard on FRAND terms.

Expiry of the TTBER in 2014 and review of the current regime

The TTBER and the TT Guidelines will expire in April 2014. As part of its evaluation of the current regime, the Commission commissioned an economic study by Pierre Régibeau and Katherine Rockett of the 2004 Technology Transfer Guidelines.

The November 2011 report by Régibeau and Rockett identifies a number of relevant developments, in particular the growth of patent thickets. Patent thickets refer to situations where access to a large number of IPRs are required in order to manufacture a non-infringing product, and these IPRs are owned by a significant number of different firms. The report discusses the main effects generally associated with patent thickets – royalty stacking and increased transaction costs for prospective licensees – together with industry responses to alleviate those negative effects, in particular cross-licensing and patent pools, which may, however, themselves give rise to anti-competitive issues. It also suggests a number of changes to the current TTBER and TT Guidelines.

In February 2013, the Commission published its proposals for the future TTBER and the accompanying TT Guidelines that will enter into force in 2014. The proposals contain a number of significant changes to the current regime. In particular, the Commission intends to narrow the scope of the safe harbour by lowering the market share threshold from 30 to 20 per cent for licensing agreements

between non-competitors. In addition, the Commission proposes to narrow the situations in which licensees may be prevented from 'passively' selling the contract products to customers outside their territory and suggests changes to the treatment of grant-back clauses. Importantly, it also suggests to no longer allow licensors to terminate the licence agreement if the licensee challenges the validity of the licensed IP. Not surprisingly, this latter proposal has attracted a lot of criticism.

In line with the proposed changes to the TTBER, the Commission suggests significant modifications to the TT Guidelines. The most notable proposed changes concern no-challenge provisions in the context of settlement agreements and licensing agreement concluded between patent pools and third parties, which would no longer benefit from the protection of the safe harbour provisions of the TTBER and would, as a consequence, be subjected to an individual assessment.

The public consultation regarding the Commission's proposals closed in May 2013. The new TTBER and TT Guidelines are expected to be published in the first months of 2014.

Pay-for-delay patent settlements in the pharmaceutical sector

The Commission's competition inquiry into the pharmaceutical sector revealed a number of structural issues and problems in companies' practices that potentially lead to distortions of competition. The anti-competitive practices highlighted by the Commission in its 2009 report included, inter alia, patent clusters, interventions before national authorities with regard to regulatory approvals, and pay-for-delay arrangements between originators and generics.

In the pharmaceutical sector, the Commission now specifically focuses on reverse payment settlements, whereby brand firms typically pay generic firms not to challenge the validity of the IP owner's patents and keep the generic version of the drug out of the market for some period of time. At the root of the Commission's argument is the concern that pay-for-delay settlements amount to anti-competitive market sharing. The Commission is concerned that these types of settlements can be an anti-competitive pay-off for an otherwise eligible competitor not to enter the market. The brand companies argue that pay-for-delay and 'reverse payments' are a legitimate means to protect and maintain their lawful patent terms and avoid lengthy and costly litigation.

Following its sector inquiry, the Commission stepped up its antitrust enforcement action in the pharmaceutical sector. First, the Commission has recently fined Johnson & Johnson and Novartis €16 million for having concluded an anti-competitive agreement to delay the market entry of a cheaper generic version of the pain-killer Fentanyl. Second, in June 2013, the Commission imposed a fine of €93.8 million on Lundbeck, as well as fines amounting to €52.2 million on several generic companies. It remains to be seen whether the Commission's findings – including the level of the fine – will be upheld on appeal and whether the Commission will adopt a different view on other ongoing patent settlement cases. These matters are by no means unique. Indeed, already in 2011 the Commission started an ex officio investigation in order to assess whether an agreement between Cephalon Inc and Teva Pharmaceutical Industries Ltd was preventing the generic Modafinil from entering the market and in *Les Laboratoires Servier*, an investigation initiated in 2009, the Commission issued a statement of objections in 2012 against Servier and other companies regarding a cardiovascular medicine, Perindopril, for delaying or preventing market entry of cheap generic versions of this medicinal product.

Its December 2013 report on settlement agreements between originators and generic companies in the pharmaceutical sector, the Commission observes that the number of patent settlements in the sector has steadily increased.

