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Allocating Territories, Customers and Fields of Use in Patent Licensing Agreements

-A thesis dealing with to what extent it is possible for the European industry to divide markets and share customers.

Master thesis
20 points

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Contents

Summary

As a matter of business reality, the allocation of markets through direct agreements are the most favourable and efficient construction in any level of commerce as it provides the delight of not having to compete with other companies in a certain territory, to a specific customer group or within a particular field of use. However, the practice of dividing different areas within a patent licensing agreement, in particular where to draw the exact line between permitted respectively prohibited allocations has long been an area of conflict. The uncertainty is mainly due to two fundamental conflicting interests, which clearly stand out when examining the question at issue. On the one hand, the European Union's policy objective to promote a harmonised development of the economic activity within the Union, where on the other hand, the industry's effort to maximize their profits by outsourcing different areas.

In order to rectify this uncertainty the Commission has adopted the Technology Transfer Block Exemption Regulation 772/2004 where the hardcore rules in Article 4.1(c) and 2(b) prohibit market and customer allocation in patent licensing agreements and, if incorporated, may cause the whole agreement to be void and unenforceable under Article 81 EC Treaty. These hardcore restrictions contain two sets of separate exceptions to the general rule that apply depending on the status of the parties, i.e. if the parties to the patent licensing agreement are regarded as competitors or non-competitors. If the parties are regarded as competitors Article 4.1(c) and its corresponding seven exceptions will apply, however, if they are non-competitors Article 4.2(b) will apply with its seven exceptions.
The rationale behind the difference is that the Commission regards agreements between competitors to pose a greater risk to competition within the Common market than agreements between non-competitors.

The EC has solved the crossing point between permitted respectively prohibited allocations on territories, customer groups and fields of use by partly relying on the preservation of free movement of goods, i.e. relying on the absolute territorial protection concept, and partly by relying on safeguarding free competition by analysing the restriction's economic effect on competition.

In essence, the concluding point is that European businesses can impose territorial, customer group and field of use restrictions in their patent licensing agreements as long as they do not prevent parallel trade hindering free competition or free movement of goods.

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Abbreviations

Cir	Circuit
CMLR	Common Market Law Report
DC	District of Colombia Circuit (United States Court of Appeals)
DOJ	Department of Justice (United States)
EC	European Community
ECJ	European Court of Justice
ECR	European Court Review
EC Treaty	Treaty establishing the European Community
EIPR	European Intellectual Property Review
EU	European Union
F.2d	Federal Report
IP	Intellectual Property
OJ	Official Journal of the European Union
REG	Case law from European Court of Justice and Court of First Instance
SME	Small and mediumsize companies
TTBER	Technology Transfer Block Exemption Regulation
US	United States Reports
VBER	Block Exemption Regulation on Vertical Agreements
WIPO	World Intellectual Property Organisation

1 Introduction

As a matter of business reality, the division of markets through direct agreements are the most favourable and efficient construction in any level of commerce as it provides the delight of not having to compete with other companies in a certain territory, to a specific customer group or within a particular field of use. The competitive strength lies in the fact that it enables the parties to the licensing agreement to enter into an efficient collaboration enabling the companies to enhance their competitive strength and acquire market-shares.

The use of patent licensing agreements is perhaps most important for SME's, i.e. small and mediumsize companies that lack the resources to fully exploit their innovation internationally, but have the possibility to exploit their development nationally. However, that is not to say that large international enterprises are not diligent users of licensing agreements. In contrast, large companies use their patent licensing agreements as a useful part of their business strategy to catch up ideas and innovations into a ready product, which also allows the usage of a new technique that can be applicable on a range of products.

The issue of dividing markets through patent licensing agreements has long been surrounded by the conflict between companies' desire to allocate and Community aims, such as the free movement of goods and free competition, as they stand in direct conflict with each other. As a consequence, the Commission has tried to provide a legal framework that would safeguard both Community aims and business interests in order to allow European business to stand a chance in a fiercely competitive global marketplace.

The question is therefore whether the Commission has rushed into the drafting of a set of rules that influence negatively on the innovative process in Europe? Or, does the framework enable European companies to enhance their effectiveness as well as competitiveness?

1.1 Purpose

The purpose with this thesis is to examine to what extent it is possible to allocate markets, customer groups and fields of use within a patent licensing agreement.

The practice of sharing out different areas within a patent licensing agreement, in particular where to draw the exact line between permitted respectively prohibited allocations has long been an area of conflict. The uncertainty is mainly due to two fundamental conflicting interests, which clearly stand out when examining the question at issue. On the one hand, the European Union's policy objective to promote a harmonised development of the economic activity within the Union, where the assurance of free competition and free movement of goods are two essential components in the legislative procedure to prevent anti-competitive restraints, where the overriding objective is to remove obstacles impeding trade between the Member States. On the other hand, the industry's effort to maximize their profits by sharing out different areas, as this will shorten the product cycle enabling the marketing of products at a faster pace. The practice comes natural to enterprises, as it is of essence in every business strategy to enhance the competitive strength at the expense of rivalling companies.

In order to rectify the uncertainty it is the Commission's view that the technology transfer block exemption regulation will strike the appropriate balance between the two interests, in particularly the rules regarding allocation of markets, customer groups and fields of use restrictions. However, the chosen area for examination is very complex and difficult to grasp, which is why it is my aim not only to as far as possible address the interface between the permitted respectively prohibited allocations, but also to try to improve the comprehension for this particular area of law.

Important matters to address when writing this thesis were; to what extent is it possible for the European industry to allocate without confronting problems? In such case, which are these problems? And, is it in consequence, possible to draw a specific line between the crossing point of such permitted and prohibited allocations?

1.2 Method

In order to make a satisfactory examination, my intention is to employ three different methods when approaching the material. These are the traditional legal method with a comparative study of the legal situation in the US, in conjunction with an economic analysis of law.

The European Community's legal sources (see further below under 'Material') will mainly be utilized in order to investigate and describe the legal framework on the practice of sharing out markets, customer groups and fields of use within a patent licensing agreement in the European Union. As I go along, I will also study and describe the American legal system's view on such allocations, in particular in regard of its case law, although there will be a similar *de lege lata* depiction of the law as it stands today.

There will also be a comparative analysis between the European Union's regulations and the American legal system in order to penetrate and go beyond the rationale governing the European rules on market division and customer allocation. My anticipation is to be able to shed some further light on the rationale through American law and consequently, attempt to amplify the comprehension of the regulatory framework on this matter.

The comparative analysis will finally be controlled from an economic analysis of law perspective in order to examine whether the law regarding market division and customer allocation gives clear and reasonable rules satisfying the EU's overriding objective to provide a favourable economic environment where European industry can flourish.

However, it is an imperative necessity to stress that this is a thesis in law and not in economics why it may appear to be a rather poor and simplified analysis of the economic perspective. One must also remember that the discussion in economics is limited to predicting the effect of the legal rule within the chosen area of law as well as serving as guidance when establishing whether the provision has fulfilled its function or not.

1.3 Material

Most of the material that have been used originate from the European Community's legal sources, such as the EC Treaty, the Technology Transfer Block Exemption Regulation from both 1996 and 2004, its corresponding guidelines, the Regulation on Vertical Agreements and Concerted Practices from 2000 and its accompanied guidelines, different reports and case law. However, it can be pointed out at this early stage, that there is little European case law on the question at issue why there will be reference to merely a handful. There will also be references to conventional legal doctrine as well as articles, published both in print and on the Internet.

American law will also be utilized such as the Sherman Act from 1890, the Clayton Act from 1914 and its related guidelines, as well as a substantial amount of case law.

The information has been gathered from briefings and other material available at third parties' homepages such as industry, trade associations, law firms and IP societies, established in both the EU and the US. My endeavour has been to utilize, as far as possible, an equal share of material from different perspectives in order to as far as possible evade preconceptions and partiality.

1.4 Delimitations

When examining to what extent it is possible to allocate markets, customer groups and fields of use within a patent licensing agreement, the Technology Transfer Block Exemption Regulation 772/2004[1] (below the TTBER) will be the subject of examination. Many fundamental legal issues arise within various areas of law when examining a legislative measure such

[1] Commission Regulation (EC) No 772/2004 on the application of Article 81.3 of the Treaty to categories of technology transfer agreements OJ [2004] L123/11.

as the block exemption regulation, although it is beyond the scope of this thesis to provide an in-depth analysis of every possible angel.

Consequently, the TTBER will not be examined in its detail but focus will be on Article 4 which contains the hardcore restrictions of market division (see Supplement A), and will therefore form the main core for this thesis. Article 4 contains several prohibitions on restrictions that can be incorporated in a licensing agreement. However, this thesis is limited to the general prohibition on market division and customer allocation in its Subsection 1(c) and 2(b). These two hardcore restrictions are followed by two sets of different exceptions, one relating to competitors and the other to non-competitors. These exceptions will not be examined on their own but will be analysed together to simplify the overall comprehension.

There will also be reference to other rules, such as the distinction between competitors and non-competitors and market-share thresholds, which is of essence in order to appreciate the rules regarding prohibited respectively permitted market division and customer allocation.

It has been argued that in order to appreciate the block exemption regulation's significance it is necessary to analyse Community Competition Law.[2] Although, I can agree with this to a certain extent, namely that it is important to briefly mention its cornerstones, I intend not to develop this any further and instead presume that the reader is well confident with that particular area of law. I also presuppose that the reader has basic knowledge in European Community Intellectual Property Law.

[2] Greaves, 1993: xii.

2 A New Asset

2.1 Technology

In the last quarter century, new assets are dominating the most important factors of production of any business economy of today compared to what was considered before as the most important ingredients.[3] The principal difference between these ‘old’ and ‘new’ assets lie in their ‘intangibility’, which functions as a categoriser when talking about companies’ recourses. The first category consists of physical possessions, such as machinery, buildings, infrastructure and financial assets, whereas the second category includes intangible assets which generally include the company’s knowledge and innovation, such as ideas, designs, brands and human capital, often referred to as technology.[4]

Conventionally, businesses have always regarded physical possessions as the most valuable resources, which also have determined a company’s competitiveness in a given market. However, as businesses are realizing that these new properties are becoming more valuable than their physical assets, there has been a significant shift in business strategy, and at WIPO’s website, one can read that;

> (…) large warehouses and factories are increasingly being replaced by powerful software and innovative ideas as the main source of income for a large and growing proportion of enterprises worldwide. And even in sectors where traditional production techniques remain dominant, continuous innovation and endless creativity are becoming the keys to greater competitiveness in fiercely competitive markets, be it domestic or international.[5]

It is quite simple to understand why these new assets have moved to the forefront of business strategy, not only due to their truly competitive significance, but also because almost every product that we use in our daily life is a result of a long chain of innovations. Consequently, the intangible assets induce companies to search for the best possible way to make use of their technology, preferably through acquiring intellectual property protection where the regulatory framework provides extensive privileges for the rights owners. It does not only give owners a valuable advantage by functioning as a mean to maintain an overall competitive lead by having the sole right to use, produce or manufacture the technology, but also the right to prevent others from using the invention.[6]

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[3] Gutterman, 1997:3.
[4] WIPO, Intellectual Property for Business > Intellectual Property as a Business Asset. Gutterman, 1997: 3.
[5] Id.
[6] Id. and WIPO, Intellectual Property for Business> Why is Intellectual Property Important to Your SME?

