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Summary

Intellectual property law seeks to promote society's industrial development through the recognition of patents. The logic of granting patent protection is clear-cut: Patents provide incentives for developing new technology. The lack of an adequate legal protection for innovations would slow progress and the benefits it brings. Without legal protection, companies would be unlikely to spend significant amounts of money on the R&D that are the source of new products and processes.¹

Unlike patents, know-how is not an intellectual property right. For companies it might nevertheless represent economic values that are the equivalent of patents. Patents and know-how are usually licensed together. A combined patent and know-how licensing agreement is advantageous for both the licensor and the licensee. From the perspective of the licensor, a combined license makes it possible to maximise the profit of the invention. From the perspective of the licensee, a combined license is valuable since it saves money and time. Moreover, most licensing agreements are beneficial for society. The possibility of exploiting an invention through the use of a license creates incentives for innovation. In addition, it leads to the dissemination of technology.

EC competition law does not affect the *existence* of intellectual property rights obtained under national intellectual property laws. However, when an inventor decides to license a patented invention and related know-how, EC competition law may be operative and thus might govern the *exercise* of intellectual property rights granted under national intellectual property law. Article 81 EC addresses anti-competitive agreements, and certain patent and know-how licensing agreements could violate Article 81(1) EC. In May 2004, a new block exemption regulation on technology transfer - the 2004 Technology Transfer Regulation - entered into force, which placed patent and know-how licensing agreements that are considered to have significant pro-competitive effects outside the scope of Article 81(1) EC.

The 2004 Technology Transfer Regulation (the 2004 TTBER) is the legal instrument that governs the framing of technology transfer agreements within the EU. The Regulation takes a positive stance to licensing. The approach underlying the 2004 TTBER is based on economics. The main features of the Regulation are the market share threshold, the distinction drawn between agreements between competitors and non-competitors and the inclusion of the principle "what is not strictly prohibited is allowed". The 2004 TTBER is expected to have a strong influence on the formation of licensing agreements in the future. The Regulation provides companies with flexibility. It brings a fruitful economic approach into the field of licensing. Furthermore, the 2004 TTBER brings the EU approach to licensing in harmony with that in the US.

¹ Jaffe and Lerner, p. 8.

As part of the Lisbon strategy, the EU has set as its objective to become the most competitive economy by the year of 2010. In reaching this objective a legal framework, which creates incentives for innovation and promotes the dissemination of technology is of outmost importance. The 2004 TTBER do these things and should have an important part to play in reaching the objective of the Lisbon strategy.

Preface

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Abbreviations

EC	European Community
ECJ	European Court of Justice
EEA	European Economic Area
EPC	European Patents Convention
EU	European Union
IP	Intellectual Property
NCA	National Competition Authorities
OECD	Organization for European Co-operation and Development
OJ	Official Journal
R&D	Research and Development
SSNIP	Small but Significant and Non-Transitory Increase in Prices
TTBER	Technology Transfer Block Exemption Regulation
US	United States
USA	United States of America

1 Introduction

1.1 Background

Intellectual property law seeks to promote society's industrial development through the recognition of patents. When an inventor contributes to technical growth through a particular invention, he is given an exclusive right – a patent – to his technical achievement.² Thus, the patent is a reward for the inventor's innovation.³ However, not all inventions are entitled to a patent. For example, European patent law, which is governed by Article 52 of the European Patents Convention (EPC), states that a patent may be granted only if the three following requirements are met: (1) the invention must be capable of industrial application;⁴ (2) the invention must represent a "state-of-the-art" advance in its field; and (3) the invention must not be an obvious creation to those familiar with the field concerned.

Patents give exclusive rights to the inventor to prevent others from exploiting the invention commercially. Without the consent of the inventor, no one else may produce, use or sell the patented invention, nor are others allowed to import or hold such an invention.⁵ When the inventor does give consent to produce, use or sell a patented invention, a common method of doing so is through the use of a license. Through a patent licensing agreement, the inventor permits someone else – the licensee – to avail itself of the patent under terms and conditions agreed upon by the parties.

Among other things, a patent application must contain a description of the invention that is clear enough to enable a skilled person to carry out the invention. However, the description need not contain information that would be required to optimize the invention's usefulness in manufacturing or other kinds of know-how concerning the invention.⁶ In other words, not all know-how needs to be published in the patent application. That said, it is common that know-how regarding the use of the patent in manufacturing and marketing is included in patent licensing agreements.

EC competition law does not affect the *existence* of intellectual property rights obtained under national intellectual property laws. Patents are granted in accordance with national patent legislation, which also sets forth the subject matters of patents. However, when an inventor decides to license a

² Bernitz and others, p. 119.

³ Craig and De Búrca, p. 1089.

⁴ An invention is capable of industrial application provided that the invention has technical character, technical effect and is reproducible. See Koktvedgaard and Levin, pp. 239-248.

⁵ According to the principle of Community exhaustion, once a product incorporating an intellectual property right is put on the market inside the European Economic Area (EEA) by the holder or with his consent, the intellectual property right is exhausted. The holder no longer controls the sale of the product.

⁶ See Koktvedgaard and Levin, p. 213.

patented invention and related know-how, EC competition law may be operative and thus might govern the *exercise* of intellectual property rights granted under national intellectual property law. For example, Article 81 EC addresses anti-competitive agreements, and certain patent and know-how licensing agreements could violate Article 81(1) EC. In general, however, patent and know-how licensing agreements are considered to have a positive impact on competition.⁷ In May 2004, a new technology transfer block exemption regulation - the 2004 Technology Transfer Regulation - entered into force, which placed patent and know-how licensing agreements which are considered to have significant pro-competitive effects outside the scope of Article 81(1) EC.

1.2 Purpose

This thesis examines how EC competition law addresses patent and know-how licensing. It focuses on the 2004 Technology Transfer Regulation and analyses whether it promotes the use of patent and know-how licensing agreements.

1.3 Method and Material

In writing this thesis, I have used traditional legal method. In order to elucidate the workings of EC law with respect to patent and know-how licensing I have studied relevant legislative material. In this context, important legislation includes the EC Treaty, the 2004 TTBER and the TTBER Guidelines. In the concluding analysis, I draw upon The Global Competitiveness Report 2005-2006. Important doctrine and articles have been surveyed. In addition, pertinent case law – especially the Consten and Grundig case, the Nungesser case and the Windsurfing case - has been looked into.

In the doctrine I have studied, the most important works have been Jones' and Sufrin's textbook *EC Competition Law – Text, Cases and Materials* and Fines' *The EC Competition Law on Technology Licensing* as well as Lidgard's *Licensavtal i EU*. Important articles include Månsson's and Persson's "Svårtillämpat nytt EG-gruppundantag för licensavtal" and Fine's "The EU's new antitrust rules for technology licensing: a turbulent harbour for licensors".

⁷ Recital 5 of the 2004 Technology Transfer Regulation states that technology transfer agreements "will usually improve economic efficiency and be pro-competitive as they can reduce duplication of research and development, strengthen the incentive for the initial research and development, spur incremental innovation, facilitate diffusion and generate product market competition". The likelihood that the pro-competitive effects will outweigh the restrictive ones, however, is according to the regulation dependent on the degree of market power held by the parties.

The thesis is mainly descriptive and expository. It, however, also includes analytical elements. In principle, the descriptive and expository parts are devoid of value judgments while the analytical elements contain value judgments.

1.4 Delimitations

This thesis solely considers patent and know-how licensing with respect to Article 81 EC. An analysis of licensing with respect to Article 82 EC falls outside the scope of this work. Thus, the thesis does not pay attention to what will apply if an undertaking that holds a dominant position refuses to out license its technology or if an undertaking in a dominant position acquires a license. Indeed, these are highly interesting and relevant topics. A discussion of these, however, would require a separate thesis.

1.5 Disposition

This thesis is divided into six parts. The first part is an introduction. In the second part, I discuss patent and know-how licensing. The terms patent and know-how are discussed and defined. In this context, I also present the particular definition of know-how that is employed in this thesis. In addition, I discuss the different functions of licensing. Thereafter I present the object of patent and know-how licensing agreements. Finally, I discuss Article 81 EC and block exemptions.

The third part provides a history of licensing within the EC. This presentation takes its starting point in the early 1960's and ends in the middle of the 1990's. I discuss case law which has influenced the attitude to licensing within the EC. The cases discussed are the Consten and Grundig case, the Nungesser case and the Windsurfing case. In this context, I also briefly present the first three block exemption regulations in the field of intellectual property rights licensing. These are the Know-how Regulation, the Patent Regulation and the 1996 Regulation.

The thesis' fourth part presents the 2004 Reform. In this part I discuss the Commission's review work of the former block exemption regulation for patent and know-how licensing, the 1996 Regulation. Moreover, I look into the early draft for a new TTBER as well as the submissions on the draft and the Commission's response to these. A short presentation of Regulation 1/2003 and the decentralisation of the enforcement system within EC competition policy also form part of chapter four.

In the fifth part of the thesis, I present the 2004 TTBER. I review the content and the function of the new TTBER. Chapter five provides the necessary background for the analysis in chapter six as to whether the 2004 TTBER promote the conclusion of patent and know-how licensing agreements. In the analysis, I underline the importance of a legal

framework, which provides incentives for innovation and promotes dissemination of technology.

2 Patent and know-how licensing

2.1 Definitions

The *Encyclopaedia Britannica* defines the term patent in the following way: “A government grant to an inventor of the right to exclude others from making, using or selling an invention, usually for a limited period.” *Nationalencyklopedin* defines patent as follows: “An exclusive right provided by law to exploit an invention for a certain period of time.”⁸

The time of protection against commercial exploitation of the invention by others is in general 20 years from the date of filing a patent.⁹ Patents are granted with respect to the product or process disclosed in the patent application.

In *Nationalencyklopedin* know-how is defined as: “A term which is mainly used within industry, as a comprehensive name for such technical and economic knowledge and experience which is peculiar for a company.”¹⁰ A similar definition is to be found in *Juridikens termer*: “The sum of such special knowledge and experience of a technical or commercial kind, which, without being protected by a patent, nevertheless is necessary for the manufacturing or marketing of a certain product.”¹¹

As is apparent from the definitions of know-how, the knowledge and experience referred to by this term does not need to be secret. However, when know-how is included in patent licensing agreements it is usually a question of secret know-how. It is this definition of the term that is employed in this thesis. Secret know-how ought to cover the same grounds as trade secrets.¹² Strictly speaking, know-how is not an intellectual property right, but it is often an element in commercial transactions such as licensing agreements.¹³ Know-how is in general included in patent licensing agreements.

⁸ Author's own translation from Swedish.

⁹ Article 63 EPC. Council Regulation 1768/92 on the creation of supplementary protection certificates for medicinal products allows for a period not exceeding five years to be added to the period of 20 years with respect to delays in regulatory approval.

¹⁰ Author's own translation from Swedish.

¹¹ Author's own translation from Swedish.

¹² Bernitz and others, p. 264.

¹³ Jones and Sufrin, p. 690.

2.2 The Functions of Licensing

In this section, I shall describe some of the functions that patent and know-how licensing fulfil. This is done from the perspective of the licensor as well as from that of the licensee.¹⁴ The section starts with a presentation of the functioning of patent licensing and continues with the functioning of know-how licensing.

Patent licensing agreements fulfil a risk spreading function. A patent licensing agreement divides the considerable investments connected with research, development and exploitation of an invention between the patent holder and the licensee. For smaller companies that are specialised on research and development, a licensing agreement with a larger company could be the only way to implement new technical ideas.¹⁵ In addition, it presents an opportunity to reach a wider market.

A patent licensing agreement only confers a right on the licensee to exploit the patent. However, the licensee is often interested in knowing how to make an optimal profit by the licensed right. For this reason, pure patent licensing agreements are seldom entered into.¹⁶ In most cases, patent licensing agreements include know-how concerning the exploitation of the patent in manufacturing and marketing. Knowledge and experience of this kind is decisive for a rational exploitation of the patent. To be sure, in the course of time, the licensee may obtain such know-how by himself, but acquisition of know-how is often time consuming and costly. From the perspective of the licensee, the licensing of know-how in connection with a patent licensing agreement is beneficial since it saves money and time. From the perspective of the patent holder, a combined license makes it possible to maximise the profit on the invention.¹⁷

2.3 The Object of Agreement

The object of agreement dealt with in this thesis is the patented invention and the know-how facilitating the exploitation of the patent for manufacturing and marketing purposes. Agreements concerning this kind of objects are usually referred to as manufacturing-licensing agreements.¹⁸

Know-how can be divided into technical and economic know-how.¹⁹ When know-how is included in patent licensing agreements it is mostly the

¹⁴ For a more thorough discussion of the functioning of patent licensing, see Sandgren, p. 79 ff. and Gozzo, pp. 105-107. For a discussion of the functioning of know-how licensing, see Gozzo, pp. 83-84.

¹⁵ Bernitz and others, p. 113.

¹⁶ Andersson and others, p. 59.

¹⁷ Fischer and others, pp. 72-74.

¹⁸ Bernitz and others, p. 167.

¹⁹ Sandgren, p. 165.

question of technical know-how. In consequence, this type of know-how will be given more space in the following discussion. I shall start with a presentation of technical know-how and then continue with a presentation of economic know-how.

In this thesis, technical know-how denotes such knowledge and experience that is needed to manufacture an invention in an optimal way.²⁰ According to doctrine, knowledge of this kind is termed complementary know-how.²¹ Know-how is brought into the manufacturing process - not as a necessary condition for its functioning – but for it to function in an optimal way. Hence, its complementary nature concerns the fact that something is brought into the manufacturing process. That is not to say that the manufacturing process would not work without this know-how. Instead, it is a question of how to render the manufacturing process more effective. Quality controls during a critical stage of the manufacturing process or the greasing of a machine at certain intervals are both examples of complementary know-how. This type of know-how is of significant economic value since it makes possible a position of precedence in terms of price and quality competition.

A licensee is interested not only in how an invention is manufactured in an optimal way but also in how the product might be marketed. That is, the licensee is interested in the type of economic know-how which concerns the sale of the finished product.²² Examples of such economic know-how include the management of an advertising campaign for a certain product, guidelines for how market research should be carried out or data obtained from earlier market surveys.

Taken as a whole, technical and economic know-how as described above aims at an optimal production and sale result.

2.4 Article 81 EC

Article 81 EC addresses anti-competitive agreements. It is applicable to horizontal as well as vertical agreements.²³ Article 81(1) EC declares:

²⁰ Technical know-how can also consist of knowledge about a whole manufacturing process or about a necessary part of this process. Accordingly, know-how does not necessarily concern the most efficient way of carrying out a process. Know-how of the former kind is called independent know-how. See Fischer and others, p. 75 and Sandgren, p. 175.

²¹ Fischer and others, p. 74. Sandgren, p. 166, uses the term optimising know-how which he means is “of complementary nature”.

²² Economic know-how, just as technical know-how, can be divided into complementary and independent know-how. When referring above to know-how concerning the sale of the finished product it is a question of complementary economic know-how. Examples of independent economic know-how would be services, i.e. the “products” of service producing companies. See Fischer and others, p. 75 and Sandgren, p. 180.

²³ See ECJ, Case 56/65, *Société La Technique Minière (STM) v. Maschinenbau Ulm GmbH*, [1966] ECR 235 [1966] CMLR 357. Horizontal agreements are agreements between firms at the same level of the production cycle. Vertical agreements are agreements between firms at different levels of the distribution cycle.