Article 102 TFEU: refusal to grant IP licences and compulsory licensing

The mere refusal to license IPRs is not in itself objectionable under EU competition law. However, in exceptional circumstances the refusal by a dominant company to grant a licence under its IPRs can be considered to be an abuse under Article 102 TFEU. The community courts have considered this question in a number of cases, in particular *Magill* (1992), *Microsoft* (2007) and *IMS Health* (2004). In *Magill*, the ECJ held that the refusal by copyright holders in the United Kingdom and Ireland to grant licences to third parties to provide a new comprehensive television listings magazine was abusive under article 102 TFEU. In *Microsoft*, Microsoft abused its dominant position by refusing to license the specifications required to ensure interoperability between its operating system and work group server operating systems of competitors, and *IMS Health* concerned the refusal to license a copyright-protected data analysis structure in Germany that is used in the pharmaceutical sector.

Recently, in the 2012 *Microsoft* judgment, the ECJ confirmed that a refusal by a dominant company to license its IPR that is indispensable for carrying on a particular business, is an abuse under article 102 TFEU where three cumulative conditions are satisfied, namely: (i) that the refusal is preventing the emergence of a new product for which there is a potential consumer demand; (ii) that it is unjustified; and (iii) that it is such as to exclude any competition on a secondary market.

While the precise legal standard may be difficult to apply in practice and continues to give rise to a number of questions, it is clear that in specific circumstances EU competition law requires dominant companies to license their IPRs.

Standard essential patents (SEPs) and FRAND licensing

Recently, the concept of fair, reasonable and non-discriminatory (FRAND) licensing terms has become a hotly debated topic in competition law (see, for instance, Paul Lugard, 'Technology Licensing: Evolving Antitrust Standards in the Smartphone and Other Sectors', *CPI Antitrust Chronicle*, April 2012(2)). FRAND licensing is particularly important in relation to SEPs (ie, patents that are necessarily infringed when manufacturing a product according to the relevant technical standard).

While standards can be set by ad hoc agreements among firms, or by formal government standard-setting bodies, technical standards agreed upon by the members of standard-setting organisations (SSOs), such as the European Telecommunications Standards Institute (ETSI), the International Telecommunication Union (ITU) and the Institute of Electrical and Electronics Engineers (IEEE) have attracted the most attention. Standards often have a positive impact on competition and consumer welfare since they ensure interoperability between products from different manufacturers and thereby increase consumer choice. However, as standards frequently involve patented technologies, firms that wish to manufacture a product according to a standard will need to obtain a licence from the holders of the essential patents.

One main concern of antitrust enforcement agencies is that holders of SEPs may engage in 'patent hold-ups' or 'patent ambushes', whereby the IP owner conceals the existence of its patent and, once its technology is incorporated in the standard and the standard has been widely adopted, charges excessive or discriminatory royalties, or even refuses to license its patents. In December 2007, for instance, the Commission issued a statement of objections against Rambus, a US chip designer, for infringing article 102 TFEU by having engaged in a patent ambush in relation to certain memory chip technologies. In 2009 Rambus agreed to lower its memory chip royalty rates. The Commission also opened proceedings against the US chipset manufacturer Qualcomm, alleging that Qualcomm's royalty rates did not adhere to FRAND terms. The Commission closed its investigation in 2009 after the complainants withdrew their complaints.

In response to litigation involving Apple and a number of companies holding SEPs for smartphones in a number of jurisdictions, in 2012 the Commission opened formal proceedings against Samsung and Google-Motorola. Complaints for failure to license SEPs on FRAND terms have also been filed against InterDigital Inc, Nokia and Microsoft. At the heart of these investigations is the question of in which circumstances seeking and enforcing injunctions with regard to SEPs encumbered by FRAND commitments amounts to an abuse of a dominant position prohibited by article 102 TFEU.

The recently proposed draft Samsung commitments make clear that the Commission takes the position that SEP owners are only entitled to seek an injunction before any EEA court if, following an independent adjudication process, the prospective licensee has been found to be unwilling to enter into a FRAND licence.

Finally, as the *IPCom* case illustrates, the Commission also seeks to ensure that IP owners that acquire patent portfolios honour FRAND commitments made by previous owners of the IPRs.


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