However, of particular interest for this thesis is the owners' exclusive right to engage others to use the technology by allowing them to exploit the inventions through licensing agreements. These technology-based transactions, also called technology transfer agreements, are important routes of bringing new technologies to markets.[7]

2.2 Allocating markets

Besides making sure that new markets are opened, technology transfer agreements, or the practice of licensing, does not only promote the development of new products and processes, and encourage dissemination of innovations, but are also, as mentioned above, a particularly valuable instrument to gain market-shares in a fiercely competitive environment.[8]

The starting point is that licensing is a form of exploitation of the intellectual protected invention in order to be financially rewarded for the efforts made. Especially since the generation and development of inventions is time-consuming and costly there must be an economically efficient strategy to be financially compensated which in turn encourages those who invest time, money and labour, not only to recoup cost and investments, but also to profit by it. New inventions also benefit society by stimulating investments and employment, as valuable information will be disclosed to the public, which in turn promotes progress of science and useful arts.[9]

Licensing agreements are usually pro-competitive and generally improve economic efficiency as they can reduce duplication of research and development as well as generate product market competition.[10] The combination of a licensor's improved technology with a licensee's efficient production or distribution can reduce production costs and lead to the production of higher quality products that will in turn remove obstacles to the development and exploitation of technology, promoting competition.[11]

However, there is another side of the same coin which can be illustrated by a quote from the European Union's website[12], namely that;

> (…) licensing agreements may also be used for anti-competitive purposes, e.g. where two competitors use a licensing agreement to share out markets between themselves (…).[13]

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7 Gutterman, 1997: 16 and Cefic, December 2003, p. 1.
8 Gutterman, 1997: 10.
9 Bently and Sherman, 2001: 32f and Scadplus; factsheet summary legislation, 14.06.2004.
10 Recital 5 TTBER.
11 Paragraph 17 TTBER.
12 Gateway to the European Union, available at: http://europa.eu.int
13 Scadplus, "Technology transfer agreements", 14.06.2004.

Obviously, the practice of allocating markets between the parties to a licensing agreement impedes competition. However, as briefly mentioned above, the point of departure is that the industry in general strives to divide markets. The reason is not to impede competition, that is to say, the industry itself does not regard its behaviour as competing between each other (i.e. competing within the same brand), but they cooperate, and when there is competition it is within *different* brands, i.e. inter-brand competition. In other words, the licensor's endeavour is precisely to share out different areas within the patent licensing agreement in order to achieve an efficient collaboration with the licensees. In this way, the licensed technology will be distributed in the most advantageous mode favouring its competitiveness.[14]

Other reasons for allocating areas are the licensor's willingness to secure that the licensed technology is exploited by competent companies, that the licensed product image and reputation is strengthened or to influence price fixing by preventing that the market is flooded by the licensed technology.[15] The practice of allocation in the licensing agreement is also advantageous for the licensee as he is able to plan his commercial activities and investments against the prevailing conditions in his territory, thereby outlining the most beneficial business strategy.[16]

Consequently, market dividing provisions in licensing arrangements are broadly applied enabling not only the licensor to take a commercial advantage of the protected technology on the markets where it is inconvenient for him to do so himself, but also gives the licensees a lead in fiercely competitive markets.[17]

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[14] Lidgard, 1997: 99.
[15] Id. p. 169.
[16] Id. p. 99.
[17] Greaves, 1994: 74.

3 Policy Issues

3.1 Free Competition

One of the most salient policy issues associated with licensing agreements within the EU is the concern over free competition where the threshold under EC competition law is whether the technology transfer agreement will contravene Article 81.1 EC Treaty. The reason is that Community competition policy alludes outermost on the promotion of a harmonised development of the economic activity within the Community as a whole. It also aims *inter alia* at a continued and balanced augmentation, an increased stability, and an improvement of the standard of living, as well as an enhanced relationship between Member States.[18]

As a tool to uphold free market competition, Article 81.1 EC Treaty is one of the basic principles of the EC competition rules containing a prohibition against agreements that impede competition within the Common Market making such agreements automatically void and unenforceable.[19] Article 81.3 EC Treaty also contains an exemption which exempt otherwise regarded anti-competitive agreements on certain specified conditions when such agreements contribute to improve the distribution or production of goods, or improve economic progress and allow consumers a fair share of the resulting benefit. Such agreements must also not impose restrictions, which are not indispensable to the achievement of the objectives of the agreement, and its provisions must not eliminate competition in regard of a substantial part of the concerned product.[20]

For this reason, Article 81.3 EC Treaty does not only exempt agreements that will benefit the European market when these benefits are deemed to outweigh the detriments to competition, but also allows the Commission to grant 'block exemptions' by issuing block exemption regulations. Therefore, the technology transfer block exemption regulation, issued by the Commission, concerns the assurance of an effective competitive single European market by functioning as a framework for the drafting of commercial agreements and helps parties to such agreements not to include clauses that can obstruct the free market. More pointedly, the block exemption permits the parties to the licensing agreement to avoid being caught by Article 81.1 EC Treaty, thereby upholding free competition.[21]

That the EC Treaty is founded on a market-economic thinking becomes obvious when reiterating the fundamental thought underpinning the creation of the common market, which, put into practice, is the constant course of

[18] Lidgard, 1997: 83.
[19] Greaves, 1993: 23.
[20] Id. p. 15.
[21] Id. p. xi and 3.

action of removing obstacles to trade between Member States. The desired result is likewise clear; to provide a favourable economic environment in which business within the European Community can flourish.[22]

3.2 Free Movement of Goods

A further but unique problem associated with balancing EU's policy objective to uphold free competition with patent owners' right to exploit their intellectual property, for instance by carving up the market between him and the licensees, is the maintenance of a single market among the Member States.[23]

The underlying problem is the fact that the current regulatory framework on patents is a two-tier system, i.e. the European Patent Convention of 1 June 1978 (which beside-the-point is not a result of a Community effort) and the patent laws of each Member States, which follows the principle of territoriality having a market-dividing effect. This means that, as the rights can only be relied on in the territory where they are granted they do not affect parallel rights that may exist in other countries with the obvious effect of portioning the single market into the different Member States until the right is exhausted.[24]

The European Court of Justice (below the ECJ) has tried to resolve the conflict between national patent laws and the free movement of goods within the EC by relying on an analysis of Article 28 and 30 EC Treaty. However, it firstly needs to be mentioned that Article 222 EC Treaty states that the EC Treaty shall in no way prejudice the rules in Member States governing the system of property ownership, i.e. the national patent laws. At the same time, the Member States' patent laws are regarded as quantitative restrictions and are therefore prohibited pursuant to Article 28 EC Treaty.

Article 30 on the other hand ascertains that Article 28 shall not prevent restrictions on imports justified on the protection of industrial and commercial property, although such restrictions shall not constitute means of arbitrary discrimination or a disguised restriction on trade between Member States. Therefore, Article 30 clearly derogates from the fundamental principle of free movement of goods although it has to be mentioned that its scope has been narrowly construed by the ECJ.

Consequently, there is an abundance of cases regarding this area of law, however, there are two concepts emanating from the Court's case law that is relevant to this thesis; the *existence-exercise* and the *specific subject matter*. The issue of the existence-exercise dichotomy was first raised in Consten &

[22] Lidgard, 1997: 83 and Greaves, 1993: 13.
[23] Gutterman, 1997: 204.
[24] Lidgard, 2003: 97f.

Grundig v Commission[25] where it was held that the existence of intellectual property rights are protected by Article 30 not the actual exercise of the right. The Court established that distinction by identifying the specific subject matter of the intellectual property as being the essential element of the right. Therefore, the exercise of the right, which derives from the specific subject matter, will be accepted even if they hinder competition, but not the exercise that is merely incidental to the property.[26] In other words, the exercise of an intellectual property right is justified in the light of Article 30 only if the intention is to protect the specific subject matter.[27]

However, the famous decision in Centrafarm v Sterling Drug[28] has come to stand for the principle that Articles 28 and 30 EC Treaty exhausts the right when a product is marketed for the first time by the owner or with his consent in one Member State, thus preventing him from hindering free circulation of products within the Common Market.[29]

Thus, the possibility to grant a licence does not form part of the existence but comes within the exercise, although ECJ has been more generous in this respect. The Court has namely held that there is no exhaustion when a licensee sells the product in one Member State where there is no licence, thus allowing the owner in that State to prevent sales. However, if the licensee sells to a third party who then exports the product to another State the owner cannot prevent sales. It is therefore important in the following to distinguish between direct sales by the licensee outside the licensed territory and sales by the licensee to third parties that export the products, i.e. parallel traders.[30]

3.3 General Framework on US Antitrust Laws

At the onset, it has to be said that the assessment of patent licensing agreements under EC competition law and US antitrust law entails the same considerations, namely the concern over conduct obstructing free competition. Yet, the problem regarding free movement of goods is unique to EU and has therefore never been an issue in the US.[31] This is due to the simple fact that the protection by the patent laws in the US only extends to its borders and if the patent owner is interested in exploiting the invention elsewhere, the owner must apply for the protection in that other country.[32]

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[25] Joined Cases 56 and 58/64, (Consten and Grundig) Establissment Consten S.A. and Grundig Verkaufs-GmbH v Commission [1966] REG 299 [1966] CMLR 418.
[26] Greaves, 1994: 72f.
[27] Gutterman, 1997: 205.
[28] Case 15/74 Centrafarm v Sterling Drug [1974] ECR 1147 [1974] 2 CMLR 480.
[29] Gutterman, 1997: 206.
[30] Greaves, 1994: 73f.
[31] Gutterman, 1997: 203.
[32] Id. p. 28.

The EC Treaty's Article 81.1 equivalence in the US legal system is Section 1 of the Sherman Act, which contains a general prohibition on trade restrictions by prohibiting *contract*, *combinations* and *conspiracies* in *restraint of trade* where US commerce is affected.[33]

The US courts have interpreted the general prohibitions much narrower by applying a *rule of reason*, which states that restrictions limiting competition to an unreasonable extent are prohibited and illegal. The system results in a case-by-case assessment besides certain agreements that are treated by the American courts as illegal *per se*. Therefore, the much broader interpretation of the prohibition by the Commission takes place when a block exemption is applicable.[34]

However, as the *rule of reason* is a rule of construction applied to the Sherman Act it does not contain any explicit exemptions as in Article 81.3 EC Treaty. The difficulty with the *rule of reason* is to define when a restriction is of such magnitude that it limits competition to an unreasonable extent. The test to decide when the rule applies has been formulated in the prominent case Chicago Board of Trade v United States.[35] In this case, it was held that if the restraint in question is such as it merely regulates and possibly promotes competition, the courts have to consider the facts that are irregular to the business to which the restraint is applied, the nature of the restraint and its actual or probable effect.

The *per se* rule is on the other hand a rule of evidence having the effect that if certain agreements are shown to exist they are automatically illegal. It is said that there exists an absolute presumption that they hinder competition and therefore no test of reasonability is required. Examples of such agreements are price-fixing and market sharing agreements, which will be further dealt with below.[36]

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[33] Gutterman, 1997: 71.
The Sherman Act does not explicitly mention patents or any form of intellectual property although it is established that it encompasses license agreements.
[34] Greaves, 1994: 16.
[35] Chicago Board of Trade v United States (1918) 246 US 231.
[36] Greaves, 1994: 17.