The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market [...].

For its application, Article 81(1) EC requires that the following three independent cumulative criteria are fulfilled: (1) there must be an agreement between two or more undertakings (“Agreement criterion”); (2) which must have an impact on trade between Member States (“Trade criterion”); and (3) which has as its object or effect the prevention, restriction or distortion of competition within the common market (“Competition criterion”).²⁴

Article 81(1) EC contains a non-exhaustive list of agreements that restrict competition. Examples include agreements that aim at the fixation of prices and the sharing of markets. Agreements, which breach Article 81(1) EC, are invalid under Article 81(2) EC.

National patent legislation confers a right on the patent holder to prevent unauthorised use of the patented invention and to exploit it, inter alia, by licensing it to third parties. Thus, national patent legislation grants the patent holder an exclusive right of exploitation. However, intellectual property rights are not immune from competition law intervention.²⁵ Although not specifically mentioned within the non-exhaustive list of agreements capable of restricting competition, it is nonetheless clear that licensing agreements may produce restrictive effects.²⁶ In fact, Article 81 EC is applicable in particular to agreements whereby the holder licenses another undertaking to exploit his intellectual property rights.²⁷ Certain licensing agreements could therefore violate Article 81(1) EC. The Article is applicable as soon as a cross-border element is present.

It should be noticed that there is no inherent conflict between intellectual property rights and Community competition rules. Both branches of law aim at promoting consumer welfare and an efficient allocation of resources.²⁸ Intellectual property rights promote dynamic competition by encouraging undertakings to invest in research and development which are the source of new products and processes in a modern economy. In the same vein, competition puts pressure on undertakings to innovate. In fact, Community competition rules seek to promote a sound competitive environment for the exploitation of intellectual property rights. These rules try to strike a balance between the intellectual property right – the right to exploit a patented invention through the use of a license - and the need to preserve a sound competitive environment.

²⁴ Lidgard 2005-2006, p. 50.

²⁵ Commission Notice – Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements, O.J. C101/2, 2004, para. 7 (TTBER Guidelines).

²⁶ Lidgard, p. 41.

²⁷ Craig and De Búrca, p. 1111. See Joined Cases 56 & 58/64, *Etablissements Consten SA & Grundig-Verkaufs-GmbH v. Commission*, [1966] ECR 299 [1966] CMLR 418.

²⁸ TTBER Guidelines, para. 7 and Craig and De Búrca, p. 936.

Licensing agreements may have restrictive effects on competition. However, most license agreements do not restrict competition; instead, they create pro-competitive efficiencies, lead to the dissemination of technology, and promote innovation.²⁹ In addition, licensing agreements, which have restrictive effects on competition, may nevertheless produce pro-competitive effects, which outweigh their downsides. Article 81(3) EC makes allowance for exemption from Article 81(1) EC for such licensing agreements that have mainly positive effects on competition. Article 81(3) EC offers the possibility of individual exemption as well as block exemption as issued by the Commission.

For a licensing agreement to obtain an individual exemption under Article 81(3) EC, it must fulfil four criteria, two positive and two negative: (1) the agreement must improve the production or distribution of goods or promote technical or economic progress; (2) consumers must receive a fair share of the resulting benefit; (3) it must only contain restrictions that are indispensable for attaining the agreement's objectives; and (4) it cannot lead to the elimination of competition with respect to a substantial part of the products in question.³⁰

2.5 Block Exemptions

Article 81(3) EC allows the Commission to issue so-called block exemptions. Block exemptions are issued by the Commission in order to exempt a whole category of agreements from the application of Article 81(1) EC.³¹ Thus, block exemptions provide a safe harbour for certain types of agreements considered to have positive effects on competition. Experience of individual agreements has led to the conclusion that certain types of agreements warrant exemption. Block exemptions take this conclusion as its starting point. Their purpose is to give detailed guidance to firms and their legal advisers on the exemptions to Article 81(1) EC.³² An agreement, which does not fall within the scope of a block exemption, is not automatically presumed to be contrary to Article 81(1) EC. It may still benefit from an individual exemption.

The Commission recently issued a new block exemption regulation for technology transfer agreements, the 2004 Technology Transfer Block Exemption Regulation (TTBER). This block exemption regulation is, as stated above, the subject matter of this thesis. The regulation brought such patent and know-how licensing agreements that are considered to have significant pro-competitive effects outside the scope of Article 81(1) EC. The 2004 TTBER is discussed in detail later in this thesis.

²⁹ TTBER Guidelines, para. 9.

³⁰ Craig and De Búrca, p. 964.

³¹ When enacting block exemptions the Commission is acting with authority delegated from the Council.

³² Craig and De Búrca, p. 968.

3 History of Licensing within the EC

3.1 General Overview

The approach to licensing agreements within the EC has shifted over the years. In the early 1960's the Commission had a permissive attitude towards such agreements. The use of licensing agreements was considered a right intrinsic to the intellectual property right, i.e. the right to exploit a patent through the use of a license. However, after a short period of tolerance, the political approach became stricter. The Commission arrived at the view that many licensing agreements restricted competition. In the course of time, however, industry's negative reactions and the fact that USA and Japan had surpassed Europe in the technological field forced the Commission to abandon its harsh politics. The role of licensing in the dissemination of new technology became evident to the Commission. In what follows, I shall give a short overview of the history of licensing within the EC.

3.2 The 1962 Christmas Message

On December 24, 1962, the Commission issued an announcement concerning patent licensing - the 1962 Christmas Message – in which it expressed a favourable opinion of licensing agreements.³³ The Commission argued that the use of licensing agreements was a right intrinsic to the intellectual property right. Thus, the licensor was in principle free when framing the licensing agreement as long as the patent covered the obligations imposed on the licensee. According to the announcement, the license might be limited to production, use or sales; technical applications or fields of utilization might be restricted and the quantity of products manufactured might be delimited. Even exclusive patent licensing agreements were considered to fall outside the scope of Article 81(1) EC. Hence, the licensor was free to refrain from appointing any other licensee within the same territory and also to refrain from manufacturing, utilising or selling within that territory. The Commission stated that licensing agreements coming within the notice, and thus falling outside the scope of Article 81(1) EC, did not need to be notified to the Commission.³⁴ The Commission motivated its permissive attitude by the following statement: “Leaving out of account the controversial question whether such exclusive undertakings have the object or effect of restricting competition, they are not likely to affect trade between Member-States as things stand in the

³³ Commission Notice of 24 December 1962 on patent licensing agreements, O.J. 1962 139/2922 – (withdrawn 1984). The announcement is referred to as the Christmas Message due partly to its issue date and partly to its contents.

³⁴ Lidgard, p. 48.

Community at present.”³⁵ The idea was that even if exclusive licensing agreements would restrict competition this was bound to yield to the national intellectual property rights legislation. Regulation 17/62 confirms that a favourable attitude was taken towards licensing agreements.³⁶ Article 4.2(2b) of that regulation conceded that notification was not required for licensing agreements between two parties which would only impose restrictions on the exercise of the licensed rights.

However, the attitude towards licensing agreements became increasingly less permissive. More and more intellectual property rights cases were put before the Court and the Commission examined an increasing number of notified agreements. The reason for this change in attitudes is partly to be found in the development of the exhaustion of rights doctrine; the most significant event was, however, the distinction established in the *Consten and Grundig* case between the existence of an intellectual property right and its exercise.³⁷ I shall discuss this case below.

3.3 Consten and Grundig

The *Consten and Grundig* case marks the starting point of the changing attitudes towards licensing agreements within the EC.³⁸ This case concerned an exclusive distribution agreement reached between a German producer, Grundig, and a French distributor, Consten. In the agreement, Grundig appointed Consten to act as its exclusive distributor in France and allowed Consten to register its trade mark GINT in France. The provisions of the agreement and the registration of the trade mark awarded Consten with absolute territorial protection by enabling it to hinder parallel imports of Grundig’s products to France through the use of proceedings against trade mark infringement.³⁹

The Court held the opinion that vertical as well as horizontal agreements could fall within the prohibition of Article 81(1) EC.⁴⁰ There was no need to distinguish between different types of collaboration if the Treaty did not so. Furthermore, the mere fact that the object of agreement was to restrict competition was enough to bring it within the scope of Article 81(1) EC. Thus, there was no reason to establish its effects. For the first time the ECJ articulated a distinction between the *existence* of an intellectual property right and the *exercise* of that right. The Court argued that while EC competition law did not affect the existence of an intellectual property right

³⁵ Quoted from Lidgard, p. 48.

³⁶ Council Regulation 17/62/EEC of 6 February 1962, First Regulation implementing articles 85 and 86 of the Treaty, [1962] O.J. L13/204.

³⁷ Jones and Sufrin, p. 704.

³⁸ ECJ, Joined Cases 56 & 58/64, *Etablissements Consten SA & Grundig-Verkaufs-GmbH v. Commission*, [1966] ECR 299 [1966] CMLR 418.

³⁹ Jones and Sufrin, p. 695.

⁴⁰ See Case 56/65, *Société La Technique Minière (STM) v. Maschinenbau Ulm GmbH*, [1966] ECR 235 [1966] CMLR 357.

obtained under national intellectual property law it might, however, affect its exercise. According to the ECJ, the transference of absolute territorial protection on Consten through the agreement reached between Consten and Grundig infringed upon Article 81(1) EC. The intellectual property right granted under national intellectual property law – in this case a trade mark – was not considered to justify the transference of absolute territorial protection. The reasoning of the ECJ was based on the position already taken in *Costa v ENEL*⁴¹ that in case of a direct conflict between national law and Community law, the former would have to yield.⁴² Thus, national intellectual property law would have to yield to Community competition rules in case of a conflict between the two bodies of law. Through the limitation set by Community competition rules on the rights inherent in the intellectual property right, the Court at the same time secured a free movement of goods; this movement being a necessary condition for the achievement of the Treaty's objective to establish an internal market.⁴³

In Consten and Grundig case the trade mark license was used in an attempt to separate Member State markets and to create absolute territorial protection. The potentially harmful effects of exclusive licensing demonstrated in the case of Consten and Grundig led the Commission to adopt a more restrictive approach to licensing. The Commission considered exclusive licenses, unless *de minimis*, to fall within Article 81(1) EC; many non-territorial restrictions were also held to be outside the scope of the patents.⁴⁴ This was the view throughout the 1970's. The rationale of the Commission's position was that if the licensor had not given an exclusive license, he might instead have given a non-exclusive one. This in turn, would have increased competition in the relevant market. However, in practice licensees seldom entertain any other license than an exclusive one. The commercial exploitation of a license entails too great risks. Hence, in reality, it is hardly a question of choosing between an exclusive and a non-exclusive license, but rather between an exclusive license and none at all.⁴⁵

3.4 The 1970's

The new less permissive approach to licensing agreements met with strong criticism from representatives of the industry. They argued that without an adequate protection licensees would be unlikely to undertake major investments that are the source of the dissemination of new technology.⁴⁶ In other words, the representatives argued that the Commission's approach to

⁴¹ Case 6/64 *Costa (Flamino) v. ENEL* [1964] ECR 585, [1964] CMLR 425.

⁴² Lidgard, p. 50. This was a different position than the one taken in the 1962 Christmas Message in which the Commission established that competition rules would have to yield to the intellectual property right. At this time the supremacy of Community law had yet to be established by the ECJ.

⁴³ Article 3.1(c) EC.

⁴⁴ Jones and Sufrin, p. 704.

⁴⁵ *Ibid.*

⁴⁶ Lidgard 2005-2006, p. 245.

licensing agreements would halt or slow technological development and the benefits it brings.

Nevertheless, during the 1970's the Commission decided that exclusive licenses were in restraint of competition and therefore came within Article 81(1) EC. If the parties were willing to modify the exclusivity clauses and other provisions considered as restrictions (such as tying-clauses, non-challenge clauses and grant-back clauses), the Commission would however exempt them under Article 81(3) EC.⁴⁷ From the experience of handling these cases the Commission set about to adopt a block exemption regulation on patent licenses. In 1979, the Commission presented its proposal of a new block exemption regulation. However, lengthy negotiations with Member States, industry and other interested parties delayed the adoption of the block exemption regulation until 1984.⁴⁸ In addition, the Commission wanted to await the ECJ's judgment in the pending Nungesser case; Nungesser was the first case since *Consten and Grundig* in which the ECJ had to deal with an exclusive licence.⁴⁹

3.5 Nungesser

The Nungesser case was an appeal against the Commission's decision in *Maize Seeds*.⁵⁰ In this case, the ECJ view on exclusivity differed from that adopted by the Commission. Although this case concerned plant breeders' rights the principles set out in the judgment are not limited to such rights.⁵¹

The case concerned an assignment of plant breeder's rights to a maize seed variety developed by INRA, a French State research institute, to Kurt Eisele and his firm Nungesser KG. Eisele registered the right in Germany. Under the agreement, Eisele was given the exclusive right to produce and distribute INRA varieties in Germany. In addition, INRA agreed with Eisele not to import the seed into Germany itself and to prevent others from doing so. The fact that the price of the hybrid maize seed was 70% higher in Germany than in France caused parallel imports of the seed into Germany. Eisele relied upon its intellectual property right to prevent parallel importers from importing seed into Germany obtained from another source in France and obtained a court approved settlement. After having received a complaint from a parallel importer, the Commission decided that the exclusivity and territorial protection provisions were covered by Article 81(1) EC and could not be exempted under Article 81(3) EC. Eisele and Nungesser appealed against the Commission's decision.

⁴⁷ Jones and Sufrin, p. 704.

⁴⁸ This Regulation is discussed in section 3.7 below.

⁴⁹ Case 258/78 *Nungesser (LC) AG and Kurt Eisele v. Commission* [1982] ECR 2015, [1983] 1 CMLR 278.

⁵⁰ Commission Decision 78/823/EEC (*Maize Seed*), Kurt Eisele and Institut National de Recherche Agronomique (INRA), [1978] O.J. L286/23, [1978] 3 CMLR 434.

⁵¹ Jones and Sufrin, p. 705.

The ECJ distinguished between an open and a closed exclusive license. The Court argued that an open exclusive license is a license relating only to the contractual relationship between the licensor and the licensee, whereby the licensor agrees not to grant other licences with respect to the same territory and not to operate in that territory himself. A closed exclusive license, on the other hand, is a license containing provisions which affect third parties and create absolute territorial protection. The purpose of the closed exclusive license is to eliminate all competition from third parties, such as parallel importers or licensees for other territories. The ECJ examined whether an exclusive license, in so far as it was an open one, would have the effect of preventing or distorting competition in the present case. The Court made an economic assessment of the license and considered whether the exclusivity clauses were necessary to induce the licensee to enter into the agreement. If this was the case competition would not be considered restricted. The Court pointed out that it was the question of a new product, which was unknown on the German market. The new technology was developed only after years of research and experimentation. The Court therefore argued that the licensee in such a situation might have been unwilling to consider any license but an exclusive one. If the grant of an exclusive license would not have been possible this would have been damaging to the dissemination of new technology and prevented inter-brand competition. Considering these circumstances the Court concluded that an open exclusive license was not in itself incompatible with Article 81(1) EC. However, the provisions related to the imposition of absolute territorial protection were automatically covered by Article 81(1) EC and did not qualify for an exemption under Article 81(3) EC. The Court argued that such a protection would clearly go beyond what would be the necessary conditions for improving production or distribution or promoting technological progress.

The distinction between an open and closed exclusive license is important. In *Nungesser* the ECJ established that an open exclusive license – granting the licensee exclusive rights without preventing a third party's right to act within the relevant territory – was not in itself incompatible with Article 81(1) EC. However, the Court did not thereby suggest that all open exclusive licenses were cleared. The Court specified four conditions, which an exclusive license had to fulfil for it to be regarded as compatible with Article 81(1) EC. Firstly, the product in question had to be new to the licensee's market. What was called for was new technology. Secondly, the new technology had to be the result of many years' of research and experimentation. Thirdly, without exclusivity the licensee might not have been willing to take on the risks involved in exploiting the new product. Finally, absence of the grant of such a license would have been damaging to the dissemination of new technology and would have prevented inter-brand competition.⁵² Provided that all of these four conditions were fulfilled the open exclusive license would not be considered as restricting competition and would fall outside the scope of Article 81(1) EC.

⁵² For further analysis of the *Nungesser* case, see Anderman, p. 64 ff.

The difference in approach between the Commission and the ECJ when assessing the agreement is noteworthy. The Commission condemned the exclusivity provisions in the agreement and claimed that they would automatically infringe upon Article 81(1) EC. The ECJ on the other hand used an approach based on rule of reason and considered the licence in its economic context. Thus, it was decisive for the conclusion of the Court whether exclusivity was necessary to get the agreement into existence. If so, then exclusivity would not infringe upon Article 81(1) EC. Therefore, the Court concluded that the open exclusive license was not in itself incompatible with Article 81(1) EC. However, when reasoning about the absolute territorial protection, the Court turned away from the approach based on rule of reason and condemned these provisions as being automatically captured by Article 81(1) EC and not qualifying for an exemption under Article 81(3) EC.

3.6 The 1980's

The discussions during the late 1970's between representatives of the industry and the Commission were largely unproductive. Both parties maintained their view on the suitability of exclusive licensing. The industry emphasised that collaboration in the form of licensing required major investments, which were in need of adequate protection. The Commission's draft from 1979 for a block exemption regulation on patent licenses did not satisfy the industry's interest in sufficient protection. Only through the ECJ's judgment in the Nungesser case was the deadlock situation eliminated. Based on Nungesser the Commission adopted Regulation 2349/84 on patent licensing agreements in 1984 and subsequently, in 1989, Regulation 556/89 on know-how licensing agreements.⁵³ Case law concerning the content of licensing agreements after the adoption of the Patent Regulation in 1984 is sparse. The Windsurfing case however is an exception, highlighting the approach of the Court and the Commission to non-territorial restrictions.⁵⁴ In what follows, I shall discuss the two block exemption regulations mentioned above and the Windsurfing case. I start with a presentation of the block exemption regulations, which are considered jointly, and then continue with a discussion of Windsurfing.

⁵³ Commission Regulation 2349/84/EEC of 23 July 1984 on the application of Article 85(3) of the Treaty to certain categories of patent licensing agreements, [1984] O.J. L219/15 and Commission Regulation 556/89/EEC of 30 November 1988 on the application of Article 85(3) of the Treaty to certain categories of Know-how licensing agreements, [1989] O.J. L61/1.

⁵⁴ Case 193/83, *Windsurfing International Inc v. EC Commission*, [1986] ECR 611, [1986] 3 CMLR 489.

3.7 The First Block Exemption Regulations

The Patent Regulation from 1984 and the Know-how Regulation from 1989 were the first two block exemption regulations adopted by the Commission within the field of intellectual property rights licensing. The Patent Regulation applied to pure patent licensing agreements and to mixed patent and know-how licensing agreements where the patent was the predominant element. In the same vein, the Know-how Regulation applied to pure know-how licensing agreements and to mixed know-how and patent licensing agreements where know-how was the predominant element.⁵⁵ Both Regulations applied only to agreements between two parties and followed a similar structure; they contained a so-called white list of provisions, which were considered not to restrict competition and therefore were exempted, and a so-called black list of provisions which were clearly prohibited and whose inclusion in an agreement would bring the whole agreement outside the block exemption regulation.⁵⁶

The Regulations exempted exclusive licensing agreements provided that they were open, i.e. that parallel trade in products was not prevented.⁵⁷ However, both Regulations contained an initial – limited – right to restrict passive sales of the licensed product.⁵⁸

Although the Regulations were very similar, differences existed. Thus, it was possible for the licensor or the licensee to benefit from these differences. When drafting an agreement lawyers could see to it that the agreement produced one sort of transaction rather than another depending on which Regulation that was the most beneficial for their client.⁵⁹

Often the Patent and Know-how Regulations are referred to as the straitjacket regulations because of their formalistic approach to licensing agreements. This formalistic approach attracted much criticism. The reactions from industry later paved the way for the enactment of a new block exemption regulation. However, the 1996 Technology Transfer Regulation that replaced the Patent and Know-how Regulations also turned out to be the result of a formalistic approach.⁶⁰

⁵⁵ Jones and Sufrin, p. 711.

⁵⁶ Ibid.

⁵⁷ However, the Court in Nungesser held these licensing agreements to fall outside Article 81(1) EC.

⁵⁸ Lidgard 2005-2006, p. 246.

⁵⁹ Jones and Sufrin, p. 711.

⁶⁰ Lidgard 2005-2006, p. 255.

3.8 Windsurfing

Provisions within a licensing agreement, which seek to insulate licensees from all kinds of competition, are not the only ones that may infringe upon Article 81(1) EC. The Windsurfing case exemplifies that also non-territorial restrictions may fall foul of the Article. This case demonstrates how the ECJ approaches terms within a licensing agreement in order to decide whether they infringe upon Article 81(1) EC.⁶¹

Windsurfing International (WI) was an American company founded by Hoyle Schweitzer. WI granted a number of non-exclusive licenses of its German patent for windsurfing equipment to German firms. The licensing agreements imposed certain conditions on the licensees. Legal proceedings were going on in Germany over whether or not the patent covered both the rig and the board. However, the licensing agreements covered both. The Commission proceeded on the basis that the patent only covered the rig. Based on this assumption, the Commission found that a number of the conditions imposed on the licensees infringed upon Article 81(1) EC. These provisions concerned quality controls, tying, licensed-by notices, non-challenge clauses and royalty calculations. WI sought to have the Commission's decision annulled by the ECJ under Article 230 EC.

The ECJ stated that although the Commission was not competent to determine the scope of a patent, this being a matter for national courts, it could not abstain from all action where this was necessary in order to decide whether there had been an infringement of Article 81(1) EC. In fact, the Commission had to be able to exercise its powers under Regulation 17/62.⁶² The Court held that the Commission was right in treating the patent as covering only the rig. There was nothing in the wording of the patent or the interpretations given to it by German authorities and courts that pointed in the direction that the patent covered both the rig and the board.

The Court upheld the Commission's findings except for the condition concerning royalty calculations. This condition imposed on the licensee an obligation to pay royalties on sales of components, i.e. the rig and the board, calculated on the net selling price of the complete sailboard. The Commission argued that this method of calculation was restricting the separate sales of components and thereby competition in the relevant markets. However, the Court held that the calculation of royalties on the complete sailboard was not a restriction of competition on the sale of separate rigs, although it was on the sale of separate boards. The Court motivated its conclusion by stating that the royalty levied on the sales of rigs on the basis of that calculation would not amount to a higher sum had the royalty be calculated on the sales of separate rigs.

⁶¹ Craig and De Búrca, p. 1112 ff.

⁶² Council Regulation 17/62 first regulation implementing Articles 85 and 86 of the Treaty, [1962] O.J. L13/204.

With regard to the other conditions imposed on the licensees, the reasoning of the Court was in line with the findings of the Commission.

The condition concerning quality controls imposed an obligation on the licensee to mount the patented rig only on boards approved by the licensor. The ECJ held that as the patent only covered the rig, the controls did not come within the specific subject-matter of the patent. Even if assuming that the patent covered the complete sailboard, i.e. the rig as well as the board, controls as those imposed on the licensee would have to be agreed upon in advance by the parties and be based on objectively verifiable criteria in order not to infringe upon Article 81(1) EC.

The condition concerning tying imposed an obligation on the licensee to sell the rigs only as part of a complete sailboard and not separately. The Court held that an obligation arbitrarily imposed on a licensee to sell the patented product only in conjunction with a product outside the scope of the patent was not indispensable to the exploitation of the patent.

The condition concerning licensed-by notices imposed an obligation on the licensee to affix to boards manufactured and marketed in Germany, a notice stating 'licensed by Hoyle Schweitzer' or 'licensed by Windsurfing International'. The Court argued that such an obligation might be covered by the specific subject-matter of the patent provided that the notice was placed only on components protected by the patent. This was not the case, however. The Court held that the notice created uncertainty as to whether the patent actually covered both the rig and the board or just the rig. According to the Court, WI hereby intended to diminish the consumer's confidence in the licensees in order to create a competitive advantage for itself.

The condition concerning non-challenge clauses imposed an obligation on the licensee not to challenge the validity of the licensed patents. The Court argued that such a provision did not fall within the specific subject-matter of the patent. It underlined that it is in the public interest that invalid patents are open to challenge.

Based on the reasoning presented above, the ECJ found the various provisions to be restrictive of competition in accordance with Article 81(1) EC. As the agreements had not been notified to the Commission, the ECJ did not have to decide on whether any of the provision could have been exempted under Article 81(3) EC.⁶³

The reasoning of the Court is straightforward: what comes within the specific subject-matter of the patent falls outside the scope of Article 81(1) EC. Conversely, what does not come within the specific subject-matter of the patent clearly falls within the scope of Article 81(1) EC. Provisions of this kind are looked upon with suspicion and are more or less automatically

⁶³ According to the Commission, the provisions could not be exempted under Article 81(3) EC.

held to be restrictive of competition in accordance with Article 81(1) EC. The Court takes a very formalistic approach to the licensing agreement and excludes all economic analysis when assessing the terms of agreement.⁶⁴

It is interesting to note that although the ECJ held that the Commission had no competence to decide on the scope of a patent, the Court nevertheless found that the Commission had the legal authority to assess this scope when necessary in order to decide whether there had been an infringement of Article 81(1) EC. Accordingly, what came under the exclusive competence of national courts could still be subject to assessment by the Commission when this was necessary in order to decide whether the exercise of the intellectual property right was in line with EC competition law. Hereby, the ECJ secured the effectiveness of EC law.

3.9 The 1990's

In the mid 1990's the Commission initiated efforts to revise the Patent and Know-how Regulations.⁶⁵ It is possible to discern two main factors that necessitated a more liberal approach to licensing at this time. Firstly, licensing as a form of collaboration for spreading technology seemed to have lost its appeal for industry.⁶⁶ The formalistic attitude to licensing during the 1980's had provoked right holders to integrate vertically to cover both manufacture and sale in other Member States. Secondly, USA and Japan had surpassed Europe in the field of technological innovation.⁶⁷ Thus, within the Community, it was generally felt that the Commission had to soften legislation in order to promote technological development. The result of the Commission's work was the 1996 Technology Transfer Regulation.⁶⁸

3.10 The 1996 Technology Transfer Regulation

On April 1, 1996, the new Technology Transfer Regulation entered into force. The 1996 Regulation unified the Patent and Know-how Regulations into one single regulation, treating patents and know-how alike. It applied to any transaction between two parties where patents and know-how were licensed either separately or jointly.⁶⁹

The Regulation pursued three main objectives: (1) the first objective was to simplify the rules for licensing agreements by unifying the Patent and Know-how Regulations into one single Regulation, so as to encourage

⁶⁴ Jones and Sufrin, p. 710.

⁶⁵ Lidgard 2005-2006, p. 254.

⁶⁶ Ibid.

⁶⁷ Lidgard 2006, p. 284.

⁶⁸ Commission Regulation 240/96/EEC of 31 January 1996, [1996] O.J. L31/2.

⁶⁹ Jones and Sufrin, p. 711.

dissemination of technical knowledge and promote manufacture of technically more sophisticated products; (2) the second objective was to create a favourable legal environment for companies investing in the EU, by providing them with legal certainty and decreasing the administrative burden of individual notifications under Article 81(3) EC; (3) the third objective was to guarantee effective competition in new or improved technological products.

Just like its predecessors, the Regulation contained a white list of permissible clauses and a black list of impermissible clauses. The white list was extended in the new Regulation as a result of the further experience of handling individual exemptions. Conversely, the Commission shortened the black list. However, it still covered hardcore restrictions as well as other less severe provisions. As a result, a larger number of licensing agreements fell within the block exemption. The Regulation also enclosed a so-called grey list. This list contained clauses, which might qualify for an exemption; however, the clauses had to be notified to the Commission beforehand.⁷⁰

During the time of the drafting procedure, the Commission had considered to let the block exemption regulation apply only to agreements reached between undertakings with a limited market share.⁷¹ This approach met with fierce criticism and was in the end rejected. The reason behind the criticism was that a market share threshold in practice would result in too many agreements still having to go through an individual notification procedure. However, a market share threshold reasoning to some extent made its way into the Regulation. According to Article 7 of the Regulation, the Commission reserved for itself the power to withdraw benefits of the block exemption from an agreement, even though the agreement fulfilled the conditions of the Regulation, if it nevertheless produced effects that were incompatible with Article 81(3) EC. In particular, exemption was to be withdrawn if the agreement restricted effective competition of the licensed products; this was likely to be the case if the licensee's market share rose above 40%.⁷² Thus, the Commission considered lack of effective competition to be more likely where the licensee's market share exceeded 40%.

The Regulation, just as its predecessors, exempted open exclusive licensing agreements and contained a limited possibility for preventing passive sales.⁷³

The 1996 Regulation is often looked upon as the last piece of legislation of the formalistic school.⁷⁴ Although the Regulation clearly was a step in the right direction for promoting technology transfer, it was still much of a straightjacket regulation. Its structure was similar to its predecessors with

⁷⁰ Article 4 of the 1996 Regulation.

⁷¹ Lidgard 2005-2006, p. 255.

⁷² Article 7(1) of the 1996 Regulation.

⁷³ Lidgard 2005-2006, p. 255.

⁷⁴ *Ibid.*

clear indications of what the Commission thought might be included into a licensing agreement and what might not. Thus, although in a new shape, the formalistic approach to licensing seems to have lingered on.

4 The 2004 Reform

4.1 Background

Licensing as a form of collaboration for spreading technology advanced after the mid 1990's.⁷⁵ One must assume that the increased importance of biotechnological inventions had a part to play here.⁷⁶ The increasing number of technology transfer licenses granted increased the workload of the Commission. Indeed, during this time the Commission was very busy with investigating notified agreements.⁷⁷ Soon it became evident that the Commission in the end could not sustain this burden of work. It prevented the Commission from curbing the most serious infringements of EC law.⁷⁸ At the same time, it became obvious that an adjustment of the legislative framework for technology transfer was necessary. A revision of the 1996 Regulation led to the conclusion that it was desirable that a new TTBER should be prepared. This TTBER ought to be guided by an approach based on economics. The solution to these problems turned out to be a decentralisation of the enforcement system through Regulation 1/2003 and the adoption of the 2004 Technology Transfer Regulation.

In what follows, I shall present the revision process of Regulation 1996, which led to the adoption of the 2004 TTBER. The 2004 TTBER is discussed in the next chapter. Thereafter I continue with a presentation of the main elements of the decentralised enforcement system and Regulation 1/2003.

⁷⁵ Evaluation Report on the Transfer of Technology Block Exemption Regulation No. 240/96. Available online at:

http://www.europa.eu.int/comm/competition/antitrust/technology_transfer/en.pdf.