4 A New Regulation

4.1 The 1996 Technology Transfer Block Exemption Regulation

On December 20, in 2001 the Commission published its Evaluation Report[37] on the Transfer of Technology Block Exemption Regulation 240/1996[38] in which a report was drawn up considering whether any revision of that Regulation was sought-after. The main question was whether the Regulation of the time had imposed on the European industry a straitjacket, unjustifiably forced them to enter into licensing agreements, which was counter-productive in the sense that it limited their effectiveness as well as competitiveness.[39]

At the time of the adoption of the 1996 Regulation the Commission acknowledged that the economic situation and development within the European Community depended on the capacity of the industry to invent new technologies and to disseminate them. Therefore, the block exemption regulation played a vital role in the strengthening of the Community's economy and development as well as ensuring that competitiveness amongst businesses predominated.[40]

However, the 1996 Regulation strived to strike a balance between three main objectives. Firstly, it aimed to encourage the manufacture of technical products and dissemination by making one single regulation combining the two then existing block exemptions on "know-how"[41] and patent licensing.[42] Secondly, the Regulation had to ensure effective competition within the technology field and finally, it had to create a favourable legal environment encouraging companies to invest within the Community.[43]

However, the 1996 Regulation was in essence mainly focused on intra-brand[44] competition and market integration, being rather form-based and following a legalistic clause-based approach. What was sought after was a

37 COM(2001) 786 final.
38 Commission Regulation (EC) 240/96 on the application of Article 85.3 of the Treaty to certain categories of technology transfer agreements OJ [1996] L31/2.
39 Paragraph 3 COM(2001) 786 final.
40 Id. para. 9.
41 Commission Regulation (EC) 2349/84 on the application of Article 85.3 of the Treaty to certain categories of patent licensing agreements OJ [1984] L219/15.
42 Commission Regulation (EC) 556/89 on the application of Article 85.3 of the Treaty to certain categories of know-how licensing agreements OJ [1989] L61/1.
43 Paragraph 10 COM(2001) 786 final.
44 Competition within the same brand, which has to be distinguish from inter-brand competition, i.e. competition between different brands, or differently explained; inter-brand competition exists when producers compete, and intra-brand competition exists when there is competition between distributors of the products of the same brand.

more economic and effect-based regulation focusing more on inter-brand competitiveness' issues.[45]

As a result, it was recognised in the following consultation of the report with third parties, such as industry, trade associations, law firms and IP societies, that the Regulation had certain advantages, for instance that it provided legal certainty by being very specific on what was prohibited, however, the shortcomings were many more.[46]

Consequently, the Commission's Evaluation Report from 2001 did not only put forward that the 1996 Regulation lacked clear definitions when companies were considered competitors in terms of market shares, and made no clear distinction when the licensing agreement was concluded between the same, but also that;

> (…) the lists of exempted clauses, white-listed, blacklisted clauses and exclusions are having the effect of forcing companies into a legal straitjacket which may discourage dissemination of technologies or deter more efficient transactions.[47]

The need for the 1996 Regulation to be better aligned with policy shifts and other economic key areas within the European Union were obvious.

4.2 The 2004 Technology Transfer Block Exemption Regulation

Following a five-year review the finalised revision of the 1996 Regulation, the new Technology Transfer Block Exemption Regulation[48] (below the TTBER), came into force on May 1, 2004 accompanied by a set of detailed non-binding guidelines[49] (below the Guidelines).

These Guidelines sum up the previous executive decisions and court rulings and explain the way in which the new TTBER applies and how companies shall analyse their agreements under the new regulation.[50] They are of particular importance for businesses since it is no longer possible to seek an individual exemption *ex ante* from the Commission for licensing agreements that are not covered by the block exemption. The parties must assess by themselves *ex post* whether an agreement is pro-competitive and therefore legal and enforceable, or whether the agreement has the opposite effect.[51]

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[45] Paragraph 3-4 COM(2001) 786 final.
[46] Id. para. 75.
[47] Id. para. 76.
[48] The TTBER covers not only patent and know-how licensing agreements between two parties but also design and model rights and software copyright licences
[49] Commission Notice Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements OJ C 101/02 (27 April 2004).
[50] Glader, 2004: 73.
[51] Treacy, P. and Heide, T., EIPR 2004, 26(9), 414-420, p. 1.

It is worth mentioning that if the licence agreement does not qualify for exemption under the TTBER it is not necessarily unenforceable but must be assessed on an individual basis under Article 81 EC Treaty.[52]

The question is thus, what is new and has been changed compared to the 1996 Regulation. To begin with, the new TTBER has taken on a less formalistic and a more economic and effect-based approach by making a significant departure from the previous *black*, *grey* and *white* lists of prohibited, potentially authorised and clearly exempted clauses respectively. At present, the regulation is only concerned with prohibiting the most serious restrictions contained in what is called the *hardcore restrictions* therefore focusing on the economic impact of a technology transfer agreement on the concerned market.[53]

The TTBER has therefore reversed the earlier position taken on by the 1996 Regulation, as the provisions not expressly excluded form the exemption will be covered by its block exemption, also called the *safe harbour*.[54]

It is further possible to pinpoint three major changes. Firstly, the introduction of market-share ceilings where the market-share of the parties plays an important role in determining whether a licensing agreement is exempted under the TTBER or not. A second major change is the clear division between competitors and non-competitors where different provisions apply depending of the status of the parties to the licensing agreement. Finally, the above mentioned hardcore restrictions which contain an extensive list of prohibited restraints that are under no circumstances permitted in a technology transfer agreements and if incorporated may cause the whole agreement to be void and unenforceable under Article 81 EC Treaty.[55]

Thus, the place to start for any company active in technology transfer licensing is therefore to determine whether the parties to an agreement are considered competitors or non-competitors, since that determines how the market-share rules apply. As a second point, companies have to calculate their market-shares respectively, in order to check whether the thresholds are exceeded or not, and finally, they have to analyse whether the agreement contain any of the hardcore restrictions.[56]

Regulation 1/2003 of ex post enforcement by the Commission and national competition authorities replaces old ex ante notification/exemption regime of Regulation 17/62 by inter alia removing the Commission's monopoly to issue exemptions or comfort letters and allows Article 81.3 EC Treaty to be enforced by national courts and national competition authorities.

[52] Glader, 2004: 90 and Hull, D., Global Counsel Life Sciences Handbook, May 2004, p. 49.

[53] Smith, J. and Moir, A., EIPR 2004, 26(7), 113-115, p. 2.

[54] Treacy, P. and Heide, T., EIPR 2004, 26(9) 414-420, p. 414.

[55] Freshfields Bruckhaus Deringer, November 2003, p. 2.

[56] NabarroNathanson, 10 October 2003, p.1.

4.2.1 Competitors and Non-competitors

The first step businesses have to undertake in order to reassure them that their agreement will be block exempted is to examine whether they are deemed to be competitors or non-competitors with reference to the TTBER which determines the applicable provisions to the licensing agreement.[57]

Article 1.1(j) TTBER states that competing undertakings means companies that compete on the relevant technology market and/or the relevant product market. When defining the relevant market, companies and their advisors have to take recourse to both the EC's General Notice on Relevant Market Definition[58], which provides guidance as to how the Commission applies the concept of relevant product and geographic market, and the Guidelines, which address the aspects of market definition in the field of technology licensing.[59]

Accordingly, Article 1.1(j)(i) TTBER states that competing companies on the relevant *technology market* are companies that license out competing technologies without infringing each other's intellectual property. Competing companies on the relevant *product market* are defined in Subsection (ii) as companies that are both active on the relevant market in which the product, produced with the licensed technology, are sold without infringing each other's intellectual property.

However, these complicated definitions are even more complex by the fact that the provision makes a further distinction between actual and potential competitors, which has to be made in the absence of the licensing agreement, i.e. before the parties entered into the agreement[60].

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[57] Freshfields Bruckhaus Deringer, August 2003, p. 2.

[58] Commission Notice on the definition of the relevant market for the purpose of Community competition law, OJ C 372 (9 Dec. 1997).

[59] Paragraph 19 Guidelines.
According to section two of the Notice, the relevant market is established by the combination of the product and geographic markets which purpose is to identify and define the boundaries of competition between different enterprises. (However, the TTBER only mentions the product market although it should be noticed that it lies implicit in the definition that it includes the geographical market as well.) Therefore, the product market is defined by grouping all the products together that are regarded by the buyer as interchangeable with or substitutable reference to the products characteristics, prices and intended use, pursuant to Article 1.1 (j)(ii) TTBER. The geographical market on the other hand, is defined as comprising the area in which the companies compete on similar conditions that can be distinguished from neighbouring areas where undertakings compete under different grounds. A new concept introduced by the TTBER is the technology market which is defined in Article 1.1 (j)(i) and in Paragraph 22 of the Guidelines as consisting of technologies that the licensees regard as interchangeable with or substitutable for the licensed technology in regard of their characteristics, royalties and intended use. The test for determining the relevant product/technology market is whether a price increase would cause customers to turn to substitutes. For further information see Vrins, O., EIPR 2001, 23(12), 576-585.

[60] Paragraph 27 and 30 Guidelines.

As a repetition, where both the licensor and the licensee are active on the same *product market* without infringing each other's intellectual property they are *actual competitors*.

The parties are regarded as *potential competitors* when they are likely to undertake the necessary additional investment to enter that market in response to a small but permanent increase in product prices. The entry has to occur within a short period, normally within one to two years, although longer periods can be taken into account.

Actual competitors on the *technology market* are parties where the licensee is already licensing out his technology and the licensor enters that technology market by granting a licence for a competing technology to that licensee. (For the application of the TTBER potential competitors on the technology market has not been considered).[61]

It is also worth mentioning that parties to a licensing agreement can *become* competitors after the conclusion of the agreement. This can happen when the licensee starts to develop and exploit the competing technology, but also when the licensor enters a product market on which the licensee was already active. However, the specific rules relating to competitors will not apply to such agreements unless the agreement is amended substantially after the parties have become competitors.[62]

The Guidelines also mention concepts of *one-way* or *two-way blocking positions* utilised to define when parties are deemed to be *non-competitors*. The first position exists where a technology cannot be exploited without infringing upon another technology. This can be the case where a patent covers the improvements of a technology, which is covered by another patent. In such case, it is assumed that the holder must obtain a license to the basic patent in order to exploit the improvement patent.

The second position exists where neither of the above mentioned technologies can be exploited without infringing upon the other technology. This means that neither of the holders can use their patents as the first holder's technology is covered by a basic patent, and the second holder's technology is covered by an improvement patent. Therefore, the parties must either obtain a licence from the other party or obtain a waiver from each other, i.e. often a written instrument signed by the person giving up his legal right, in order to be able to use their technology.[63]

4.2.2 Market-share Thresholds

As a second step, companies have to examine the market-share thresholds provided for in Article 3 TTBER. Worth mentioning, however, is that the

[61] Paragraph 28-29 Guidelines.
[62] Id. para. 31 Guidelines.
[63] Id. para. 32 Guidelines and Bainbridge, 2002: 114.

same principles regarding the relevant technology and product markets as outlined above apply when determining the market-share thresholds.[64] These market-share thresholds play an important role in the new TTBER as the list of exempted clauses in the 1996 Regulation has been replaced with a broadly defined safe harbour in Article 2 TTBER (from the prohibition in Article 81.1 EC Treaty) based on market-share thresholds. Consequently, certain categories of licensing agreements up to a certain level of market-share will be exempted under Article 81.3 EC Treaty as not being regarded as anticompetitive and therefore not being contrary to the article.[65]

Accordingly, Article 3.1 TTBER states that the exemption in Article 2 shall apply to *competitors* who are party to a licensing agreement on condition that their combined market-share does not exceed *20 percent* on the affected relevant technology and product market. If the parties are *non-competitors*, Article 3.2 holds that in such case neither undertaking's market-share shall exceed *30 percent*. In Recital 10 and 11 of the TTBER, it is clearly outlined that where the market-share thresholds has not been surpassed, there is a presumption that the agreements do not distort competition but give rise to economic efficiencies.[66]

However, that is not to say that it can be presumed that above these market-share thresholds agreements do fall within the scope of Article 81.1 EC Treaty, nor that such agreements falling within the scope of Article 81.1 will satisfy the conditions for exemption in Article 2 TTBER.[67] Furthermore, if the parties' market-shares initially fall under the stated limits but later exceed them, the exemption will continue to apply for two years.[68]

Difficulties arise when calculating market-shares on the relevant market in order to decide whether the technology licenses have an impact on competition. This is due to the fact that not only must the market-shares on the relevant market for the licensed technology be determined, but also the parties respective market-shares on the different markets for the products incorporating the licensed technology, including the market-shares of all the licensor's licensees![69]

What makes it even more complicated is that in each case the market-shares have to be calculated based on sales value data relating to the preceding calendar year where available. If these data are not available Article 8.1 TTBER states that estimates based on other reliable market information *may* be used, including market sales volume data.[70]

[64] Leone, L., Competition Law Review, Hewitsons Solicitors, Summer 2004, p. 1.
[65] Latham & Watkins, 23 October 2003, p. 1.
[66] Paragraph 35 Guidelines.
[67] Recital 12 TTBER.
[68] See Article 8.2 TTBER.
[69] See Article 3.3 TTBER.
[70] See Paragraph 72 Guidelines.

In short, it is worth mentioning that the issue with market-shares is particularly sensitive for companies dealing with new technologies. The problem emanates from the fact that where the technology has not yet been converted into products and therefore not yet been sold, market-shares cannot be calculated as a market does not yet exist. In addition, if the technology is particular innovative the market-share of the holder will soon be exceeded taking the licensing agreement outside the safe harbour in Article 2 TTBER. In some cases a radical new technology will create its own market where the holder will automatically take a hundred percent market-share.[71]

4.3 General Framework on US Licensing

Before describing the final step of the self-assessment companies in the EU have to undertake in order to determine whether the licence agreement has any anti-competitive effects on trade, some preliminary points in regard of the general framework on patent licensing in the US has to be mentioned.

As briefly mentioned above, the *per se* rule prohibits market allocation agreements and applies generally only to horizontal agreements between competitors, i.e. competitors at the same distribution level. However, the *per se* rule is also relevant to Section 7 of the Clayton Act as it prohibits certain acquirements of assets, including intellectual property, where the effect is to substantially diminish competition, for instance in the form of exclusive licensing agreements. In order to provide guidance for the application of Section 7 Clayton Act the 1995 Antitrust Guidelines for the Licensing of Intellectual Property[72] (below the IP Guidelines) were adopted on April 6 1995.[73]

In order to analyse a licensing agreement's effect on competition and deciding whether it diminishes competition in such a way as Section 7 provides the relevant market, i.e. the relevant product and geographic markets, must firstly be defined as well as the effect on competition. In other words, Section 3.1 IP Guidelines points out that antitrust concerns may arise when a licensing agreement harms competition among companies that would have been actual or likely potential competitors in a relevant market in the absence of the licensing agreement.

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[71] Glader, 2004: 90 and Freshfields Bruckhaus Deringer, November 2003, p. 3.
[72] Antitrust Guidelines for the Licensing of Intellectual Property, Issued by the U.S. Department of Justice and the Federal Trade Commission, April 6, 1995.
[73] Gutterman, 1996: 72ff and Glader, 2004: 78.
US antitrust regulators have for a long time issued specific guidelines designed to assist those who need to examine in beforehand whether their agreements will be contrary to US antitrust laws. These guidelines are usually drafted so as to sum up recent executive decisions and court rulings allowing competition authorities to communicate their position on the question at issue.

Companies are regarded as potential competitors when it is reasonably probable that the company in question could have entered that relevant market.[74] The relevant market is therefore defined by considering the degree of interchangeability of use of the product or the demand of the product in question and its substitutes. However, Section 3 IP Guidelines requires the technology market to be delineated when the intellectual property is marketed separately from the products in which it is used and consists of the licensed technology and its close substitutes.

The effect on competition is determined with reference to the market shares of the parties and the concentration of the market, where Section 4.3 IP Guidelines set out a *safety zone* which allows the licensor and a licensee to agree on certain restraints without getting under the scrutiny of the U.S. Department of Justice (below the DOJ). However, this is on the condition that the restraints are not regarded as illegal *per se*, and that the parties to the licensing agreement make up no more than twenty percent on the relevant market affected by the restraint.[75]

[74] See Note 15 IP Guidelines.
[75] Gutterman, 1996: 72.

5 Allocation of markets, customers and fields of use

5.1 Article 4 - Hardcore Restrictions

The third and final stage of the self-assessment companies have to undertake in order to determine whether the licence agreement has any anti-competitive effects on trade is to examine whether it contains any of the hardcore restrictions. It is important to underline that the above stated rules concerning competitors and non-competitors and market-share thresholds will only come into question on the condition that no hardcore rules are present in the agreement, i.e. licensing agreements are automatically exempted provided that any of the hardcore restrictions are contained in the agreement.[76]

Thus, when companies have concluded whether they are regarded as competitors or non-competitors the different market-share ceilings apply. Assuming that the parties fall below these thresholds the parties must also avoid including any of the regulation's stated hardcore restrictions.[77]

Article 4 TTBER (see Supplement A) contains a list of hardcore restrictions of competition by *object*, based on the nature of the restriction to the effect that such restrictions are regarded as almost always anti-competitive.[78] These restrictions are considered by the Commission to be anti-competitive by their very nature having such a high potential for negative effects on competition. It is therefore not necessary for the application of Article 81.1 EC Treaty to demonstrate any actual effects on the market and the conditions in Article 81.3 are unlikely to be fulfilled.[79]

In order to decide whether a particular clause in a licensing agreement constitutes a hardcore restriction, companies have to be exceedingly observant when examining the clauses against the real object of the licensing agreement, the facts underlying the agreement and the specific circumstances in which the agreement operates.[80]

Furthermore, the list of hardcore restrictions in Article 4 consists of two separate lists of prohibitions where one concerns licensing agreements between competitors and the other between non-competitors. In regard of competitors, it is especially prohibited to restrict output, i.e. limit how much a party may produce and sell, or restrict the licensee's ability to exploit his own technology or restrict any of the parties to carry out research and

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[76] Glader, 2004: 89.
[77] Freshfields Bruckhaus Deringer, November 2003, p. 3.
[78] Paragraph 74 of the Guidelines.
[79] Id. para. 14.
[80] Id. para. 14 and 74.

development. For agreements between non-competitors, it is especially regulated against any restrictions of active and passive sales to end-users by a licensee that is a member of a selective distribution system operating at the retail level. Otherwise, both lists contain prohibitions against restrictions on the other party's ability to determine prices and, in this context the most important; to allocate markets and customers.

In this context, it has to be reiterated that Article 81.1(c) EC Treaty especially prohibits the simple sharing of markets as these clauses are deemed to hinder competition within the common market. However, there is a slight difference in the formulation of the same prohibition in Article 4 depending on the status of the parties.

Where the parties are *competing* companies Article 4.1(c) states that licensing agreements having as their object to *allocate markets and customers* are prohibited, whereas Article 4.2(b) provides that where the parties are *non-competitors* it is prohibited to *restrict the territory into which or the customers to whom the licensee may passively sell the contract products*. The rationale behind the difference is the Commission's view that agreements between competitors pose a greater risk to free competition within the Common Market than agreements between non-competitors.[81]

5.2 Article 4.1(c) - Competitiors

Where the parties are *competing* companies Article 4.1(c) TTBER states that licensing agreements having as their object to *allocate markets and customers* are prohibited, except;

- (i) Field of use or product restriction on licensee
- (ii) Field of use, product restriction or exclusive territory or customer group in a non-reciprocal licence
- (iii) Sole licence
- (iv) No poaching by either party on other's exclusive territory or customer group in a non-reciprocal licence
- (v) Active sales ban to protect licensor or another licensee in non-reciprocal licence
- (vi) Captive use restriction
- (vii) Alternative source

Under the following section the above mentioned exemption will be examined where the exceptions relating to territorial and customer restrictions firstly will be scrutinized and subsequently the field of use restrictions. The reason for this course of action depends on their fundamental distinction as courts and regulators have historically treated them differently.

[81] Paragraph 26 Guidelines.

5.2.1 Territorial and Customer Restrictions

At the onset, it has to be pointed out that most of the licensing agreements are exclusive licences owing to the fact that the determination of the licensee's geographical or territorial area in the licensing agreement is closely related to the question as to whether the right shall be exclusive or not. In other words, the licensee will often be limited in his licence agreement as to his ability to make and/or distribute the licensed product outside the exclusive territory.[82]

Furthermore, Deutsche Grammophone v Metro[83] held that the possibility to exploit inventions through licensing arrangements subject to territorial restriction is the essence of the right as it enables the owner of the invention to take a commercial advantage in a particular marketplace where it is not convenient for him to do so himself.[84]

This strategic utility of exclusive licences stems from the fact that the licensor in many cases lacks the resources to fully exploit the invention himself and therefore an exclusive licence will provide the necessary incentive for the licensee to engage in the licensing activities. The exclusive licence will in such case make the licensor give up all of his rights related to the invention in respect of all geographical areas or in all potential fields of use, in favour of the licensee, preventing the licensor from competing in that area. For instance, when a licensee is given an exclusive licence to make and sell products to retailers in a certain market place and other licensees are given non-exclusive licences to other markets.[85]

When customer restrictions are concluded in licensing agreements they presuppose that a specific group of customers is identified and that the licensee is restricted only to sell to that group. Worth mentioning, however, is that field of use restrictions may correspond to that particular group of costumers although it does not imply that the restraint is to be categorized as a customer group restriction. This has to be viewed in the light of that field of use restrictions are block exempted and that certain customer group restrictions are hardcore under Articles 4.1(c) and (b) TTBER. Therefore, field of use restrictions shall be determined objectively with reference to the technical character of the licensed product.[86]

Territorial and customer allocation restrictions actualise the market division prohibition in Article 4.1(c) TTBER and its corresponding seven exceptions, where the first exemption relating to field of use will be discussed in the subsequent chapter.

[82] Gozzo, 1998: 117 and Gutterman, 1997: 272.
[83] Case 78/80 Deutsche Grammaophon Gesellschaft mbH v Metro GmbH [1971] ECR 45 [1971] CMLR 631.
[84] Greaves, 1994: 74.
[85] Gutterman, 1997: 265ff.
[86] Paragraph 180 Guidelines.

Subsection (ii) and (iii) of Article 4.1(c) TTBER

In the context of exclusive licences, Subsection (ii) of Article 4.1(c) TTBER exempts restrictions where the licensor and/or licensee in a non-reciprocal agreement, i.e. where only one party is licensing technology, or in the case of cross-licensing the licensed technologies are not competing[87], is obliged not to produce with the licensed technology in a particular territory reserved for the other party. It also applies where one party is limited to one or more technical fields of use or one or more product markets and irrespective of the scope of the territory even if the licence is worldwide.

Subsection (ii) merely exempts exclusive licences with the important consequence that both parties are prevented from competing in the exclusive territory allocated to the other party, i.e. the licensee is obliged only to produce within his exclusive allocated territory and the licensor is compelled not to compete there, nor licence the technology to other licensees in that territory. The rationale for allowing the arrangement is to give the licensee an incentive to invest and develop the invention, not necessarily to share markets.[88]

The same motivation is put forward in regard of Subsection (iii) which exempts restrictions in licensing agreements where the licensor undertakes not to licence the invention to another licensee in a particular territory, i.e. the licensee has been appointed as his sole licensee in a particular territory. The difference compared to an exclusive licence is that the licensor in sole licence arrangements is allowed to reserve for himself the right to compete in the licensed territory allocated to the licensee, but cannot licence the technology to third parties in that territory as in the case of exclusive licences.[89]

The underlying idea behind these exceptions, in particular in regard of exclusive licences, stems form ECJ's decision in the famous case Nungesser v Commission[90] from 1982, where the exclusive licence as such was not at issue but the exercise was, drawing the important distinction between open and closed exclusive licences.

The ECJ held that the obligation on the licensor not to license others except for the licensee holding the exclusivity in a particular territory and to undertake not to compete in that area himself was permitted. On the other

[87] Paragraph 78 Guidelines states that reciprocal agreements are agreements between two parties where technologies are cross-licensed and where these technologies are competing or can be used for the production of competing products. Non-reciprocal agreements exist where only one party is licensing his technology or, in case of cross-licensing the licensed technologies are not competing or cannot be used for the production of competing products. It has been clearly outlined that the hardcore list is stricter for reciprocal agreements between competitors than for non-reciprocal agreements. The concern is evidently that such agreements are in fact market-sharing arrangements

[88] Paragraph 86 Guidelines.