(2006-04-29) paras 61 et seq. (Commission Evaluation Report).

⁷⁶ This was a development in both the EU and the US. The increase in the importance of biotechnology patent activity is suggested by an OECD study which concluded that "the absolute number of USPTO and EPO biotechnology patents has grown substantially in comparison with the total number of patents. At the USPTO between 1990 and 2000, the number of biotechnology patents increased by 15%, compared to an increase of just 5 % for patents overall. At the EPO, biotechnology patents show a very similar trend: between 1990 and 1997, the number of biotechnology patents increased by 10,5%, while total patents rose by 5%". See "Biotechnology Statistics in OECD Member Countries; Compendium of Existing National Statistics", STI Working Paper 2001/6, p. 11.

⁷⁷ Commission Evaluation Report, paras 84 et seq.

⁷⁸ Recital 3 of Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, O.J. L1/1 (Council Regulation 1/2003).

4.2 The Commission's Evaluation Report

In December 2001, the Commission adopted a mid-term Evaluation Report on the 1996 Regulation, pursuant to Article 12 of that Regulation.⁷⁹ The 1996 Regulation was criticised on several points. Firstly, the 1996 Regulation was found to be overly formalistic, too complex and too narrow in scope.⁸⁰ The listing of white, grey and black clauses was strongly criticised in the Report. It was argued that, rather than encouraging dissemination of technology, the system of listing clauses produced the opposite effect. The Regulation was considered rather narrow in scope as it only covered certain types of licensing agreements, while excluding others. No economic justification for this narrowing of scope was presented. Secondly, it was argued that the Regulation did not sufficiently emphasize inter-brand issues and did not follow a consistent approach as regards the competitive relationship between the licensor and licensee.⁸¹ The Regulation was said to focus mainly on intra-brand competition and market integration. The result of not sufficiently emphasising the relationship between the licensor and licensee, it was argued, might be, that certain licensing agreements, which did not deserve coverage, would come under the exemption. Lastly, the Regulation was found to be out of line with more recently adopted block exemption regulations concerning vertical and horizontal agreements.⁸² These regulations entailed a shift from a legalistic and form-based approach to a more economic and effect-based one, focusing more on inter-brand competition issues and on the analysis of the possible efficiencies of certain restrictions. This shift was accomplished by, among other things, the use of market share thresholds, the elimination of lists of white and grey clauses in the relevant regulations and by the formulation of Guidelines. Thus, the co-existence of two different types of regulations put the consistency of Community competition policy and the predictability of the rules at risk.

Considering these facts, the Evaluation Report concluded that there were strong reasons to undertake an in-depth review of the 1996 Regulation.⁸³ Indeed, the Report raised the question whether the 1996 Regulation had

⁷⁹ Evaluation Report on the Transfer of Technology Block Exemption Regulation No. 240/96. Available online at:

http://www.europa.eu.int/comm/competition/antitrust/technology_transfer/en.pdf.

(2006-04-29)

⁸⁰ Ibid., para. 175.

⁸¹ Ibid., para. 176.

⁸² Ibid., para. 177. The Block Exemption Regulations referred to in the Report were the Vertical Regulation (Commission Regulation 2790/99 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, [1999] O.J. L336/21), the Specialisation Regulation (Commission Regulation 2658/2000 of 29 November 2000 on the application of Article 81(3) of the Treaty to categories of specialisation agreements, [2000] O.J. L304/3) and the R&D Regulation (Commission Regulation 2659/2000 of 29 November 2000 on the application of Article 81(3) of the Treaty to categories of research and development agreements, [2000] O.J. L304/7).

⁸³ Ibid., para. 174.

imposed a straightjacket on industry, which forced companies unduly to enter into agreements limiting their effectiveness and possibly limiting the competitiveness of the European industry.⁸⁴ The Commission invited interested parties to comment on the Report. All the comments received also welcomed an in-depth review of the Regulation.⁸⁵

The proposed decentralisation of the enforcement system through the adoption of Regulation 1/2003 also called for a reassessment of the 1996 Regulation. The proposed reform would give national competition authorities (NCA) and national courts the power to apply Article 81 EC in its entirety. At this time, the right to apply Article 81(3) EC was a right reserved for the Commission. Thus, clear and consistent rules were necessary in order to ensure a predictable application of the rules in all Member States. Moreover, the abolishment of the notification system required a removal of the grey list from the block exemption regulation. The grey listed clauses would either have to be covered by the block exemption regulation or be treated as hardcore.⁸⁶

Based on the criticism of the 1996 Regulation and the need to make the Regulation consistent with the new competition rules, the Commission decided to issue a new block exemption regulation on technology transfer together with accompanying guidelines.

4.3 The Commission's Draft for a New Block Exemption Regulation

On October 1 2003, the Commission published a draft for a new TTBER, together with the draft Guidelines.⁸⁷ A period of heated debate and much lobbying followed. The Commission received over seventy submissions on its proposals.⁸⁸ The submissions came from industry, trade associations, law and IP societies, individual law firms, national authorities, individual companies, universities and consultants.⁸⁹

Recital 4 of the Commission's draft gives a glimpse of the main features of the Commission's proposal for a new TTBER.⁹⁰ It reads:

⁸⁴ Ibid., para. 3.

⁸⁵ Jones and Sufrin, p. 713.

⁸⁶ Commission Evaluation Report, paras. 6 and 7.

⁸⁷ Draft Commission Regulation on the application of Article 81(3) of the Treaty to categories of technology transfer agreements, [2003] O.J. C235/11 and Draft Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements, [2003] O.J. C235/17.

⁸⁸ Jones and Sufrin, p. 713.

⁸⁹ The submissions are available online at:

http://www.europa.eu.int/comm/competition/technology_transfer_2. (2006-04-29)

⁹⁰ The same text is to be found in recital 4 of the 2004 TTBER.

It is appropriate to move away from the approach of listing clauses and to place greater emphasis on defining the categories of agreements which are exempted up to a certain level of market power and on specifying the restrictions or clauses which are not to be contained in such agreements. This is consistent with an economics based approach which assesses the impact of agreements on the relevant market. It is also consistent with such an approach to make a distinction between agreements between competitors and agreements between non-competitors.

The proposed changes for a new TTBER were largely a response to the criticism directed against the 1996 Regulation.⁹¹ I list some of the main features of the draft TTBER.

Firstly, the Commission proposed to replace the “straightjacket” with a more flexible framework. The new TTBER was no longer to contain white- and greylisted clauses. It was to have a limited list of blacklisted clauses (hardcore restrictions) and a list of excluded restrictions,⁹² while other restraints were to be covered by the block exemption.

Secondly, it was suggested that the scope of the new TTBER was to be extended. The new TTBER was to cover software copyright licenses in addition to patent and know-how licenses. In its Evaluation Report, the Commission had considered to extend the scope of the block exemption to other intellectual property rights such as trademark and non-software copyright licenses. However, this idea was rejected in the end.

Thirdly, the introduction of a market share threshold was proposed. A distinction was to be made between agreements entered into by competitors and non-competitors, allowing a greater market share when an agreement was reached between non-competitors. Thus, under the draft TTBER, agreements between competitors could benefit by the block exemption if their *combined* market share did not exceed 20%, whereas agreements between non-competitors could benefit by the block exemption if the market share of *each* of the parties did not exceed 30%.

Fourthly, the idea was put forward that agreements between competitors should be treated more strictly. Hence, apart from the imposition of different market shares, the draft TTBER would also impose stronger restrictions on licences between competitors than between non-competitors.

In addition, the draft TTBER proposed a re-definition of the term know-how. For the purpose of applying the 1996 Regulation, know-how was defined as “a body of technical information that is secret, substantial and identified in any appropriate form”. Under the 1996 Regulation, know-how had to include information that was useful in order to be substantial, i.e. know-how had to be capable of improving the competitive position of the licensee. However, the draft TTBER defined “substantial” as indispensable for the manufacture or provision of the contract product. Thus, the re-

⁹¹ For a thorough discussion of the changes proposed by the draft TTBER see Dolman and Piilola 2003.

⁹² The excluded restrictions are termed conditions in the draft TTBER.

definition had the effect of narrowing the scope of the TTBER. As will be demonstrated below, the suggested re-definition of know-how never made its way into the final 2004 TTBER.

4.4 Submissions on the Commission's Draft

In general, the submissions welcomed a replacement of the 1996 Regulation with a more economical and flexible block exemption. However, many comments were critical of the proposals on a number of important points.

The critics were most concerned about the introduction of a market share threshold.⁹³ Although a market share threshold was in line with the other new block exemptions it caused particular worry in the field of IP licenses. This was due to the difficulties involved in assessing market shares in many licensing situations within the IP field.⁹⁴ The critics argued that as licensing is often used in the field of new technology and products for which it may be difficult to define the relevant markets, the accounted market share might not really reflect the actual market power of the parties.⁹⁵ The effect could be that the use of market share thresholds would go against one of the purposes of the new TTBER, that of creating legal certainty. However, legal certainty was of outmost importance to companies. The new TTBER would enter into force simultaneously with Regulation 1/2003. This would compel companies to make an individual assessment in situations where their agreement did not fall under the block exemption.⁹⁶ There was also concern about the fact that the draft TTBER made a distinction between competitors and non-competitors. For example, with regard to the market share threshold the submissions raised the question of what might happen if the parties began as non-competitors but later became competitors.⁹⁷

There were also concerns about other elements of the draft. For example, even though the draft TTBER represented a more flexible framework, its hardcore list was in some respects stricter than the 1996 Regulation's list.⁹⁸ Finally, the draft Guidelines were criticised for their failure to bring out the important part played by licensing in providing incentives for innovation.⁹⁹

4.5 The Commission's Response

The European Competition Commissioner, Mario Monti, explained the Commission's response to the consultation procedure in a speech in Paris on

⁹³ Jones and Sufrin, p. 713.

⁹⁴ *Ibid.*, p. 714.

⁹⁵ See e.g. the submission from the International Chamber of Commerce.

⁹⁶ Jones and Sufrin, p. 714.

⁹⁷ *Ibid.*

⁹⁸ For example, the territorial and customer restrictions were stricter.

⁹⁹ Jones and Sufrin, p. 714.

January 16, 2004.¹⁰⁰ The Commissioner made clear that the Commission had taken due account of the submissions and re-drafted the proposals to remedy a great deal of the concerns expressed in the submissions. However, the Commission had by no means accepted all the criticism. Above all, the Commission refused to alter the imposition of market share thresholds.¹⁰¹

The Commissioner drew attention to the fact that the market share threshold had mainly been opposed on three grounds. The submissions had claimed that market shares were of no relevance in high tech sectors; that the assessment of market shares throughout the life of the agreement would decrease legal certainty and be costly; and that relevant product and geographical markets were often difficult to define. The Commissioner responded in the following way:

Let me first recall that the TTBER applies to all sectors not just high tech ones. It is fair to state that most sectors are mature and that even sectors which are in such a state of flux are so usually only for a limited period. Therefore in most sectors, and that also means in most sectors where licensing takes place, market shares do matter. In addition, usually licensing concerns products that either will continue to compete with existing products or that will replace existing products. There are not many products which cater to a human need for which nothing existed before. Therefore market definition in case of licensing will not be markedly more difficult than market definition for most other agreements.

Thus, the Commission stood firm in its decision to introduce a market share threshold in the new TTBER. The work of the Commission continued as the date for the 2004 TTBER to come into force was approaching. The new TTBER was set to come into force on May 1, 2004. This was also the date for the accession of ten new Member States and the date on which Regulation 1/2003, which would decentralise the enforcement system, would come into force.

4.6 Regulation 1/2003

Regulation 1/2003 represents a new approach to the enforcement of EC competition law. In contrast, Regulation 17/62, the predecessor of Regulation 1/2003, represents a traditional approach. The traditional approach had two foundations. Firstly, agreements not coming under a block exemption had to be notified to the Commission. Secondly, the Commission had a monopoly on the application of Article 81(3) EC.¹⁰² In this sense, the system was a centralised one. Nonetheless, it had certain decentralised aspects. Article 81 had direct effect. Hence, national courts could apply Article 81(1) EC in cases that came before them. However, they could not grant an individual exemption under Article 81(3) EC since this

¹⁰⁰ See speech by Commissioner Mario Monti, The New EU Policy on Technology Transfer Agreements, Ecole des Mines, Paris, 16 Jan. 2004, available online at: http://www.europa.eu.int/comm/competition/speeches/index_speeches_by_the_commissioner.html. (2006-05-02)

¹⁰¹ Jones and Sufirin, p. 714.

¹⁰² Craig and De Búrca, pp. 1062-1064.

was a right reserved for the Commission. This was hardly a consistent system. The growing number of agreements notified to the Commission overstrained the Commission's resources. It did not have resources enough to adjudicate but a handful of individual exemptions. In other words, the existing system prevented an effective application of the EC competition rules at both the national and the Community level. Thus, in its White Paper on Modernization the Commission proposed a thorough overhaul of the enforcement regime.¹⁰³ This was accomplished through the adoption of Regulation 1/2003. Under Regulation 1/2003 the notification system is abolished as is the Commission's monopoly on Article 81(3) EC. The new Regulation empowers national courts and national competition authorities (NCA) to apply Article 81 in its entirety. Under this new system, agreements not coming under a block exemption have to be subjected to a procedure of self-assessment. Through balancing the positive and negative effects of the agreement, companies will need to reach a conclusion as to whether their agreement may benefit from an individual exemption under Article 81(3) EC. Obviously, an assessment of this kind is difficult.¹⁰⁴ Thus, it will be important to know beforehand which agreements that fall within the scope of a block exemption. Clear and consistent rules are extremely important here, as they will secure a uniform application of the Community competition rules in all Member States.

¹⁰³ White Paper on Modernization of the Rules Implementing Articles 85 and 86 of the EC Treaty, Commission Programme 99/27, 28 Apr. 1999.

¹⁰⁴ Fine, p. 55. However, the TTBER Guidelines contain guiding principles on how to proceed with such an assessment.

5 The 2004 Technology Transfer Regulation

5.1 Introduction

On April 7, 2004, the Commission published the text on a new Regulation for the application of Article 81(3) EC to categories of technology transfer agreements (the 2004 TTBER) along with a set of accompanying guidelines for the application of Article 81 EC to technology transfer agreements (the TTBER Guidelines). These measures entered into force on May 1, 2004. The publication of the 2004 TTBER and the TTBER Guidelines concluded a five-year long review process initiated by the Commission in 1999.¹⁰⁵

The 2004 TTBER was the last block exemption to be modernised by the Commission. It was based on an economic approach focusing on the effects that the exempted category of agreements would produce in the relevant market. Hence, the economic analysis behind the TTBER led to the conclusion that agreements falling within the block exemption would generally have such positive effects on competition that these would overshadow its downsides. The economic approach underlying the 2004 TTBER aligned the EU approach to licensing to developments in the US. Under the TTBER licensing agreements are generally favoured as efficiency enhancing and pro-competitive.¹⁰⁶ The aim of the 2004 TTBER is twofold: to ensure effective competition and to provide companies with adequate legal certainty.¹⁰⁷

As should be apparent from the previous chapter, the preparatory work for the 2004 TTBER was surrounded by much controversy. This controversy did not end with the coming into force of the new TTBER. While some considered the TTBER a major breakthrough within the area of licensing, others were less enthusiastic. Again, the criticism was directed against the inclusion of a market share threshold, which had already been vividly resisted during the review process. The opinions differed as to whether the system of market share thresholds would provide companies with more legal certainty than a system of listing clauses.¹⁰⁸ However, even the critics welcomed the new TTBER in general. They commended the TTBER for bringing the EU attitude towards licensing more into harmony with developments in the US. In particular, they underlined the importance of a legal framework, which recognises the global dimension of licensing.