[89] Id. para. 88.

[90] Case 258/78 Nungesser (LC) AG and Kurt Eisle v Commission [1982] ECR 2015 [1983] 1 CMLR 278.

hand, absolute territorial protection under which the parties to the agreement attempted to eliminate all competition from third parties, i.e. non-licensees, such as parallel importers, was held contrary to Article 81.1 EC Treaty.[91]

The reasoning illustrates ECJ's recognition that exclusivity provides the necessary incentives for the licensee to engage in licensing arrangements thereby promoting innovative efforts. In other words, the Court held that if the licensor would not be able to provide an exclusive territory to a licensee then that licensee might not engage in the licence activities at the risk of encountering competition both from other licensees in that territory and from the licensor himself. The effect would damage the dissemination of new technologies and would prejudice competition between new products and similar existing products.[92]

However, *Nungesser* seems not applicable to cases where the licensee is restricted from making sales into territories reserved for the licensor, as they have no direct impact upon parallel traders or licensees from other dealers (see Article 4.2(b)(i) TTBER below).[93]

Subsection (iv) and (v) of Article 4.1(c) TTBER

Subsection (iv) of Article 4.1(c) TTBER exempts in non-reciprocal agreements[94] bans on active and/or passive sales[95] by the licensee or licensor into exclusive territories or customer groups allocated to the other party. The same reasons are given as for Subsection (ii) above where the difference is that this subsection concerns active and passive sales whereas the above subsection concerns production licences. The cuase is that production licences have always been regarded to be subject to separate consideration compared to sale licences.[96]

It is thus hardcore for competitors to agree on active and passive sale bans in reciprocal agreements, i.e. where the parties licence technologies that can be used for the production of competing products. The rationale to prohibit restrictions in reciprocal agreements stems from the fact that they are generally considered market sharing as they affect the other party in the agreement by preventing him from selling into territories or customer groups which he would have done in the absence of the agreement.[97]

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[91] Lidgard, 2003: 183.
[92] Gutterman, 1997: 236ff.
[93] Id. p. 275.
[94] See Note 103.
[95] According to Paragraph 50 of the Commission Notice on the Guidelines on Vertical Restraints OJ C 291/01 (13 October 2000) active sales mean actively approaching individual customers inside other licensees' exclusive territory or exclusive customer group by for instance direct mail or visits or the active engagement in advertising activities. Passive sales are defined as when the licensee merely responds to unsolicited orders from individual customers and general advertising in media or on the Internet that reaches customers in other licensees' exclusive territories or customer groups which is a reasonable way to reach customers outside those territories or customer groups.
[96] Lidgard, 2003: 198.
[97] Paragraph 169 Guidelines.

When it comes to the obligation on the licensee not to actively sell to another licensees' exclusive territory or customer group, Subsection (v) exempts such restrictions provided that there is only one party licensing technology and that the latter was not a competitor of the licensor at the conclusion of his own licence.

The Guidelines state that the reason behind the exemption is that such restrictions are likely to induce the licensee to exploit the technology more efficiently if the second licensee was not a competitor of the licensor at the time of the conclusion of his own licence, as the relationship between the two licensees would have created a cartel.[98]

The Guidelines further advance the view that such restraints are likely to be within the meaning of Article 81.3 EC Treaty when it is a question of entering a new market, i.e. for the period required for the licensee to enter a new market and to establish himself in the allocated territory or, vis-à-vis the allocated customer group.[99]

Subsection (vi) and (vii) of Article 4.1(c) TTBER

One can also briefly mention the *captive use restriction* in Subsection (vi) which concerns the licensee's obligation to produce the invention only for his own use provided that the licensee is not restricted in selling the contract products actively and passively as spare parts for his own products. However, if the licensed technology is a component then the licensee can be further compelled not to sell the component to other producers.[100] Yet the licensee will be able to sell the component as spare part for his own products and must be able to supply third parties that carry out after sales service on these products.

The justification of the captive use restriction is the necessity to encourage dissemination, in particular between competitors as the obligation imposed on the licensee when being competitor prevents him from being a supplier of components to third party producers.[101]

The final exemption regarding territorial and customer restrictions is the *second source provision* in Subsection (vii) which concerns the obligation in a non-reciprocal licence to produce the licensed technology only for a particular customer in order to create an alternative source of supply for that customer. The provision also covers the fact that more than one licensee may supply the same customer. The Guidelines clearly state that the potential for such agreement to be market sharing is limited, as the licensee has concluded the agreement with the licensor only on the proposition to supply that particular customer.[102]

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[98] Id. para. 87 and 89.
[99] Paragraph 171 Guidelines.
[100] See Article 4.(b) Regulation on Vertical Agreements.
[101] Paragraph 92 and 187 Guidelines.
[102] Id. para. 93.

5.2.2 Field of Use Restrictions

Territorial restrictions in licences are usually coupled with a production or application limitation to the effect that the licensed technology may be used to manufacture different products, which have different technical field of applications. Worth mentioning, however, is that the above mentioned distinction between field of use and customer group restrictions is not a decisive factor in real business life as a licensed product in many cases can be suitable for both different technical fields and different classes of users. For instance, products in the computer and electronic area can be suitable for sales in both the consumer market and the business market.[103]

Field of use restrictions are commonly included in licensing arrangements as they usually restrict the licensee's exploitation to one or more technical fields without limiting the licensor's ability to exploit the licensed technology himself. Such restrictions have generally been permitted and the common view has been that they do not infringe Article 81.1 EC Treaty on the condition that they do not amount to market sharing or customer allocation.[104]

However, as there are no cases explicitly dealing with field of use restrictions one has to take recourse to the *Windsurfing* case in which it is possible to draw some parallels.

Windsurfing International v Commission[105] concerned the company Windsurfing International that had granted patent licences to several German partners for its 'windsurfing' invention where these licensing agreements contained several restrictions *inter alia* obliging the licensees to use and sell the rig and sailboard together. Windsurfing International argued that the limitations or field of use restrictions in the licensing arrangement were not to restrict competition but merely to ensure that the sailboards were not of lower quality, that such quality controls were justified on the ground of product liability under Californian law and to prevent 'slavish imitations' of the boards.

ECJ was not impressed by the arguments put forward and held that the fact that Windsurfing had sufficient product differentiation between its licensed sailboards was merely to satisfy their own interest of having covered the widest possible field of market demand, hindering competition. The Court therefore held that the 'field of use' restrictions imposed by the company upon its licensees hindered competition going *beyond* the scope of the

[103] Lidgard, 1997: 176 and Gutterman, 1997: 273.
[104] Gutterman, 1997: 281 and Treacy, P. and Thomas, H., EIPR 2004, 26(9), 414-420, p. 5.
[105] Case 193/83 Windsurfing International Inc. v Commission [1986] ECR 611 [1986] 3 CMLR 489.

licensed technology as the restrictions made it possible for the company to amplify the utility and sales of the invention.[106]

Similarly, Subsection (i) of Article 4.1(c) TTBER expressly states that field of use (or product market) restrictions imposed on the licensee are permitted whether or not in a reciprocal agreement, provided that they do not go beyond the scope of licensed technology. In addition, the licensee shall not be limited in the use of his own products, as that arrangement would amount to market sharing.[107]

For competition law reasons the Guidelines introduce two new concepts; symmetrical and asymmetrical field of use restriction in which competition law concerns only may arise in the latter case. *Symmetrical field of use restrictions* exist where the parties to a licensing arrangement are cross-licensed to use each other's technologies within the same field of use. *Asymmetrical field of use restrictions* on the other hand exist where one party is permitted to use the licensed technology within one technical field of use and the other is permitted to use the other technology in another technical field of use. Such arrangement might raise competition law concern if the effect is to restrict the licensee's ability to be a competitive force outside of the licensed field of use. It is also important that the restrictions in this regard relate to different fields of use and not to customers, allocated by the territory or by group who buy the products within the same technical field of use, as the risk of market sharing would be substantially higher.[108]

When it comes to the distinction between competitors and non-competitors the Guidelines are clear on the fact that the same concern is likely to be raised in cases where field of use restrictions are imposed between competitors, although one has to remember that such agreements are block exempted up to the market-share threshold of twenty percent. Thus, the Guidelines state that the risk is greater that the licensee shall cease to be a competitive force in cases where competitors have cross-licensed the technology and where the agreement provides for asymmetrical field of use restrictions.[109]

Field of use restrictions in agreements between non-competitors are block exempted up to the market-share threshold of thirty percent and the general view has been that such restrictions are non-restrictive of competition. The underlying idea is that they promote the dissemination of new technologies by encouraging the licensor to licence the invention to be exploited in fields of use where he himself is not interested in exploiting the invention. If the licensor would not be able to prevent licensees to operate in 'his' fields of

[106] Lidgard, 1997: 62 and Lidgard, 2003: 189.
[107] Paragraph 90 Guidelines.
[108] Paragraph 91 Guidelines and Treacy, P. and Thomas, H., EIPR 2004, 26(9), 414-420, p. 5.
[109] Id. para. 183.

use, it would be likely to create a disincentive for the licensor to licence thereby prejudice competition.[110]

5.3 Article 4.2(b) - Non-competitors

Article 4.2(b) TTBER provides that where the parties are *non-competitors* it is prohibited to *restrict the territory into which or the customers to whom the licensee may passively sell the contract products*, except;

(i) To protect exclusive territory or customer group of licensor
(ii) To protect exclusive territory or customer group of another licensee
(iii) Captive sales
(iv) Alternative source
(v) Separate wholesale and retail trade
(vi) Selective distribution

As previously discussed, where competitors agree to share markets among themselves, i.e. horizontal division, the effect is to eliminate competition within the allocated territory, customer group or field of use expressly condemned by Article 81 EC Treaty, although with some exceptions. The question now is what position the European Community has taken in regard of non-competitors dividing markets, i.e. vertical division, for instance when a manufacturer restricts a distributor from selling in certain areas or to certain customers.[111]

The two earliest cases dealing with this matter were *Société Techniqueq Minière* and *Consten and Grundig* where both these cases recognised that Article 81 EC Treaty were applicable to vertical agreements (and still is).

The case *Consten and Grundig*[112] concerned Consten, which was exclusive distributor in France of Grundig products and agreed not to deliver products directly or indirectly outside France. Grundig also obliged all its distributors in Europe not to deliver products outside their respective territories. The object and effect was to protect its dealers from parallel imports. Grundig therefore conferred an absolute territorial protection on Consten so that customers in France could not obtain products from anyone other than Consten. ECJ held that the exclusive agreement as such was not prohibited under Article 81 EC Treaty although the arrangement to eliminate parallel import was.

[110] Id. para. 184.
[111] Crotti, 1977: 134.
[112] Case 56 & 58/64 (Consten and Grundig) Establissement Consten S.A. and Grundig Verkaufs-GmbH v Commission [1966] REG 299 [1966] CMLR 418.

The case *Société Techniqueq Minière*[113] concerned an agreement where a French company was given an exclusive right to sell machinery in France by a German company. In order to decide whether Article 81 EC Treaty did apply to the agreement ECJ had, as a first step, to consider the object of the agreement. The Court held that the exclusive right of sale did not by its very nature have the object to restrict competition, at least not where the exclusive right was necessary for the penetration of a new territory. The second step was therefore to consider the effects of the agreement on competition on the relevant market taking into account the full economic context. The Court concluded that the effect on competition must be shown to be *appreciable* whether or not the agreement prevented parallel import.