¹⁰⁵ Hansen and Shah, p. 465.

¹⁰⁶ Lidgard 2005-2006, p. 256.

¹⁰⁷ Recital 4 of the 2004 TTBER.

¹⁰⁸ See Fine 2004, p. 786.

The 2004 TTBER is expected to have a strong influence on the formation of licensing agreements in the future. Licensing agreements that do not fall within the scope of the block exemption will have a somewhat uncertain legal status. Even though it is not presumed that these agreements are invalid, they will have to be subjected to a procedure of self-assessment. This may, as should be apparent from the above, be a risky endeavour.¹⁰⁹ Hence, it will be in the interest of the contracting parties to frame their agreement to fit the framework of the TTBER. Agreements that fall within the block exemption will be walking a safe path.¹¹⁰

In this chapter, I shall review the content and function of the 2004 TTBER. This provides the necessary background for an analysis as to whether the new TTBER would promote the conclusion of patent and know-how licensing agreements. I undertake this analysis in the next chapter.

5.2 The TTBER Guidelines

The Commission has issued guidelines in different areas related to competition. The Guidelines are a kind of policy documents. Through these, the Commission communicates its outlook on the state of competition policy within the area for which the relevant guidelines are issued.¹¹¹ The Guidelines are based on judgments by the Court and decisions by the Commission. Although the Guidelines are not binding for the Court, their importance has increased as the Court has cited and applied them in some of its judgments.¹¹² It is most likely that the Commission will act in accordance with the principles and rules which they have themselves established.

In the case of technology transfer, the Commission has expressed its view on how to deal with this type of agreement through issuing the TTBER Guidelines. The TTBER Guidelines do three things. First, they establish a framework of general principles concerning Article 81 EC and intellectual property rights. Secondly, they explain the provisions and application of the TTBER. Thirdly, they explain the application of Article 81(1) EC and Article 81(3) EC to agreements outside the scope of the TTBER.¹¹³ Hence, the TTBER Guidelines contain important information for a correct application of the TTBER. When reviewing the content and function of the 2004 TTBER below, I treat the Guidelines and the TTBER as a whole.

5.3 Main Features

The main features of the 2004 TTBER should be noted already from the outset. The category of agreements covered by the TTBER is wider than

¹⁰⁹ See section 4.6.

¹¹⁰ Månsson and Persson, pp. 741-742.

¹¹¹ Glader, p. 73.

¹¹² *Ibid.*, p. 74.

¹¹³ Jones and Sufrin, p. 715.

that covered by the 1996 Regulation. The TTBER covers not only patent and know-how licensing but also licenses of copyright software and designs. It includes a list of hardcore restrictions and a list of excluded restrictions. Hence, there are no white and grey lists in this Regulation. As already mentioned, the 2004 TTBER only applies in so far as certain market share thresholds are not exceeded. In the Regulation, a distinction is drawn between agreements between competitors and agreements between non-competitors. The market share thresholds, the hardcore restrictions and the excluded restrictions differ. With respect to some types of provisions, in horizontal relations, the TTBER makes a distinction between reciprocal and non-reciprocal agreements. Finally, when applying the TTBER, there are two markets that must be taken into account: the technology and the product market.¹¹⁴

5.4 Structure

The structure of the 2004 TTBER is somewhat different from the 1996 Regulation. However, it is similar to other block exemption regulations issued by the Commission from the late 1990's onward. The 2004 TTBER contains twenty recitals and eleven articles. The recitals contained in the preamble of the Regulation are as usual important for the interpretation of the articles. Article 1 contains a list of definitions of the most significant terms in the Regulation. Article 2 sets forth the scope and duration of the TTBER. Article 3 contains the market share threshold which limits the application of the Regulation. In this Article, different market share thresholds are stipulated depending on whether the agreement is reached between competitors or non-competitors. Article 4 contains the list of hardcore restrictions. The presence in an agreement of any of these restrictions removes the entire agreement from the protection of the block exemption. Article 5 contains the list of excluded restrictions. Their presence in the agreement, however, does not remove the agreement from the protection of the block exemption. This, in fact, is the difference between the hardcore list and the list of excluded restrictions. Article 6 provides that the Commission might in certain circumstances withdraw the benefit of the TTBER from an agreement. In the same vein, NCA are empowered to withdraw the benefit with respect to the territory of that Member State. According to Article 7, the Commission may declare the TTBER inapplicable in situations where parallel networks of similar agreements cover more than 50% of the market. Article 8 contains provisions about the calculation of the market share thresholds. It gives some marginal relief where market share increases during the lifetime of the agreement. Article 9 repeals the 1996 Regulation. Article 10 contains transitional provisions. Finally, Article 11 provides that the 2004 TTBER will enter into force on 1 May 2004 and expire on 30 April, 2014.

¹¹⁴ Jones and Sufrin, p. 721.

5.5 Scope and Duration

Article 2 of the 2004 TTBER sets forth the scope and duration of the exemption. It reads:

Pursuant to Article 81(3) of the Treaty and subject to the provisions of this Regulation, it is hereby declared that Article 81(1) of the Treaty shall not apply to technology transfer agreements entered into between two undertakings permitting the production of contract products.

This exemption shall apply to the extent that such agreements contain restrictions of competition falling within the scope of Article 81(1). The exemption shall apply for as long as the intellectual property right in the licensed technology has not expired, lapsed or been declared invalid or, in the case of know-how, for as long as the know-how remains secret, except in the event where the know-how becomes publicly known as a result of action by the licensee, in which case the exemption shall apply for the duration of the agreement.

For its application, the Article requires that three cumulative criteria are fulfilled: (1) it must be the question of a technology transfer agreement; (2) to which no more than two undertakings are party; and (3) which permits the production of contract products.

The first criterion is that the agreement is indeed a technology transfer agreement. The term “technology transfer agreement” is defined in Article 1(1)(b) of the TTBER as a patent licensing agreement, know-how licensing agreement, software copyright licensing agreement or a mixed licensing agreement containing these type of objects. Any provisions relating to the sale and purchase of products included in these agreements also form part of the term “technology transfer agreement”. Patent is defined in Article 1(1)(h) of the TTBER to cover patents, patent applications, utility models, applications for registration of utility models, designs, topographies of semiconductor products, supplementary protection certificates for medicinal products or other products for which such supplementary protection certificates may be obtained and, finally, plant breeder’s certificates. The TTBER does not comprise any other copyright than software copyright nor does it comprise trademarks. In Article 1(1)(i) of the TTBER the term know-how is defined as a package of non-patented practical information, resulting from experience and testing which is secret, substantial and identified. In this context, the word “secret” means that the know-how is not generally known or easily accessible. The word “substantial” signifies that the know-how includes information which is significant and useful for the production of the products covered by the license agreement or the application of the process covered by the license agreement. In other words, the know-how must significantly contribute to or facilitate the production of the contract products. However, it does not need to be indispensable - as was suggested in the draft TTBER - for the production of the products. The word “identified” means that it is possible to verify that the licensed know-how fulfils the criteria of secrecy and substantiality. This condition will be satisfied when the general nature of the licensed know-how is described in the agreement. Except for the immaterial rights already mentioned, the TTBER also comprises licensing of such rights that do not constitute the

primary object of the agreement and that are directly related to the production of the contract products. A licensor who permits the licensee to use his trademark when selling the products under contract would be an example of this type of license.¹¹⁵

The second criterion requires that no more than two undertakings are party to the agreement. However, when counting the parties to an agreement the single economic entity doctrine must be borne in mind. Hence, the parties and their connected undertakings count as one.¹¹⁶ The term “connected undertaking” is defined in the TTBER.¹¹⁷ It should be noticed that the two party limitation does not prevent an agreement which stipulates conditions to be put on a third party falling within the TTBER. For example, an agreement may stipulate the obligations the licensee must impose on resellers of the products produced under the license.¹¹⁸

The third criterion requires that an agreement permits the production of contract products. According to Article 1(1)(f) contract products denote products produced with the licensed technology. The aim of the licence must be to allow the licensee to exploit the licensed technology to produce goods or services. Technology licenses, which permit sub-licenses fall within the TTBER, provided that the primary object of the agreement remains the production of contract products.¹¹⁹

The TTBER is applicable to technology licenses for as long as the intellectual property right that forms the subject matter of the agreement has not expired, lapsed or otherwise been declared invalid. The protection for know-how lasts as long as the information remains secret. If the know-how becomes publicly known due to the conduct of the licensee, the TTBER is applicable for the duration of the agreement.¹²⁰

5.6 The Safe Harbour

Article 3 of the TTBER sets forth the so-called safe harbour of the Regulation.¹²¹ It reads:

1. Where the undertakings party to the agreement are competing undertakings, the exemption provided for in Article 2 shall apply on condition that the combined market share of the parties does not exceed 20% on the affected relevant technology and product market.

¹¹⁵ TTBER Guidelines, paras. 46 et seq.

¹¹⁶ Jones and Sufrin, p. 722.

¹¹⁷ Article 1(2) of the TTBER.

¹¹⁸ TTBER Guidelines, paras. 38 et seq.

¹¹⁹ Ibid., paras. 41 et seq.

¹²⁰ Ibid., paras. 54 and 55.

¹²¹ The term, safe harbour, is used by the Commission to describe licenses which fall below the TTBER thresholds. See TTBER Guidelines, paras. 65 et seq.

2. Where the undertakings party to the agreement are not competing undertakings, the exemption provided for in Article 2 shall apply on condition that the market share of each of the parties does not exceed 30% on the affected relevant technology and product market.

For the parties to a technology transfer agreement to establish whether they are covered by the TTBER safe harbour they must determine the following. First, they must define the relevant market including both the relevant technology and product market. Second, they must determine whether they are competing undertakings on any of these markets. Third, they must calculate their respective market shares on the basis of the markets affected by the license.¹²² The markets affected by the license will equal those markets in which either or both of the parties are active prior to entering into the license. In what follows, I shall elaborate further on the safe harbour analysis.

5.6.1 The Relevant Market

The first step in the safe harbour analysis is to determine the relevant market. The usual principles of market definition apply. Hence, the Commission's Notice on the definition of the relevant market (the Markets Notice) is of primary importance in this analysis.¹²³ However, the TTBER Guidelines, and to a lesser extent, the TTBER, address the specific issue of market definition in the case of technology licensing.¹²⁴ Thus, the Markets Notice, the TTBER and the TTBER Guidelines are all pertinent to a definition of the relevant market.

As should be clear from the above, the relevant market includes both the technology market and the product market. Technology is an input, which is integrated into either a product or a production process.¹²⁵ Consequently, companies have the potential to restrict competition on both the product and the technology market because of the licensed technology. However, as in every traditional market analysis one must also consider the geographical market when defining the relevant market. In fact, the TTBER Guidelines indicate that the relevant product market in case of technology licensing has both a product and geographical dimension.¹²⁶

5.6.1.1 The Relevant Technology Market

The relevant technology market consists of the licensed technology and its close substitutes, i.e. other technologies which customers could use as a substitute.¹²⁷ Thus, the starting point when defining the relevant technology market is to identify the licensed technology. The analysis then turns to

¹²² Fine, p. 61.

¹²³ Notice on the definition of the relevant market for the purposes of Community competition law [1997] O.J. C372/5.

¹²⁴ Fine, p. 61.

¹²⁵ TTBER Guidelines, para. 20.

¹²⁶ Ibid.

¹²⁷ Ibid., para. 22.

determining those technologies which are interchangeable for the technology in question. The issue is whether the licensed technology is interchangeable for other technologies on the basis of their characteristics, royalties and intended use.¹²⁸ Price elasticity may be a relevant factor for determining interchangeability of technologies. In the context of technology markets, the issue would be whether licensees would switch to a particular technology on the basis of a small but permanent increase in price, i.e. royalties.¹²⁹ This is the application of the so-called SSNIP test.¹³⁰ The relevant technology market will thus include all those markets where there is technology that is interchangeable with the licensed technology. The affected relevant technology markets are those technology markets in which either party, or both parties, are licensing, even to each other, prior to the license in question.¹³¹

5.6.1.2 The Relevant Product Market

The relevant product market includes products regarded as interchangeable or substitutable for the contract products by reason of the products' characteristics, price and intended use.¹³² Therefore, the market is defined as including products which consumers consider as substitutes for the contract products incorporating the licensed technology. When determining the relevant product market one must identify the contract products and those products which are substitutable for the contract products. Again, substitutability is best judged by price elasticity. According to the Markets Notice, "The question to be answered is whether the parties' customers would switch to readily available substitutes or to suppliers located elsewhere in response to an hypothetical small (in the range 5%-10%), permanent relative price increase in the products and areas being considered".¹³³ Where the substitution of products renders the price increase unprofitable because of the resulting loss of sales, the substitute products are included in the market definition.¹³⁴ The process of inclusion will continue until the price increases become profitable. In this way, the relevant product market is determined. The affected relevant product markets are those product and geographical markets in which either party, or both parties, are active prior to the license in question.¹³⁵

5.6.1.3 The Relevant Geographical Market

The TTBER Guidelines are silent on how to determine the relevant geographical market. However, they refer to the Markets Notice for general

¹²⁸ Fine 2004, p. 774.

¹²⁹ Fine, p. 62.

¹³⁰ SSNIP is an abbreviation for "small but significant and non-transitory increase in prices".

¹³¹ Fine, p. 62.

¹³² Article 1(1)(j)(ii) of the TTBER and TTBER Guidelines, para. 21.

¹³³ The Markets Notice, para. 17.

¹³⁴ Ibid.

¹³⁵ Fine, p. 62.

guidance.¹³⁶ The Markets Notice indicates that the relevant geographical market is that “in which the conditions of competition are sufficiently homogenous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas”.¹³⁷ Whether the conditions of competition are homogenous depends on a number of factors. For example, legal, economic or technical barriers to entry, transport costs and physical barriers as well as the structure of distribution channels and differences in prices between territories could all be relevant factors for the assessment.¹³⁸ The relevant geographical market does not need to encompass the whole of the EU; it needs only to consist of a substantial part of it, for example, parts of a Member State.¹³⁹

5.6.2 The Distinction between Competitors and Non-Competitors

The second step in the safe harbour analysis turns on determining whether the contracting parties are competing undertakings in any of the markets discussed above. For this assessment, an *ex-ante* approach is used. Thus, whether the parties are competing undertakings is determined in the absence of the license agreement.¹⁴⁰ It is important to bear in mind that when deciding whether the parties are competitors, the parties’ respective connected undertakings must be taken into account.¹⁴¹ When establishing whether the parties are competitors on the relevant technology markets, the TTBER merely considers whether the parties are actual competitors.¹⁴² In contrast, when establishing whether the parties are competitors in the relevant product markets, the TTBER considers both whether the parties are actual or potential competitors.¹⁴³ It is therefore necessary to distinguish between actual and potential competition when determining the parties’ competitive relationship. Furthermore, it is necessary to consider what might happen if there are alterations in the parties competitive relationship during the lifetime of the agreement.¹⁴⁴

5.6.2.1 Actual Competitors

The parties are deemed to be actual competitors when they are both active in the technology market or product market without infringing upon each

¹³⁶ Ibid., p. 63.