The apparent inconsistency between these two cases lies in the fact that the agreement in *Société Techniqueq Minière* concerned an exclusive dealing agreement, which did not grant absolute territorial protection. In other words, it allowed parallel trade as the consumers in France could buy machinery by placing orders with other distributors outside for re-importation into France, contrary to what was possible in *Consten and Grundig*.[114]

However, the effect of *Consten and Grundig* on licensing agreements was not determined until the ECJ handed down its judgment in *Nungesser*. As mentioned above, the Court permitted open exclusive licences in which the owner agrees not to grant other licences in respect of the same territory and not compete himself in that same area. As a direct consequence of permitting open exclusive licences, ECJ permitted the inclusion of provisions restricting both parties to sell actively in each other's territories. However, nothing was decided on passive sales.

It should be noted that passive sales are on the one hand tantamount to grant absolute territorial protection and on the other hand if not provided for in the agreement, it might deter licensees from engaging in such activities due to the risk of facing competition.[115]

The judgment in *Erauw-Jacquéry*[116] was handed down ten years later, which has been regarded as a clarification of *Nungesser*. The case concerned a licensing agreement, which ECJ allowed under Article 81.1 EC Treaty even though it hindered both active and passive sales between different countries. The reason for the result was that it involved considerable financial sacrifices for the licensee in the development of a new seed variety. As a direct consequence of the ruling, the Commission commenced

[113] Case 56/65 Société Techniqueq Minière v Masehinenbau Ulm GmbH [1966] ECR 235 CMLR 357.
[114] Mendelsohn, 2002: 19.
[115] Lidgard, 1997: 111f.
[116] Case 27/87 (Erauw-Jacquéry), Louis Erauw-Jacquéry Sprl v La Hesbignonne Société Co-opérative [1988] REG 1919 [1988] 4 CMLR 576.

to make a narrower interpretation of *Nungesser* accepting exclusive arrangement only when it involved new technology.[117]

The Court's case law has been inconsistent on passive sales, however, it appears to accept exclusive licensing agreements that protect licensees against activities from other licensees in a particular territory whether they are of passive or active nature. The underlying idea is that it provides incentives to licensees to engage in such activities. But, when the products in question are supplied in one country it is not allowed to restrict these products from being supplied to another country, as absolute territorial protection would come into question.[118]

When it comes to allocating customer groups in vertical relationships, the only case that could be regarded to deal with this matter is the *Windsurfing* case, although it cannot be viewed as concerning a traditional customer group allocation restriction. As mentioned above, the fact that the licensees were prohibited in selling the sail without the board could be regarded as equivalent to a customer group allocation restriction. Windsurfing's real object was to monitor the distribution of its products by prohibiting the distribution of the sail to other companies producing competing boards. Therefore, the arrangement could be regarded as a forbidden form of vertical customer group allocation where the licensor attempted to monitor the destination of the distributed licensed products.[119]

5.3.1 Passive Sales

The general rule in Article 4.2(b) TTBER prohibits the restriction of the territory or customer group to which the licensee may passively sell the contract products. The Guidelines state that such restrictions on the licensee can take the form of both direct and indirect obligations.

Direct obligations are restrictions on the licensee not to passively sell to customers in certain territories or to specific customer groups or to refer orders from these customers to other licensees. *Indirect* measures are used to induce the licensee to refrain from selling into these territories or to the customers in question. Examples of indirect measures to restrict passive sales are financial incentives and employment of a monitoring system aimed at verifying the effective destination of the licensed products and quantity controls.

However, the Commission will not assume that quantity controls as such serve this purpose. The Commission will instead regard quantity controls as indirect means to restrict passive sales when they are used to portion markets. Indications of such practices occur when the agreement provides for adjustments of quantities over time to cover only local demand, or the

[117] Lidgard, 1997: 113f.
[118] Id. p. 115.
[119] Lidgard, 1997: 181.

combination of quantity limitations and an obligation to sell minimum quantities in a territory. Signals of market sharing can also arise when the parties have agreed on minimum royalty obligations linked to sales in the territory, differentiated royalty rates depending on the destination of the products and the monitoring of the destination of products sold by the licensees.[120]

However, Subsection (i) exempts the restriction on licensees to passively sell into an exclusive territory or to an exclusive customer group reserved for the licensor up to the market share threshold of thirty percent.[121] The Guidelines state that the exception applies both to passive and active sales.

As mentioned above, it seems that ECJ's reasoning in *Nungesser* does not apply to cases where the licensee is restricted from making sales into territories reserved for the licensor, as they have no direct impact upon parallel traders or licensees from other dealers. The rationale behind the exception is that up to the threshold the restriction is pro-competitive. In other words, failure to provide such exclusive protection in the licensor's own territory or to the customer group reserved for him might lead to both less exploitation in that territory or to that customer group as well as reducing the overall licensing. This will provide a disincentive to engage in innovative efforts as the licensor will not be able to recoup the investments made, which in turn will lead to less dissemination of new technology damaging competition.[122]

Subsection (ii) exempts restrictions on passive (and active) sales by licensees into an exclusive territory or to an exclusive customer group allocated to another licensee for two years. This period is calculated from the date when the licensed technology where first marketed as a product inside the licensee's exclusive territory or to his exclusive customer group. After the expiry of this period, it would be hardcore if the restriction would remain as a direct consequence of the reasoning in the *Nungesser* case. In other words, it would amount to absolute territorial protection, which is caught by Article 81.1 EC Treaty.

The underlying idea behind this exception is the fact that licensees often invest substantial amounts of money in order to produce and promote a new product into a certain territory or to a specific customer group and would not otherwise be able to recoup his expenses and would therefore never engage in such activities.[123]

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[120] Paragraph 98 Guidelines.
[121] See Article 3 VBER.
[122] Gutterman, 1997: 275 and Paragraph 100 Guidelines.
[123] Paragraph 101 Guidelines and see Paragraph 77 of the Judgment.

5.3.2 Active Sales

Before considering the regulatory framework on active sales, the correlation between the Technology Transfer Block Exemption Regulation 772/2004 and the Regulation on vertical agreements 2790/1999[124] (below the VBER) needs to be explained as these two regulations are closely related.[125]

As already stated, the TTBER covers agreements between two parties that licence technology permitting the production of products incorporating the licensed technology. These products are often sold by the licensee who often is a supplier. The VBER on the other hand covers agreements between two or more parties for the production or distributions relating to the conditions under which the parties may purchase, sell or resell goods or services, i.e. supply and distribution agreements.[126]

The licensing agreement between the licensor and the licensee is therefore subject to the TTBER whereas the agreement between the licensee and the buyer is subject to the VBER.[127] However, the TTBER block exempt agreements as to the way the licensee is obliged to sell the products, for instance if the licensor obliges the licensee to establish certain types of distribution systems such as exclusive distribution or selective distribution. In such case, the agreement must also comply with the VBER as it follows from Article 4(b) VBER that distributors must be free to make passive sales into the territories of other exclusive distributors. Consequently, distribution agreements must comply with the VBER in order to be block exempted by the TTBER.[128]

In short, the VBER contains several hardcore restrictions which are set out in its Article 4 (see Supplement B) where Subsection (b) and its corresponding four exceptions are the most relevant. Thus, Article 4(b) VBER prohibits contractual (vertical) provisions that have the object or effect of portioning distribution network by customer or by territory. That is to say, it is prohibited to restrict sales by the buyer or distributor to the territory into which or the customer to whom the buyer or distributor may sell the contract products.[129]

However, Subsection (i) of Article 4(b) VBER exempts the possibility to restrict active sales by a distributor to a territory or customer group that has been allocated exclusively to another distributor or to the supplier himself, also called exclusive distribution agreement or exclusive customer allocation agreement.

[124] Commission Regulation (EC) No 2790/1999 on the application of Article 81.3 of the Treaty to categories of vertical agreements and concerted practices OJ [2000] L103/36.
[125] Paragraph 62 Guidelines.
[126] See Article 2 TTBER and Paragraph 61 Guidelines.
[127] Paragraph 62 Guidelines.
[128] Id. para. 63.
[129] Paragraph 49 Guidelines on vertical restraints.

In exclusive distribution agreements there is only one distributor appointed for a contractual defined territory that is usually limited in actively selling into other licensee's exclusive territories. These agreements are thus block exempted if the supplier's market share does not exceed thirty percent. The same applies to exclusive customer allocation agreements where the supplier agrees to sell his products only to one distributor for resale to a particular class of customers. On the other hand, the distributor is often limited in selling actively to other exclusively allocated classes of customers.[130]

Likewise, the general prohibition on passive sales in Article 4.2(b) TTBER does not cover active sales restrictions on the licensee with the exception of what is stated in Subsection (vi) of Article 4.2(b) TTBER. That subsection exempts restrictions of the licensor prohibiting the licensee to sell to unauthorised distributors, which permits the licensor to impose on the licensees an obligation to form part of a selective distribution system, restricting both the number of authorised distributors and the possibility of resale. Exactly the same exception is provided for in the Subsection (iii) of Article 4(b) VBER whether it is passive or active sales.[131]

Subsection (v) TTBER and Subsection (ii) VBER exempts the restriction on both passive and active sales to end-users by licensees operating at the wholesale level of trade, i.e. they are only allowed to sell to retailers. The difference is that exclusive distributors at the wholesale level sell to all retailers in their territories whilst retailers sell to the final consumers.[132]

Worth mentioning is that in cases where restrictions of active sales are imposed between licensees' territories or customers, the licensees need not to be exclusive in order for the exemption to apply as it will also be applicable in cases where more than one licensee has been appointed for a particular territory or customer group. Thus, the rationale behind the block exemption on restrictions on active sales is based on the belief that such restrictions are pro-competitive, i.e. they promote investment and improve the quality of the services provided by the licensee as the free-rider and hold-up problems are solved.[133]

As in the case of agreements between competitors, Subsection (iii) exempts captive use restrictions and Subsection (iv) exempts second source

[130] See Article 3 VBER. Paragraph 161 and 178 Guidelines on vertical restraints.
[131] Paragraph 52 Guidelines on vertical restraints.
[132] Id. para. 175.
[133] Paragraph 99 Guidelines.
Paragraph 116 Guidelines on vertical restraints defines 'free-rider problem' when one distributor free-ride on the promotion efforts of another distributor usually at the wholesale and retail level of trade. Restrictions that may be helpful to resolve this matter are exclusive distribution or similar restrictions. Furthermore, the so-called 'hold-up problem' may occur when for instance, there is a client-specific investment to be made by either the supplier or the buyer and the investor will not invest until specific supply arrangements are fixed. Vertical restraints such as non-compete are likely to resolve such problems.

provisions. There is no substantial difference compared to the same exceptions in regard of competitors.

Finally, as briefly mentioned above under the section regarding captive use restrictions between competitors, the fourth and final exception in Article 4(b) VBER precisely exempt restrictions on buyers not to sell components actively nor passively to customers who would use them to manufacture the same type of goods as those produced by the supplier.

5.4 US Position

As already mentioned, the IP Guidelines state that the key competitive issue raised by licensing agreements is whether it harms competition between competing companies where such harm is exemplified as occurring when the licensing facilitate market division.[134]

At the same time Section 2.3 IP Guidelines state that field of use, territorial and other limitations on the licensee in licensing agreements may have pro-competitive effects by allowing the licensor to exploit his invention as efficiently and effectively as possible. The IP Guidelines underline that the rationale is that these forms of exclusivity can be used to give a licensee an incentive to invest and distribute the technology and to develop additional applications for the licensed property as the limitations may protect the licensee from *free-riders*. They can also give the licensor an incentive to licence by protecting the licensor from competition in the licensor's own technology in a market niche that he prefers to keep to himself.

The general framework for evaluating and determine whether a particular restraint facilitates market division is subject to either the *per se* rule or the *rule of reason*. This in turn depends largely on whether the restraint is concluded between competitors or non-competitors as it will affect the possible competitive consequence of the licensing restriction. It can generally be held that restraints between competitors will often be evaluated under the *rule of reason*, but in some circumstances they may be subject to a *per se* treatment. On the other hand, restraints between non-competitors require a *rule of reason* treatment.[135]

In order to decide whether a particular restraint requires a *per se* or *rule of reason* treatment the DOJ has to look at whether the restraint in question could be expected to contribute to an efficiency-enhancing integration of economic activity or not. If the restraint can be expected to contribute to an efficiency-enhancing integration of economic activity and is not regarded as requiring a *per se* treatment the DOJ will apply a *rule of reason* analysis.