¹³⁷ The Markets Notice, para. 8.

¹³⁸ Fine, p. 63.

¹³⁹ See Case C-179/90, *Merci Convenzionali Porto di Genova SpA v. Siderurgica Gabrielli SpA*, [1991] ECR I-5889 [1994] 4 CMLR 422.

¹⁴⁰ See Article 4(3) of the TTBER and TTBER Guidelines, paras. 27 and 31.

¹⁴¹ Jones and Sufrin, p. 728.

¹⁴² TTBER Guidelines, paras. 28 and 30.

¹⁴³ TTBER Guidelines, paras. 28 and 29.

¹⁴⁴ The question of what would happen if the parties became competitors during the lifetime of the agreement was raised during the consultation procedure. See above section 4.4. This issue has been addressed in the new TTBER.

other's intellectual property rights.¹⁴⁵ Thus, if there is a one-way (when either party's technology cannot be exploited without infringing upon the other's intellectual property rights) or a two-way (when neither party may exploit its technology without infringing upon the other's intellectual property rights) blocking situation, the parties will be deemed non-competitors.¹⁴⁶ Considering the fact that the parties will usually wish to be regarded as non-competitors, any blocking claims will of course be examined carefully.¹⁴⁷ As regards the technology market, the parties will be considered as actual competitors if, for example, the licensee is already licensing out his own technology and the licensor enters the technology market by granting the licensee a license for a competing technology.¹⁴⁸ With respect to the product market, actual competitors will be those undertakings which in the absence of the agreement are both active in the relevant product and geographical market in which the contract products are sold.¹⁴⁹ The parties are active if the products are sold either directly by the parties themselves or via agents or distributors.¹⁵⁰

5.6.2.2 Potential Competitors

The parties are considered to be potential competitors in the product market if it is likely that the parties in the absence of the agreement and without infringing each others' intellectual property rights would have undertaken the necessary additional investments to enter the relevant market in response to a small but permanent increase in product prices.¹⁵¹ Hence, supply substitutability is used in determining the existence of potential competition in the relevant product market. Neither the Markets Notice nor the TTBER Guidelines provides information on the amount of the small but permanent increase in product prices which is necessary to cause product market entry. However, market entry should be likely to occur within a short period corresponding to one or two years.¹⁵²

5.6.2.3 Alterations in the Parties' Competitive Relationship

As should be clear from the above, it is the period before the reaching of the agreement that is decisive for assessing whether the parties are competitors or not. However, alterations in the parties' competitive relationship may occur post-license. For example, where the technology concerned is dynamic and swiftly developing the technology under license may represent such a technological progress that it renders the licensee's previous

¹⁴⁵ Article 1(1)(j)(ii) of the TTBER and TTBER Guidelines, para. 28.

¹⁴⁶ *Ibid.*, para. 32.

¹⁴⁷ Jones and Sufrin, p. 728.

¹⁴⁸ TTBER Guidelines, para. 28.

¹⁴⁹ Article 1(1)(j)(ii) of the TTBER.

¹⁵⁰ Fine, Frank, p. 65.

¹⁵¹ Article 1(1)(j)(ii) of the TTBER.

¹⁵² TTBER Guidelines, para. 29.

technology obsolete.¹⁵³ The question thus arises whether the parties still ought to be regarded as competitors in the relevant technology and product markets in such a situation. The TTBER Guidelines provide that the parties will still be considered competitors unless, at the time of conclusion of their license agreement, it was obvious that the licensee's technology had become obsolete.¹⁵⁴ However, when the licensee's technology does become obsolete, the relationship between the parties will be held to be non-competitive. In the opposite situation, i.e. where the parties start as non-competitors and later become competitors, Article 4(3) of the TTBER provides that the more liberal list of hardcore restrictions for agreements between non-competitors will apply for the lifetime of the agreement.¹⁵⁵ This, however, is subject to the condition that the agreement is not subsequently amended in any material way. This has been taken to mean that Article 3(2) rather than Article 3(1) should be applicable as to the question of which safe-harbour threshold that should apply.¹⁵⁶

5.6.3 The Market Share Calculation

The third and final step in the safe harbour analysis is to determine the market shares held by the parties in the relevant market. The TTBER is based on the premise that agreements between competitors are likely to be more harmful to competition than agreements between non-competitors. Hence, different market share thresholds apply to competitors (20%) and non-competitors (30%). When determining the parties market shares, again, both the technology and product market must be considered.

5.6.3.1 The Technology Market

Article 3(3) of the TTBER suggests the approach to use when calculating market shares. Market shares are to be calculated on the basis of the sales of products incorporating the licensed technology in downstream product markets and on the basis of the sales of products incorporating substitute technology in downstream product markets.¹⁵⁷ By using this approach all sales in the relevant product market are taken into account irrespective of whether the product incorporates a licensed technology. Therefore, also technologies which are only used in-house by the parties, are relevant for the market share calculation.¹⁵⁸

¹⁵³ Fine, p. 66.

¹⁵⁴ TTBER Guidelines, para. 33.

¹⁵⁵ TTBER Guidelines, para. 31. Parties might become competitors during the term of the agreement because of the fact that one of the parties upgrades his own technology so as to compete with that of the other party.

¹⁵⁶ Fine 2004, p. 779. See also Jones and Sufrin, p. 728.

¹⁵⁷ TTBER Guidelines, para. 23 and Fine, p. 68.

¹⁵⁸ Ibid.

5.6.3.2 The Product Market

As indicated above, the approach to calculating market shares adopted in the TTBER is to define them in terms of presence on the relevant product market. Where it is accessible, market share is to be calculated on the basis of market sales value data. Otherwise, other reliable market information, including market sales volumes, may be used.¹⁵⁹ The licensor's market share in the relevant technology market is based on the following two elements: (1) the combined market share of all of the licensor's licensees on the basis of all products sold which incorporate the licensed technology; together with (2) sales attributable to direct exploitation by the licensor of his own technology.¹⁶⁰ Similarly, the licensee's market share in the relevant technology market is based on: (1) the combined market share of the licensee and all of his licensees based on all products sold which incorporate the licensee's competing technology; together with (2) sales attributable to direct exploitation by the licensee of his own technology.¹⁶¹ These calculations must be made for each relevant product and geographical market. Where the licensee is only manufacturing and selling products incorporating the licensed technology (i.e. that of the licensor) the licensee would have a zero market share in the relevant market.¹⁶² The TTBER Guidelines provide that where the parties are competitors in the relevant technology market, the sales of products incorporating the licensor's own (licensed) technology must be combined with the sales by the licensee of products incorporating his own technology.¹⁶³

5.6.3.3 Alterations in Market Power

Market power may in some cases keep below the market share threshold initially but subsequently rise above it. This could even happen as a result of the license agreement. In many areas, where technology is rapidly evolving, the market share once calculated may very well be surpassed after a couple of years. A system making the agreement fall outside the exemption due to a development of this kind was considered too unforgiving. Therefore, Article 8(2) of the TTBER give some marginal relief in such a situation. This Article provides that in the case where the parties' market share would rise above the 20% respectively 30% threshold during the term of the agreement, the exemption will continue to apply for a period of two consecutive calendar years following the year in which the market share threshold was first exceeded.¹⁶⁴

¹⁵⁹ Article 8(1) of the TTBER. The calculation is based on the preceding year.

¹⁶⁰ Fine, p. 68. See also Article 3(3) of the TTBER and TTBER Guidelines, para. 70.

¹⁶¹ Fine, p. 68.

¹⁶² TTBER Guidelines, para. 23 and Fine, p. 69.

¹⁶³ TTBER Guidelines, para. 70 and Fine, p. 69.

¹⁶⁴ See Månsson and Persson, p. 749. These authors argue that the marginal relief period is too short. According to them, a system of this kind - where agreements fall outside the exemption after only two years - results in technical development being punished.

5.7 Hard-Core Restrictions

Article 4 of the TTBER contains the so-called hard-core restrictions. As already noted there are two lists of hard-core restrictions. Article 4(1) is applicable to agreements between competing undertakings and Article 4(2) is applicable to agreements between non-competing undertakings.¹⁶⁵ To determine whether the parties are competing or not will thus be of relevance for not only what market share threshold that will be applicable to the agreement, but also for what hard-core list the parties have to observe. The observance of the hard-core restrictions when framing the agreement will be of vital importance, since the presence of any of these prohibited restrictions within the agreement will take it outside the safe harbour of the block exemption. The reason for this is that hard-core restrictions are not severable from the rest of the agreement and an agreement containing restrictions of this kind is unlikely to fulfil the conditions in Article 81(3) EC apart from in exceptional circumstances.¹⁶⁶ The presence of hard-core restrictions within an agreement makes for the presumption that the entire agreement is illegal. This, in turn, may subject the parties to fines of up to 10% of their global turnover.¹⁶⁷ Moreover, nullity in the context of commercial transaction could result in claims for damages.¹⁶⁸

In what follows, I shall outline the lists of hard-core restrictions that apply in relation to competing and non-competing undertakings respectively.

5.7.1 Hard-Core Restrictions in Agreements between Competitors

It is possible to discern five categories of hard-core restrictions between competitors: price restrictions; limitations on output; the allocation of markets or customers; restrictions on the licensee to exploit his own technology; and restriction on either party to carry out research and development.¹⁶⁹ I discuss these categories of restrictions in turn. However, before proceeding, it is necessary to explain the distinction between reciprocal and non-reciprocal agreements. The hard-core restrictions applicable to agreements between competitors differ depending on the nature of the agreement. The terms reciprocal and non-reciprocal agreements are defined in Article 1(1)(c) and (d) of the TTBER. A reciprocal agreement is an agreement where the parties are cross-licensing competing technologies or technologies, which can be used for the production of competing products. On the other hand, a non-reciprocal agreement is an agreement not containing any of these types of elements.

¹⁶⁵ Jones and Sufrin, p. 729.

¹⁶⁶ TTBER Guidelines, para. 75.

¹⁶⁷ See Article 23(2) of Regulation 1/2003.

¹⁶⁸ Fine, p. 70. See also Case C-453/99 *Courage Ltd v. Crehan*, [2001], ECR I-6297 [2001] 5 CMLR 28.

¹⁶⁹ Fine, p. 70.

The TTBER treats reciprocal agreements more harshly as this type of agreements are considered to have a greater potential to restrict competition.¹⁷⁰ Consequently, hard-core restrictions applicable to reciprocal agreements are more severe.

5.7.1.1 Price Restrictions

Article 4(1)(a) of the TTBER provides that the block exemption does not apply to agreements between competitors which have as their object the restriction of a party's ability to determine its prices when selling products to third parties. The prohibition applies to direct as well as indirect price fixing. Examples of the former include the imposition of fixed, minimum, maximum or recommended prices and price lists providing for maximum rebates.¹⁷¹ Example of indirect price fixing would be when the agreement provides disincentives to deviate from an agreed price level by, e.g., providing that the royalty rate will increase if the product prices are reduced below a certain level. However, an obligation on the licensee to pay a certain minimum royalty will not in itself amount to price fixing.¹⁷² Article 4(1)(a), on the other hand, treats as hard-core a provision providing that the royalty is to be calculated on the basis of all product sales irrespective of whether the licensed technology is being used.¹⁷³ Such a restraint will have as its effect the restriction of the licensors ability to use his own technology since the cost of using this technology would increase. Thus, the agreement would restrict competition, which would exist in the absence of the agreement.¹⁷⁴

5.7.1.2 Output Limitations

An output restriction is a limitation on how much a party may produce and sell. Limitations of this kind are dealt with harshly by the TTBER as their object and effect is to reduce output in the market.¹⁷⁵ From the licensors point of view, the purpose of such a provision might be to avoid the risk that the licensee's production will find its way back to the licensor's sphere of activity.¹⁷⁶ Article 4(1)(b) of the TTBER provides that limitation on output in agreements between competitors is considered a hard-core restriction. However, the Article clarifies that the hard-core treatment does not apply to

¹⁷⁰ For a further analysis see TTBER Guidelines, para. 83.

¹⁷¹ This should be compared with the price fixing provision in the hard-core list for non-competitors. See section 5.7.2.1 below. Price fixing provisions in the form of maximum or recommended prices are not treated as hard-core restrictions in vertical relations.

¹⁷² TTBER Guidelines, para. 79.

¹⁷³ This kind of provision would also be caught by Article 4(1)(d) of the TTBER.

¹⁷⁴ In this respect, see Case C-193/83, *Windsurfing International*, [1986] ECR 611. The case is discussed in section 3.8. above. See also TTBER Guidelines, para. 81. An agreement whereby royalties are calculated on all product sales may in exceptional circumstances fulfil the conditions of Article 81(3) EC. This would be the case if, on the basis of objective factors, it could be concluded that the restriction is indispensable for pro-competitive licensing to occur.

¹⁷⁵ TTBER Guidelines, para. 82.

¹⁷⁶ Månsson and Persson, p. 752.

output limitations imposed upon the licensee in a non-reciprocal agreement or imposed upon one of the licensees in a reciprocal agreement, if the output limitation only concerns products produced with the licensed technology. Thus, in effect, Article 4(1)(b) identifies as hard-core restrictions, reciprocal output restrictions on the parties and output restrictions on the licensor with respect to his own technology.¹⁷⁷

5.7.1.3 Market or Customer Allocation

Article 4(1)(c) of the TTBER treats as a hard-core restriction, the allocation of markets or customers by competitors. Agreements whereby competitors share markets or customers have as their object the restriction of competition.¹⁷⁸ However, this hard-core restriction is subject to seven very important exceptions. In effect, these exceptions state what the parties can do without falling outside the TTBER.

The TTBER applies to an obligation on the licensee, whether the agreement is reciprocal or not, to produce with the licensed technology within only one or more technical fields of use or one or more product market.¹⁷⁹ However, a field of use restriction, which goes beyond the scope of the licensed technology, is regarded as a hard-core restriction. This is the case if the licensees are limited in the use of their own technology.¹⁸⁰

The TTBER is applicable to the 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, product markets or exclusive territories reserved for the other party.¹⁸¹ Hence, it is not a hard-core restriction when the licensor in a non-reciprocal agreement grants the licensee an exclusive license to produce on the basis of the licensed technology within a particular territory. The exclusive license is exempted irrespective of the scope of the territory. The purpose of bringing such a restriction outside the hard-core list is to provide the licensee with incentives to invest in and develop the licensed technology.¹⁸²

The TTBER applies to the obligation of the licensor not to license the technology to another licensee in a particular territory.¹⁸³ Hence, the TTBER allows the grant of a sole license. Hereby, the licensee may be protected from competition from other licensees producing in the same territory. The exception applies to both reciprocal and non-reciprocal agreements, but must not affect the parties' ability to exploit their own technology in their respective territories.¹⁸⁴

¹⁷⁷ TTBER Guidelines, para. 82.

¹⁷⁸ *Ibid.*, para. 84.

¹⁷⁹ Article 4(1)(c)(i) of the TTBER.

¹⁸⁰ TTBER Guidelines, para. 90. The Guidelines stipulate that when licensees are limited in the use of their own technology the agreement amounts to market sharing.

¹⁸¹ Article 4(1)(c)(ii) of the TTBER.

¹⁸² TTBER Guidelines, para. 86.

¹⁸³ Article 4(1)(c)(iii) of the TTBER.

¹⁸⁴ TTBER Guidelines, para. 88.