[134] Section 3.1 IP Guidelines.
[135] Id. section 5.1.

It can be emphasised that the vast majority of the restrictions are analysed under the *rule of reason* where the DOJ in such case will assess whether the particular restriction is likely to have anti-competitive effects and, if so, whether the restriction is reasonably necessary to achieve pro-competitive effects that would outweigh the anticompetitive effects.[136]

In some cases, the US courts have concluded that a restraint's *nature and necessary effect are so plainly anti-competitive* that it should be treated as unlawful *per se* without analysing the restraints likely competitive effect. In such case there would be no efficiency-enhancing of economic activity and the licensing agreement would not involve a useful transfer of technology where;

> (…) the evaluating Agency based on the facts of each case would be likely to challenge the arrangement under the per se rule as a horizontal (…/…) market allocation scheme and to view the intellectual property aspects of the arrangement as a sham intended to cloak its true nature.[137]

Thus, licence provisions that limit the field of use in which a licensee may practice the patent, the customers with which they can deal or to the territories in which they can sell are subject to a *rule of reason* treatment and are in most cases lawful.

However, if the restriction is viewed as a sham to cover a market or a customer allocation agreement it will be challenged under the *per se* rule. The DOJ will, as a general rule, challenge certain types of horizontal restraints as *per se* unlawful, including restraints that constitute allocation of markets or customers. The remaining horizontal restraints as well as all vertical restrictions will be evaluated under the *rule of reason*.[138]

Furthermore, the IP Guidelines make a distinction between exclusive licences and exclusive dealings where the former restricts the licensor's right to licence others and to use the technology himself. The latter arises when a licence prevents the licensee from licensing, selling distributing or using competing technologies.[139]

Antitrust concerns may arise in respect of exclusive licensing only if the licensee or the licensor and its licensees are competitors, for instance in cross-licensing where two or more owners of different intellectual property licence one another or third parties. Generally, cross-licensing are pro-competitive but can have anti-competitive effects in certain circumstances for example when cross-licensing are mechanisms to bring about market division. In such cases cross-licensing are subject to challenge under the *per*

[136] Section 3.4 IP Guidelines.
[137] Discussion of Example 7 IP Guidelines.
[138] Gutterman, 1997: 246.
[139] Section 4.1.2 IP Guidelines.

se rule where exclusive dealings on the other hand are evaluated under the *rule of reason*.[140]

5.4.1 Case Law Developments on Fields of Use, Customer Group and Territorial Restraints

At the onset, one has to bear in mind that the IP Guidelines as they stand today reflect the different attitudes that have predominated the US view on licensing agreements, or as *Marcus Glader* puts it in his dissertation from November 2004 that these IP Guidelines are;

> (…) the most concrete expression of paradigm shift in the antitrust outlook towards IPRs. (.../...) These Guidelines handed out the final blow to the restrictive practices in the 1960s and ´70s, the era of the so-called 9 no-no’s.[141]

In order to understand the rationale behind the US rules on vertical respectively horizontal field of use, customer group and territorial restrictions one has to take recourse to the underlying case law.

The first landmark case on territorial restrictions between competitors came in 1898 where the basic principle underlying every scheme was set out, namely the historic declaration in United States v Addyston Pipe and Steel Co[142] that territorial division of markets between competitors was illegal *per se*. The rationale for the *per se* treatment depended on the view that agreements between competitors which divided markets could have no other object than to restrain competition.[143]

However, as we will see below, the question as to whether territorial restrictions in licensing agreements between non-competitors were illegal *per se* was not decided until the landmark case in Continental TV v GTE Sylvania.[144]

During the early part of this century, US courts were positive towards patent owner’s exercise of the right, clearly illustrated by United States v Untied States Shoe Machinery Co[145] in which the Supreme Court recognised the existence of a restraint in a patent as being the strength to exclude others from the use of the invention. However, by the end of 1930s a shift in attitude was noticed, as US courts repeatedly held that patent holders’ exercise of a patent right should be limited by antitrust rules. It was done by relying on the exhaustion of monopoly doctrine where the Court examined whether the restraint in the licence at question were beyond the proper scope

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[140] Section 5.4 and 5.5 IP Guidelines.
[141] Glader, 2004: 76 and 77.
The 9 no-no’s included for instance exclusive licensing and sale-restrictions.
[142] United States v Addyston Pipe and Steel Co, 8 February 1898.
[143] Crotti, 1977: 129.
[144] Id. p. 133.
[145] United States v Untied States Shoe Machinery Co 247 U.S. 32, 57 (1918).

of the patent, i.e. the subject matter of the patent right, and if not, applied traditional antitrust rules to the licensing arrangement.

Around this time, another historic case was handed down, namely General Talking Pictures Corp. v Western Electric Co[146] which dealt with field of use restrictions and was handled slightly differently compared to the general view on patent licensing restrictions. The case set out the basic rule regarding field of use restrictions namely that such provisions were inherent in the scope of the patent right where the holder was able to exploit his invention at his discretion therefore enabling him to impose such restrictions as he saw fit.[147]

However, in United States v Westinghouse Electric Corp[148] a limitation was imposed on the use of field of use restrictions when the Court held that they were allowed as long as they were not used to *extend* the granted right, thereby limiting competition.[149]

Therefore, up until the late 1970s US antitrust laws were concerned with the anti-competitive effects of licensing agreements limiting competition in the patented technology field without considering any positive economic effects from the use of such restrictions.[150]

A famous case illustrating the current view was United States v Arnold Schwinn & Co[151] in which the Supreme Court held that *all* territorial restrictions imposed by a manufacturer on reseller distributors (i.e. vertical restrictions or restrictions between non-competitors) were illegal *per se* ignoring the fact that territorial exclusivity could function as incentives to licence. The Court applied the exhaustion doctrine holding that the manufacturer's effort to restrict a territory or persons to whom the product may be transferred was a *per se* violation of the Sherman Act.

Similarly, using the exhaustion doctrine it was held in Ansul Co v Uniroyal[152] that a patent holder was not allowed to impose customer restrictions upon the purchasers of the patented product holding that such vertical restrictions were illegal *per se*.[153]

Consequently, the US courts followed the attitude taken by the DOJ, which was concerned over the fact that patent owners through licensing agreements imposed limitations on their licensees by using governmentally enforced property rights. In order to mitigate the negative effects on competition by these licensing arrangements, the DOJ took the position that

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[146] General Talking Pictures Corp. v Western Electric Co. 305 U.S. 1705 (1937).
[147] Lidgard, 1997: 173.
[148] United States v Westinghouse Electric Corp. 648 F.2d 642 (9th Ci.1981).
[149] Gutterman, 1997: 281
[150] Id. p. 221.
[151] United States v Arnold Schwinn & Co 388 U.S. 365 (1967).
[152] Ansul Co v Uniroyal Inc 404 U.S. 1018 (1972).
[153] Gutterman, 1997: 222.

a number of commonly used restrictions in licensing agreements where illegal *per se*, thereof the *Nine No-No's*.[154]

5.4.2 The Important Turnover

By the end of the 1970s and beginning of the 80s US court started to revise old case law as well as DOJ began to change their own policies appreciating the pro-competitive sides of licensing agreements, even when containing limitations. The DOJ came to hold that it was better with some restraints in licensing agreements than no licensing at all, as it gave incentives to innovate and making new investments and therefore held that the Nine No-No's were more error than accuracy.[155]

This significant turnover came with the ruling in Continental TV v GTE Sylvania[156] in which the earlier *Schwinn* case was revised. The case concerned Sylvania, a manufacturer of television sets which set up a franchising practice (which is a vertical relationship) in order to remain in a particular market. The agreement contained no restrictions as to where or to whom the franchisees could sell but there was a restriction that the franchisee could not remove the location of his dealership. Continental, which was the franchised dealer in California, shipped TV sets from Sylvania to Sacramento where it was not franchised. Sylvania then enforced the location clause and finally terminated the agreement why Continental brought an action against Sylvania. The Supreme Court approved Sylvania's activities holding that the franchise was the company's last attempt to remain in the market thereby promoting inter-brand competition. It was held that if the Court had overturned the case only on the facts that the clause somewhat limited intra-brand competition it would be *to overlook the forest while watching the trees*.[157]

Thus, the Supreme Court expressly held that territorial restrictions and other types of vertical restrictions should not be regarded as unlawful *per se* but should be analysed under the *rule of reason*. The Court based its findings partly on the fact that there had been no showing that the vertical restrictions had a *pernicious* effect on competition, and partly on that the departure from the *rule of reason* standard had to be based upon demonstrable economic effects rather then on formalistic reasoning as in the *Schwinn* case.[158]

The US Courts started to place emphasis upon the role intellectual property rights could play in the creation of incentives to the development of new technologies and new investments in the technology field. The case Dawson Chemical Co v Rohm & Haas[159] came to illustrate this significant and

[154] Gutterman, 1997: 222.
[155] Id. page 231.
[156] Continental TV, Inc v GTE Sylvania 433 U.S. 36 (1977).
[157] Crotti, 1977: 145ff.
[158] Gutterman, 1997: 231.
[159] Dawson Chemical Co v Rohm & Haas 448 U.S. 175 (1980).

fundamental change where the Supreme Court held that it was of crucial importance to ensure that the endeavours and investments of the inventor did not got unrewarded. The Court thereby acknowledged that patent owners had to be allowed to recoup the investments through commercially workable schemes if the objective to encourage development was to be achieved. The Court took the view that from now on it would respect the absolute right of the patent owner to choose not to licence competitors.[160]

The final essential case illustrating the fundamental change of the US courts was United States v Studiengesellschaft Kohle.[161] The case concerned an exclusive licence to one firm covering the production and marketing of unpatented products by using the patented process, as well as a separate series of non-exclusive licenses to other companies covering only the right to produce and use the patented process internally in the production of the products. The US government argued that the patent holder, by the fact that the licensing scheme restricted items, which were not patented, extended his monopoly. The D.C. Circuit rejected the government's argument and overturned the lower courts findings of *per se* illegality holding that the restraints on the unpatented products where not greater then those which followed from the patented process, which the patent owner had lawful right to licence or withhold as he saw fit.

The Court's findings that the restriction had to be examined under the *rule of reason* and that it was lawful under the Sherman Act was a radical departure form the strict application of the exhaustion of monopoly doctrine. Most notably, the court reached its conclusion after making an analysis of both its commercial and social effects indicating that restrictions on use were both pro-competitive and socially beneficial as it encouraged the licensor to licence his invention to others thereby promoting competition.

Taken as a whole, these cases show that US courts and regulators began to recognise that being an owner of a patent was not an equivalent to be able to control a particular market. On the contrary, instead of just striking down important licensing restrictions using old mechanical principles, the US courts started to analyse the competitive effects of patent licensing provisions.[162]

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160 Gutterman, 1997: 232.
161 United States v Studiengesellschaft Kohle, m.b.H. 670 F.2d 1122 (D.C. Cir. 1981).
162 Gutterman, 1997: 232f and 284.

6 Analysis

6.1 Basic Summary

The above sections, as can be seen, are a description of how the regulatory framework has been laid down with regard to territorial, customer group and field of use restrictions in a patent licensing agreement under both the European Union's and the United States' legal system.

In order to be able to examine to what extent it is possible to allocate in the licensing agreement, that is to say, to analyse the interface between permitted respectively prohibited allocations in Europe, a comparison will be made with how the US courts and regulators have solved the tricky task. The comparative method is necessary to undertake as it enables us to go beyond the rules in Article 4.1(c) and 2(b) Technology Transfer Block Exemption Regulation in order to provide the European businesses with a tool to better comprehend a provision that is plainly complex.