The TTBER is applicable to the restriction, in a non-reciprocal agreement, of active and/or passive sales by the licensor and/or the licensee in the exclusive territory or customer group reserved for the other party.¹⁸⁵

The TTBER applies to the restriction, in a non-reciprocal agreement, of active sales by the licensee in the exclusive territory or customer group allocated by the licensor to another licensee provided that the latter licensee was not competing with the licensor at the time of concluding his license.¹⁸⁶ Would the licensees agree amongst themselves not actively or passively to sell in certain territories or to certain customers, the TTBER Guidelines point out that this would amount to a cartel and would certainly be outside the TTBER.¹⁸⁷

The TTBER is applicable to the restriction on the licensee to produce the contract products exclusively for his own use.¹⁸⁸ This exception covers the situation where the licensee takes a license in order to make products for his own use (so-called captive use contract products).¹⁸⁹ The licensor may in such a situation limit the licensee to making components to be incorporated into his own products and prohibit him from selling the components to others. However, for the exception to apply, the licensee must be allowed to sell the components as spare parts for his own products.¹⁹⁰

Finally, the TTBER applies to the obligation on the licensee, in a non-reciprocal agreement, to produce the contract products only for a particular customer, where the license is granted in order to provide that customer with an alternative source of supply.¹⁹¹ This exception covers so-called second source provisions.¹⁹² The whole point of an agreement of this kind is to provide a particular customer with an alternative source of the products. Thus, the licensee may be banned from supplying anyone else. It is not a condition that only one such license is granted. The exception also covers situations where more than one licensee is appointed to supply the same customer.¹⁹³

5.7.1.4 Limitations on Exploitation of Own-Technology and R&D

Article 4(1)(d) of the TTBER provides that neither party to the agreement should be prevented from carrying out R&D, unless the purpose is to

¹⁸⁵ Article 4(1)(c)(iv) of the TTBER.

¹⁸⁶ Article 4(1)(c)(v) of the TTBER.

¹⁸⁷ TTBER Guidelines, para. 89.

¹⁸⁸ Article 4(1)(c)(vi) of the TTBER.

¹⁸⁹ Jones and Sufrin, p. 732.

¹⁹⁰ TTBER Guidelines, para. 92.

¹⁹¹ Article 4(1)(vii) of the TTBER.

¹⁹² Jones and Sufrin, p. 732.

¹⁹³ TTBER Guidelines, para. 93.

prevent the licensed know-how from being disclosed to a third party.¹⁹⁴ In addition, the Article treats as hard-core any limitation on the licensee's ability to exploit his own technology. These restrictions are treated as hard-core irrespective of whether the agreement is reciprocal or non-reciprocal. Restrictions of this kind are considered to reduce competition on existing technology and product markets and reduce the licensee's incentive to invest in the development and improvement of his technology.¹⁹⁵

5.7.2 Hard-Core Restrictions in Agreements between Non-Competitors

The hard-core restrictions applicable between non-competitors fall into three categories: price restrictions; passive sales restrictions imposed on the licensee; and restrictions on a licensee, who is a member of a selective distribution system at the retail level, from making active or passive sales to the end users.¹⁹⁶ Parties who are non-competitors are allowed more leeway when forming their agreement.

5.7.2.1 Price Restrictions

Article 4(2)(a) of the TTBER excludes restrictions on a party's ability to determine its prices when selling its products to third parties from the block exemption. This, however, is without prejudice to the possibility of imposing a maximum or recommended sales price, provided that it does not amount to a fixed or minimum sales price due to pressures from or incentives offered by any of the parties. Hence, it should be noted that there is a difference in this respect between the hard-core list applicable to competitors and non-competitors. While it is possible to impose a maximum or recommended sales price between non-competitors this is - as should be clear from the above - strictly prohibited where the parties are competitors. A fixed or minimum sales price may be established directly or indirectly.¹⁹⁷ Examples of the latter are agreements fixing the margin, fixing the maximum level of discounts, linking the sales price to the sales price of competitors, threats or intimidation, or by punishing the licensee for having adopted a given price level. Furthermore, measures to enforce price discipline, such as price monitoring systems, the obligation of licensees to report price deviations or the imposition of a most-favoured-customer clause on the licensee, would all fall outside the scope of the TTBER.¹⁹⁸

¹⁹⁴ In a such case, the restriction must be proportionate and necessary. For example, it may be sufficient if the agreement designates particular employees of the licensee to be trained in and responsible for the use of the licensed know-how. See TTBER Guidelines, para. 94.

¹⁹⁵ TTBER Guidelines, para. 95.

¹⁹⁶ Fine, p. 74.

¹⁹⁷ TTBER Guidelines, para. 97.

¹⁹⁸ Ibid.

5.7.2.2 Passive Sales Restrictions Imposed on the Licensee

Article 4(2)(b) of the TTBER disapples the block exemption to restrictions of the territory into which, or the customers to whom, the licensee may passively sell the contract products. Restrictions of this type fall outside the TTBER even when they are indirect, for example, as when a licensor provides financial incentives or imposes a product tracking system. Quantity limitations may also constitute a restriction on passive sales where they are used to implement an underlying market partitioning agreement.¹⁹⁹ It is important to note that the Article does not treat as hard-core any sales restrictions on the licensor or active sales restrictions on the licensee. Hence, sales restrictions on the licensor and active sales restrictions on the licensee are block exempted.²⁰⁰ However, there are a number of exceptions to the principal rule as always. Thus, restrictions on the licensee's passive sales may fall within the scope of the TTBER in the following circumstances.

The licensee may be prevented from making passive sales in an exclusive territory or to an exclusive customer group reserved for the licensor.²⁰¹ These restrictions are block exempted as they promote pro-competitive dissemination of technology and integration of such technology into the production assets of the licensee.²⁰² If it would not have been possible for the licensor to hinder such sales, he might not have chosen to disseminate the technology through the use of a license in the first place.²⁰³

The licensee may be restricted from making passive sales in the exclusive territory, or to an exclusive customer group, allocated by the licensor to another licensee.²⁰⁴ However, this restriction is block exempted only for the first two years that this other licensee is serving that territory or customer group.²⁰⁵ The purpose of the exception is to permit the protected licensee to start his business and regain initial investments without the intrusion by other licensees into his territory.²⁰⁶ As the investments connected with the exploitation of the licensed right could be significant, this rule might be necessary in order to induce the licensee to take the license.

The licensee may be obliged to produce the contract products only for his own use, provided that the licensee is not restricted from selling the contract products actively and passively as spare parts for his own products.²⁰⁷ Captive use restrictions are hereby exempted, as in the hard-core competitor list.

¹⁹⁹ *Ibid.*, para. 98 and Fine, p. 75.

²⁰⁰ *Ibid.*, para. 99.

²⁰¹ Article 4(2)(b)(i) of the TTBER.

²⁰² TTBER Guidelines, para. 100.

²⁰³ Jones and Sufrin, p. 734.

²⁰⁴ Article 4(2)(b)(ii) of the TTBER.

²⁰⁵ This passive sales exemption for licensees is less generous than the one in the 1996 Regulation, which allowed restrictions on passive sales for a period of five years.

²⁰⁶ TTBER Guidelines, para. 101.

²⁰⁷ Article 4(2)(b)(iii) of the TTBER.

The licensee may be obliged 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.²⁰⁸ This exception, again, exempts the so-called second source restrictions, as in the hard-core competitor list.

The licensee may be restricted from making sales to the end users when operating at the wholesale level of trade.²⁰⁹ In other words, the licensor can be required to sell only to retailers.²¹⁰

Finally, the TTBER allows members (licensees) of a selective distribution system to be restricted from selling to unauthorised distributors.²¹¹ However, in this situation, licensees must be permitted to sell both actively and passively to the end users.²¹²

5.7.2.3 Selective Distribution

Article 4(2)(c) of the TTBER provides that a licensee who is a member of a selective distribution system and who operates at the retail level cannot be restricted from active or passive selling to the end-users. However, the agreement does not lose the benefit of the block exemption when the licensor prohibits a licensee from operating out of an unauthorised place of establishment.

5.8 Excluded Restrictions

Article 5 of the TTBER sets forth the so-called excluded restrictions. As mentioned before, these are restrictions which are not exempted by the TTBER, but whose inclusion into the agreement does not remove the protection of the block exemption from the rest of the agreement.²¹³ However, the excluded restrictions require individual assessment of their anti-competitive and pro-competitive effects under Article 81(3) EC. Three categories of excluded restrictions can be identified: exclusive grant-backs/assignments of severable improvements; no-challenge clauses; and

²⁰⁸ Article 4(2)(b)(iv) of the TTBER.

²⁰⁹ Article 4(2)(b)(v) of the TTBER.

²¹⁰ TTBER Guidelines, para. 104.

²¹¹ Article 4(2)(b)(vi) of the TTBER.

²¹² TTBER Guidelines, para. 105.

²¹³ Jones and Sufrin, p. 734. See also Fine, p. 77. where the author argues that the TTBER Guidelines are somewhat misleading in this regard as they seem to imply that there is an EU rule of automatic severability for Article 5 restrictions. The author concludes that when the excluded restriction will not be severable from the rest of the agreement – which ultimately depends on the relevant national law of contracts - then the entire agreement will fall outside the scope of the TTBER.

limits on the exploitation of own-technology or R&D.²¹⁴ The restrictions that focus on exclusive grant-backs/assignments of severable improvements and no-challenge clauses are without regard to whether the parties to the agreement are competitors. Conversely, the restrictions concerning the exploitation of own technology or R&D are excluded only when the parties to the license are non-competitors.²¹⁵

5.8.1 Exclusive Grant-Backs/Assignments of Severable Improvements

It is common that the licensee will make improvements to the licensed technology during the term of the agreement. These improvements may be severable or non-severable.²¹⁶ Article 5(1)(a) and (b) of the TTBER treat as excluded restrictions any obligation on the licensee to grant back his own severable improvement to, or his own new applications of, the licensed technology, whether by exclusive license or by assignment in whole or in part, to the licensor or a third party designated by the licensor. The rationale for excluding these restrictions is to preserve the licensee's incentives to innovate.²¹⁷ Indeed, if the licensee would be hindered from exploiting his own severable improvement either in-house or by licensing it to a third party, this would undoubtedly reduce any incentives to innovate. However, non-exclusive grant-backs with respect to severable improvements fall within the scope of the TTBER. This is the case even when the grant-back obligation is imposed only on the licensee, and when the licensor is permitted to pass on the severable improvements to other licensees. Such a non-reciprocal grant-back obligation is considered to promote innovation and the dissemination of technology by permitting the licensor to freely determine whether and to whom he wants to pass on his own improvements.²¹⁸ Finally, it should be noted that exclusive grant-backs and assignments of non-severable improvements are not restrictive of competition within the meaning of Article 81(1) EC as these cannot be exploited by the licensee without the permission of the licensor.²¹⁹

5.8.2 No-Challenge Clauses

Article 5(1)(c) of the TTBER excludes no-challenge clauses, whereby a licensee is prohibited from challenging the validity of any intellectual property rights held by the licensor in the common market, from the scope

²¹⁴ The TTBER Guidelines identify four types of excluded restrictions. See TTBER Guidelines, para. 107. However, I shall treat exclusive grant backs of severable improvements and assignments of severable improvements as one category.

²¹⁵ Fine, p. 77.

²¹⁶ An improvement is severable if it can be exploited without infringing upon the licensed technology. TTBER Guidelines, para. 109.

²¹⁷ TTBER Guidelines, para. 108.

²¹⁸ *Ibid.*, para 109.

²¹⁹ *Ibid.*

of the TTBER. The reason for excluding these clauses from the block exemption is that licensees are normally in the best position to determine whether or not an intellectual property right is invalid.²²⁰ However, the exclusion of no-challenge clauses is without prejudice to the licensor reserving his right to terminate the license in the event of a challenge to the licensed rights. Hence, a licensor is not obliged to keep on dealing with a licensee who challenges the very subject matter of the agreement.²²¹ As far as know-how is concerned, a favourable approach to no-challenge clauses is taken.²²² The reason for this is the sensitive nature of know-how, which once disclosed may be of no or little value to the licensor. This standpoint, of course, is of special importance to weaker licensors dealing with stronger licensees as it gives them the means to reach an agreement without fear of a challenge once the know-how has been absorbed by the licensee.²²³

5.8.3 Limits on the Exploitation of Own Technology and R&D

Article 5(2) of the TTBER provides that when the parties to the agreement are non-competitors, the block exemption is inapplicable to restrictions limiting the licensee's ability to exploit his own technology. The same holds for any limitation on the ability of either party to the agreement to carry out R&D, unless such a restriction is indispensable to prevent the disclosure of the licensed know-how to a third party. The content of this provision is identical to that in Article 4(1)(d). However, this latter Article is included in the competitor hard-core list. Thus, including such restraints in an agreement between competitors will cause the disapplication of the block exemption to the entire agreement.

5.9 Other Specific Restraints

A discussion of technology transfer agreements would not be complete if it did not consider these agreements' relation to non-compete obligations and tying-clauses. These restraints are common within the context of licensing agreements. The TTBER does not address these restraints. Hence, the principle applies that what is not expressly prohibited by the TTBER is allowed as long as the parties keep below the market share threshold applicable to their agreement. The TTBER Guidelines confirm this conclusion.²²⁴

²²⁰ Ibid., para. 112.

²²¹ Ibid., para. 113.

²²² Ibid., para. 112.

²²³ However, licensors wanting to protect their know-how against any form of disclosure by the licensee most commonly require the licensee to sign a confidentiality letter already during early negotiations and well before any significant know-how is disclosed to the licensee.

²²⁴ TTBER Guidelines, paras. 192 et seq. and 197 et seq.

A non-compete obligation within the context of technology licensing takes the form of an obligation imposed on the licensee not to use third party technologies which compete with the licensed technology.²²⁵ An obligation of this kind is expected to provide the licensee with incentives to invest in and exploit the licensed technology effectively.²²⁶

Tying in the context of technology licensing occurs when the licensor makes the licensing of one technology conditional upon the licensee taking a license for another technology or purchasing a product from the licensor or someone designated by him.²²⁷ In some cases, tying-clauses may be necessary in order to ensure a technically satisfactory exploitation of the licensed technology or for ensuring that the production under the license conforms to certain quality standards.²²⁸ It may also allow the licensee to exploit the licensed technology more efficiently.²²⁹

5.10 The Possibility of Withdrawal

Article 29(1) of Regulation 1/2003 provides that the Commission may withdraw the benefit of a block exemption from an agreement in a particular case where the agreement has effects which are incompatible with Article 81(3) EC. Article 6(1) of the TTBER identifies three situations with respect to technology transfer agreements where the Commission may exercise its right of withdrawal. The first situation is when the access of third parties' technologies to the market is restricted by the cumulative effect of parallel networks of similar restrictive agreements prohibiting licensees from using third parties' technologies.²³⁰ The second situation is where the access of potential licensees to the market is restricted by the cumulative effect of parallel networks of similar restrictive agreements prohibiting licensors from licensing to other licensees.²³¹ Finally, the Commission may withdraw the benefit of the block exemption from an agreement when the parties without any objectively valid reason, do not exploit the licensed technology.

The Commission's concern in the first two situations is the foreclosure effects, which might result from networks.²³² In the last situation, when the parties do not exploit the licensed technology and hence no efficiency enhancing activity takes place, the Commission considers that the very reason for the block exemption disappears.²³³

²²⁵ *Ibid.*, para. 196.

²²⁶ *Ibid.*, para. 202.

²²⁷ *Ibid.*, para. 191.

²²⁸ *Ibid.*, para. 194. See also the Windsurfing-case, discussed above under section 3.8. and the Commission Evaluation Report, para. 161.

²²⁹ *Ibid.*, para. 195.

²³⁰ Article 6(1)(a) of the TTBER.

²³¹ Article 6(1)(b) of the TTBER.

²³² TTBER Guidelines, para. 121.

²³³ *Ibid.*, para. 122.

As a direct consequence of the decentralisation of the enforcement system also NCA are empowered to withdraw the benefit of a block exemption from an agreement.²³⁴ Article 6(2) of the TTBER provides that NCA may exercise its right of withdrawal in the same circumstances as the Commission when the effects of the agreement are felt on its national territory. However, the withdrawal will only apply with respect to that specific territory.

5.11 The Possibility of Disapplication

In some situations, individual withdrawal may not be a remedy effective enough to preserve a sound competitive market. Therefore, Article 7(1) of the TTBER provides that the Commission may exclude from the scope of the block exemption parallel networks of similar agreements when these cover more than 50% of a relevant market and contain specific restraints relating to that market. Whereas the right of withdrawal is exercised by way of a decision addressed to a specific undertaking, the right of disapplication is exercised by way of a regulation describing a certain type of agreement to which it applies.²³⁵ It must be underlined that Article 7(1) by no means requires the Commission to disapply the TTBER when the 50% threshold is exceeded. Disapplication is considered an appropriate measure when it is likely that access to the relevant market or competition is appreciably restricted.²³⁶

5.12 Agreements Outside the Scope of the TTBER

There are several plausible reasons for why a licensing agreement may fall outside the scope of the TTBER. From the preceding exposition, it should be clear that such is the case when the contracting parties hold a higher share of the market than allowed by the market share thresholds and when the agreement contains hard-core restrictions. In addition, a licensing agreement may fall outside the TTBER if it is the question of a multiparty licensing agreement or if the agreement contains non-severable excluded restrictions. In this context, it should be recalled that if the agreement falls outside the scope of the TTBER, this fact does not lead to the presumption that the agreement is invalid. However, this requires that the agreement does not contain any hard-core restrictions.²³⁷

If the agreement falls outside the scope of the TTBER it is a disadvantage to the parties as it leads to a degree of legal uncertainty as to whether the

²³⁴ Article 29(2) of Regulation 1/2003 provides for this.

²³⁵ Jones and Sufrin, p. 736.

²³⁶ TTBER Guidelines, para. 126.

²³⁷ *Ibid.*, para. 130.

agreement constitutes a restriction of competition and if it still might be exempt under Article 81(3) EC.²³⁸ The contracting parties will have to do an individual assessment of their agreement by balancing its positive and negative effects. Such an assessment will comprise a significant measure of uncertainty requiring the parties to collect information concerning e.g. the nature of the agreement, the market position of the parties, the market position of competitors, entry barriers and the maturity of the market.²³⁹ However, the TTBER Guidelines provide detailed guidance on how to proceed with an individual assessment.²⁴⁰ In fact, the TTBER Guidelines devote no less than 53 paragraphs to examining the relation between 10 common licensing restraints and Article 81(1) and (3) EC. These guiding principles should be of great help to undertakings when performing an individual assessment of their technology transfer agreements.

²³⁸ Månsson and Persson, p. 759.

²³⁹ TTBER Guidelines, para. 132.

²⁴⁰ The Commission Guidelines on the application of Article 81(3) of the Treaty might also be of use in this context.

6 Concluding Analysis

The relation between patents and know-how

The grant of patents spurs innovation and ultimately economic growth and welfare to the benefit of everyone.²⁴¹ In fact, this is the intention of the patent system. The main characteristic of patents is that they exist in the public domain. In order to obtain a patent the inventor must disclose his innovation. This, in a manner of speaking, is the cost for acquiring a patent. The idea of the patent system is that society will grant the inventor an exclusive right – a patent – to his technical achievement in exchange for disclosing the new technology underlying the patent. When the time of protection expires, the technology will be free for everyone to use. This is the great value of the patent system.

Unlike patents, know-how is not an intellectual property right. For companies it might nevertheless represent economic values that are the equivalent to patents. From a legal point of view, however, know-how and patents are worlds apart. As know-how is not an intellectual property right it does not receive protection under intellectual property law.²⁴² Instead, it may enjoy competition law protection for trade secrets.²⁴³ This legislation does not grant the holder an exclusive right to know-how; instead it protects him against unfair exploitation or disclosure.²⁴⁴ Unfair exploitation of know-how may occur as a result of know-how being exposed to a potential licensee in the situation of patent and know-how licensing negotiations.²⁴⁵

When an invention is accomplished, an inventor may face the choice of either filing a patent or keeping the invention a trade secret. However, it will not be the question normally of an “either-or”- choice.²⁴⁶ Due to the great risks posed by reverse engineering, far from all inventions are suitable to be kept as trade secrets.²⁴⁷ Thus, the inventor will usually file for a patent as well as keep other information regarding the invention secret. This secret information, i.e. know-how, may concern the optimisation of the manufacturing process or the marketing of the invention.

²⁴¹ Jaffe and Lerner, p. 7.

²⁴² However, Article 39 TRIPS requires its members to provide a sufficient protection for know-how against unfair competition.

²⁴³ However, for know-how to enjoy competition law protection for trade secrets it must be the question of secret know-how, i.e. the definition of the term that is employed in this thesis.

²⁴⁴ For a thorough discussion of the Swedish legislation on trade secrets, see Fahlbeck.

²⁴⁵ During patent and know-how negotiations know-how may enjoy protection through competition law protection for trade secrets, by the contracting parties signing a confidentiality letter and by the principle of loyalty underlying commercial contract law.

²⁴⁶ Fahlbeck, p. 106.

²⁴⁷ Koktvedgaard and Levin, p. 210.

Patent and know-how licensing in relation to EC competition law – striking the right balance

Patents and know-how are usually licensed together. A combined license is advantageous for both the licensor and the licensee. From the perspective of the licensee, a combined license saves money and time. From the perspective of the licensor, a combined license makes it possible to maximise the profit on the invention. Moreover, most licensing agreements are valuable for society. The possibility of exploiting an invention through the use of a license creates incentives for innovation. In addition, it leads to the dissemination of technology. Undoubtedly, there is a lot to be said in favour of licensing. However, licensing agreements may also produce anti-competitive effects. It is the task of competition law to militate against these effects. As soon as licensing agreements have cross-border effects, EC competition law becomes operative. Hence, EC competition law may affect the exercise of an intellectual property right granted under national intellectual property law. The ECJ established this principle in the Consten and Grundig case.

Intellectual property law and competition law have different points of departure. A patent creates a kind of legal monopoly for its owner. This monopoly depends on the breadth and extent of the patent grant. Competition law, however, seeks to counteract any unfair exploitation of a monopoly position. Hence, it might appear that what one hand gives (intellectual property law) the other takes away (competition law). However, there is no inherent conflict between intellectual property law and competition law. At the highest level of analysis, intellectual property law and competition law are, in fact, complementary since they both aim at promoting consumer welfare.²⁴⁸ When competition law intervenes in an intellectual property right one must try to strike the right balance between over- and under-protection of innovators' efforts.²⁴⁹ Principle administrator in DG Competition Luc Peeperkorn et al. have put it well: "As the main driving force for innovation is competition it is important to find a balance between protection of competition and protection of intellectual property rights."²⁵⁰

The 2004 TTBER – does it promote the conclusion of patent and know-how licensing agreements?

The 2004 Technology Transfer Regulation is the legal instrument that governs the framing of technology transfer agreements within the EU. How the TTBER addresses licensing is of utmost importance, as it affects the technological development within the Union and ultimately its competitive strength.

²⁴⁸ Peeperkorn, p. 528.

²⁴⁹ Over-protection may delay follow-on innovation. On the other hand, under-protection may result in lack of incentives for innovation.

²⁵⁰ This passage is quoted from Dufwa, p. 41.

The 2004 TTBER takes a positive stance to licensing. Already in the preamble, the Regulation recognises that licensing agreements will usually be pro-competitive and improve economic efficiency.²⁵¹ This is the attitude towards licensing underlying the new TTBER.

The 2004 TTBER allows the grant of exclusive licenses in both horizontal and vertical relations. In horizontal relations, however, the licensor may not abstain from acting within the territory allocated to the licensee if the agreement is reciprocal. Hence, in these relations only the grant of a sole license is allowed. The purpose, of course, is to promote competition as the parties in a reciprocal agreement are cross-licensing technologies, which can be used for the production of competing products. Thus, the interest of promoting competition outweighs the parties' interest of protection. Such a restriction seems fair. The above rules apply in the same way when the licensor reserves a territory for himself (the licensee can be obliged not to act within that territory in a vertical and non-reciprocal horizontal relation).

As regards territorial sales restrictions, the licensor may abstain from pursuing active and passive sales in the territory of the licensee in both vertical and non-reciprocal horizontal relations. In these relations, the licensor may also protect the licensee against active sales by other licensees. However, in reciprocal horizontal relations the licensee cannot be protected against active/passive sales by the licensor or against active sales by other licensees. Again, in this respect the interest of promoting competition outweighs the interest of protection for the parties. Moreover, within vertical relations the licensor may protect the licensee against passive sales by other licensees during a period of two years. This amounts to a strong territorial protection. Its objective is to make it easier to introduce a new product in the market by the licensee. In relation to the licensor, the licensee in a similar vein can be obliged not to pursue active and passive sales in the territory reserved for the licensor in both vertical and non-reciprocal horizontal relations.

The possibility of exclusivity and imposition of territorial restraints are always important elements in licensing agreements. In fact, these two possibilities may be decisive for the conclusion of a licensing agreement. The ECJ recognized the importance of exclusivity in the Nungesser-case. The TTBER allows the parties a great room of flexibility and freedom as regards the grant of exclusive licenses and imposition of territorial sales restrictions. This approach creates a favourable environment for licensing.

On the other hand, the TTBER takes a harsh approach to price-fixing. This is true both for vertical and horizontal relations. Although the parties in a vertical relation are allowed more leeway, the TTBER makes a clear signal that restraints of this kind ought not to be included in the agreement. Price-fixing could have detrimental consequences as it could lead to increased customers prices. In a market economy, the market mechanism regulates

²⁵¹ Recital 5 of the TTBER.

prices. Moreover, the possibility to fixate prices is probably not a necessary condition to induce a licensor to out license his invention.

The TTBER attacks any prohibition on the licensee to use his own technology, as well as any restraint on either of the parties to engage in R&D. This holds true both for horizontal and vertical agreements. In other words, the road to technological development and innovation must not be blocked. Hence, according to the Regulation, the licensing agreement should not require the licensee to refrain from using his own technology or the parties from engaging in R&D.

The excluded restrictions within the Regulation concerning exclusive grant-backs/assignments to severable improvements and no-challenge clauses apply in relation to both vertical and horizontal relations. The reason for excluding exclusive grant-backs/assignments to severable improvements is to create incentives for the licensee to further technological development. No-challenge clauses are excluded from the exemption as the higher interest of only having valid patents on the market outweigh any interest of the licensor not to have his intellectual property right challenged. This negative stance towards no-challenge clauses was already evident in the Windsurfing-case. Needless to say, invalid patents are not in the interests of anyone as they may slow technological progress. Invalid patents could produce blocking effects on new technology.

The 2004 TTBER undoubtedly creates a favourable environment for technology transfer. Those restraints, which are prohibited or excluded, will not as a rule have a major effect on the parties' incentive for entering into a licensing agreement. This is not to say that the parties may not have an interest of including such provision into the agreement. However, they will not be considered indispensable. On the other hand, the analysis underlying the Regulation has led to the conclusion that such restraints might produce negative effects on competition. Thus, they should not be exempted automatically.

The inclusion of a market share threshold in the new TTBER is the part of the new legislative framework, which has encountered most criticism. Critics have argued that the old system of listing clauses, represented by the 1996 Regulation, although formalistic, at least stated which agreements could be exempt and which could not. It has been argued that in reality the safe harbour is anything but a safe harbour.²⁵² Hence, when considering whether the new TTBER promotes patent and know-how licensing, it is necessary to address the issue whether the market share threshold might have negative effects on licensing.

An assessment of whether an agreement will fall within the so-called safe harbour is not always an easy task. Nevertheless, the inclusion of a market share threshold in the TTBER is necessary. A liberal framework, like the

²⁵² Fine, p. 53.

TTBER, is built on this foundation. Without the market share threshold, it would not have been possible to include the principle “what is not strictly prohibited is allowed”. The market share threshold system secures a sound competitive environment. The system is beneficial for the parties since when it is established that the agreement might benefit from an exemption under the TTBER, the exemption applies to the whole agreement. This, of course, is subject to the condition that the agreement does not contain any hard-core or non-severable excluded restrictions. The benefit consists in the fact that the licensing parties are dispensed from performing a self-assessment of the license.

The somewhat complex safe harbour analysis must not overshadow the advantages of the present system. The TTBER Guidelines provide detailed guidance on how to proceed with the safe harbour analysis. It ought not to be that difficult for the contracting parties to carry out this analysis. Indeed, the Commission has done a laudable job in creating the TTBER Guidelines.

When considering whether the 2004 TTBER promotes licensing one must keep in mind that the new TTBER recognises the global dimension of licensing. The EU approach to licensing is brought in line with that in the US. Although the systems are not identical, it makes the task of framing a license agreement more comprehensible for the contracting parties. The main difference between the approach in the EU and US is the stands taken towards vertical licensing, i.e. licensing between non-competitors. In the US these types of agreements seldom run into problem with competition law. The view is that the rights holder in such a situation should in principle be allowed to impose those restraints on the licensee as he considers appropriate. In other words, the licensor should be able to exploit his intellectual property rights through a licensee in the same way would he have had exploited the invention in-house.²⁵³ This of course differs from the approach taken in the EU. Although agreements between non-competitors are allowed more leeway, the licensor is not entitled to impose any kind of restraints on the licensee. The difference between these approaches is due to the market integration aspect, which must be taken into consideration in the context of licensing within the EU. As the idea of an internal market is a fundamental cornerstone for the creation of a European Union this difference in approaches is inevitable.

This analysis leads to the conclusion that the 2004 TTBER promotes the conclusion of patent and know-how licensing agreements. The system provides companies with flexibility. It brings a fruitful economic approach into the field of licensing. Indeed, the approach to licensing today is not far from that expressed in the 1962 Christmas Message, other than that market power and hard-core prohibitions have a more pronounced place in the Regulation.²⁵⁴

²⁵³ Peeperkorn, pp. 538-539.

²⁵⁴ Lidgard, p. 257.

The Lisbon strategy

As part of the Lisbon strategy, the EU has set as its objective to become the most competitive economy by the year of 2010. In reaching this objective a legislative framework, which creates incentives for innovation and promotes the dissemination of technology is of outmost importance. The 2004 TTBER do these things. The Global Competitiveness Report 2005-2006 rates three EU member states – Finland (1st place), Sweden (3rd place) and Denmark (4th place) – amongst the four most competitive nations in the world.²⁵⁵ These ratings give some support for my conclusion that the 2004 TTBER creates a favourable environment for technology transfer. Indeed, the 2004 TTBER should have an important part to play in reaching the objective of the Lisbon strategy.

²⁵⁵ The Global Competitiveness Report 2005-2006, Executive Summary, p. 3.

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