Ab initio, as we have seen, the shape of the rules regarding licensing agreements and its permitted respectively prohibited allocations have been directly influenced by the tension that has predominated the judicial attitudes in the Union. On the one hand, there has been the Community's representatives with the Commission at the front defending free competition, concerned with preventing business activities impeding competition. On the other hand, there has been the industry's outcry for the fact that allocation in patent licensing arrangements leads to the reduction of production costs and to the production of higher quality products removing obstacles to the development and exploitation of technology, promoting competition.

However, the discussion of free movement of goods has been unique to EU and has centred on the licensor's desire to grant, and the need of the licensee to receive exclusive territorial and customer rights in the use of the licensed subject matter. As we have seen, these type of exclusivity clashes directly with EU's endeavour of removing all territorial barriers to free movement of goods within the Community.

Except for the issue of free movement of goods, similar fundamental issues have dominated the debate in America where the regulators have been preoccupied with balancing the licensors' right to protect their legitimate interest with respect to the licensed subject matter, while avoiding provisions in licensing agreements that extended beyond the right related to the underlying patent.[163]

[163] Gutterman, 1997: 223.

6.2 Regulatory Framework

When reading the material above it may firstly appear that US and EU regulators have solved the matter differently, however, to a certain extent it is true, although there are several similarities.

In the European Union the Commission adopted the Technology Transfer Block Exemption Regulation based on Article 81.1 EC Treaty in order to strike an appropriate balance between the two competing interests taking account of ECJ's case law to a large extent. On the other hand, the US solved the matter by a case-by-case analysis relying on Section 1 Sherman Act, save for certain agreements that have been treated as *per se* illegal without analysing each case.

As a complement to the relatively old legal acts, US antitrust regulators had for a long time issued specific guidelines drafted to sum up recent executive decisions and court rulings to assist those who needed to examine their licensing agreement in beforehand to see whether their agreement would be contrary to US antitrust laws. The same idea formed the basis for the issuance of the Guidelines as they also sum up decisions and judgments explaining the way in which TTBER applies and how companies shall analyse their agreements under the regulation. As the Guidelines bear a striking resemblance to the IP Guidelines it is no secret that the Commission has been greatly influenced on that point.

Furthermore, as we have seen, both the EU and US legal system have adopted provisions that contain a general but not absolute prohibition on trade restrictions, which are Article 81.1 EC Treaty's and Section 1 Sherman Act. However, the prohibition in EU is much broader and takes place when the block exemption regulation is applied, compared to the much narrower interpretation developed in the US antitrust case law by the application of the *rule of reason*.

More pointedly, the much broader interpretation of the general prohibition in EU actualises when a restriction is permitted by the application of Article 4 TTBER, which in fact concretises Article 81 by explicitly setting out permitted respectively prohibited restrictions. This can be contrasted with US courts' interpretation of Section 1 Sherman Act by the *rule of reason* analysis to the effect that the legal rules on the matter have been gathered from US case law and summed up in the IP Guidelines. The reason for this case-by-case analysis is that the *rule of reason* is a rule of construction applied to the Act and therefore cannot contain any explicit exemptions as in Article 81.3 EC Treaty, or an explicit prohibition.

However, there are several other similarities when comparing the two legal frameworks such as the rules with regard to competitors, non-competitors, market-share thresholds and the safe harbour-rules (or the safety zone-rules), an extensive comparison on this matter lies well beyond the scope of this thesis and will therefore not be undertaken.

6.3 Horizontal Territorial and Customer Restrictions

As already pointed out, Article 4.1(c) TTBER explicitly prohibits licensing agreements in which competitors allocate territories and customer groups between each other. The rationale is that such provisions in licensing agreements are perceived as being so anti-competitive that they would preclude any of the positive effects enumerated in Article 81.3 EC Treaty. More pointedly, Paragraph 74 Guidelines state that *based on the nature of the restriction and experience shows that such restrictions are almost always anti-competitive*.

A similar parallel can be drawn to the *per se* rule which prohibits market and customer group allocation agreements between competitors where US courts have found such restrictions' *nature and necessary effect as being so plainly anti-competitive* that such agreements shall be treated as unlawful *per se* without considering their likely effect on competition.

Thus, the similarities are striking where both EC and US regulators are of the opinion that limitations in patent licensing agreements relating to horizontal territorial and customer group restrictions, with the object to divide markets and share customers, are prohibited as the competing companies in such cases would have no other object than to restrain competition. The pervading characteristics of such horizontal prohibitions in both regulatory systems relate to the fact that there is no need to demonstrate any actual effects on competition. More pointedly, if such restrictions are deemed to exist they are either in the EU; *already decided to be anti-competitive by their very nature having such a high potential for negative effect on competition* or *because of their pernicious effect on competition* in the US.

However, as we have seen, most licensing agreements relating to territorial and customer group restrictions between competitors are exclusive and therefore it is of essence to draw attention to a profound difference when comparing EC and US rules on the matter. The issue of exclusive patent licensing agreements have appeared to pose little problems for courts and regulators in the US. Paragraph 4.1.2 IP Guidelines set out the general rule that antitrust concern may arise only if the parties are actual or potential competitors on the relevant market in the absence of the agreement. No such concerns will arise where the parties are non-competitors, on the contrary the exclusive licences will promote competition.

In contrast, exclusive licences have posed a major problem for both the Commission and the ECJ during many years. Apart from upholding free competition, the major concern has been to safeguard free movement of goods within the Union, which has been manifested in the protection of parallel trade.

As already mentioned, the underlying principle was set out in *Nungesser* where ECJ permitted exclusive licences as long as they did not amount to absolute territorial protection preventing parallel trade. Consequently, exclusive licence restrictions will fall outside the application of Article 81.1 EC Treaty only to the extent that they do not affect the position of third parties, such as licences for other territories.

For this reason, the TTBER allows the possibility to impose territorial restrictions being either exclusive or the licensor's sole licensee as long as it does not prevent third parties to produce in that territory. This applies likewise to active and passive sales bans by the licensee and/or licensor into the exclusive territory or customer group allocated to the other party. The fact that the TTBER makes a distinction between sales licences and production licences depends merely on the fact that they have been regarded to require separate considerations, although the general principle is the same.

However, the TTBER sets out a slightly different rule governing the situation where a product is launched on a new market. In that case, the licensor is allowed to restrict active sales by a licensee to another licensee's exclusive territory or customer group if the latter was not a competitor when the licence was concluded for the period required to enter the new market or to establish himself in relation to the allocated customer group.[164]

Nonetheless, as the TTBER place emphasis upon inter-brand competition, it is important to mention that exclusivity and active/passive sales bans between competitors are allowed on the condition that only one party is licensing technology, or if both cross-licence the licensed technologies shall not be competing. Therefore, European businesses cannot agree to licence products that can be used to produce competing products, as it would amount to unlawful market sharing and customer allocation.

6.4 Horizontal and Vertical Field of Use Restrictions

As already put forward, field of use restrictions have generally been permitted in patent licensing agreements where the general attitude has been that they do not infringe Article 81.1 EC Treaty. A similar view has been shared by US courts and regulators where both the EC and US have allowed patent owners to impose various field of use restrictions on their licensees even though the parties may have been competitors. Yet, on the condition that they are not used as a device to divide markets and share customers. However, the attitude has been much narrower in the EU even though there are several similarities.

[164] Gutterman, 1997: 267ff.

The principal case in America was *General Talking Pictures* where it was held that field of use restrictions were inherent in the scope of the granted patent and therefore the holder was able to exploit the invention as he saw fit, as long as the use did not amount to the extension of the granted right. Similarly, in the *Windsurfing* case ECJ did not allow the field of use restrictions as they went beyond the scope of the licensed technology. Consequently, similar circumstances are considered in the Guidelines.

The much narrower attitudes of regulators in the EC came with the Commission's concerns over the possible use of fields of use restrictions to divide markets and share customers. As a direct remedy, the concepts relating to symmetrical and asymmetrical field of use restrictions were introduced by the Guidelines. It is only in the latter case that competition concerns may arise as both parties are allowed to use the respective technologies within different fields where the risk of market sharing is considered substantially greater.

It may also be worth reiterating that the general view of field of use restrictions between non-competitors is that they are non-restrictive of competition. Consequently, European businesses can impose asymmetrical field of use restrictions as long as they relate to different products belonging to different markets.[165]

6.5 Vertical Territorial and Customer Restrictions

There has never been a doubt in Europe that it is illegal for competitors to share markets through licensing agreements, as Article 81 EC Treaty has always expressly condemned it. However, there was early doubt as to whether Article 81 applied to vertical agreements, and as mentioned above, this was first made clear in *Consten and Grundig*.[166]

In contrast to the US development on vertical restraints, the EC did never introduce a policy rule of reason into Article 81.1 EC Treaty. Instead, it took other measures to deal with the problem, which is best demonstrable in regard of exclusive distribution agreements and in particular in *Consten and Grundig*.

As already mentioned, the Commission held that the licensing agreement in question provided absolute territorial protection and therefore was caught by Article 81 EC Treaty. Both *Consten* and *Grundig* argued for the introduction of a *rule of reason* holding that the Commission should have considered the economic effects of the agreement on competition resulting in the comparison between producers, i.e. inter-brand competition, with that between distributors of the product of the same brand, i.e. intra-brand

[165] Gutterman, 1997: 280ff.
[166] Crotti, 1977: 134.

competition. However, ECJ held that it was unnecessary to carry out an economic analysis, as the object of the agreement was clearly to restrict competition, that is to say, the restrictions was contrary to the fundamental objective of the EC Treaty and was therefore by its very nature prohibited.

A similarity can be drawn to what has been stated earlier on the general market and customer allocation prohibition between competitors and the American *per se* rule. As already mentioned, Article 4.2(b) TTBER prohibits absolute territorial protection because its very nature is contrary to Article 81.1 EC Treaty. There is therefore no reason to analyse a vertical restraints actual effect on competition when absolute territorial protection is deemed to exist. When it is not a question of absolute territorial protection ECJ has in some cases been willing to accept a *rule of reason* approach. For instance, in *Société Techniqueq Minière* the ECJ assessed the effect on the exclusive dealing arrangement in the market at issue, however, the justification for allowing the agreement was because it did not amount to absolute territorial protection.[167]

As we have already seen, a direct consequence of ECJ's decision in *Nungesser* to allow open exclusive licences was the permission of restrictions that prevented the parties from actively selling into each other's territories, which also came to include restrictions on passive sales. As such, parallel traders were not prevented from operating in the licensee's territory or to the customer group. (Worth reiterating is the fact that *Nungesser* appears to apply to a licensor-licensee relationship where parallel traders are affected and not to cases where the licensee is restricted from making active and passive sale into territories reserved for the licensor as the restriction have no direct impact upon parallel traders.) Therefore, the TTBER allows European companies to prevent licensees' passive sales into certain territories and customer groups as long as it does not amount to absolute territorial protection where non-licensees are prevented from trading.

However, it is possible to partly evade this general prohibition when a new market is entered as it is possible to restrict sales into a territory or to a customer group allocated by the licensor to another licensee during the two first years that this other licensee is selling in the same territory or to the same customers.

Thus, the difference compared to how the EC have solved the matter on vertical agreements can be seen in light of the US cases *Schwinn* and *Sylvania*. The underlying basis for the latter judgment was the change in attitude towards vertical restrictions where the Supreme Court clearly stated that vertical restrictions were no longer likely to have a *pernicious* effect on competition. The effect was that US courts had to start analysing the economic effects on competition and not to base its findings on formalistic grounds.

[167] Greaves, 1993:18 and Mendelsohn, 2002: 20.

The subsequent cases following this landmark case came, as we have seen, to clarify the attitude on licensing in general.

In the *Dawson Chemical* case the Court came to place emphasis upon the role intellectual property played in the creation of incentives to the development of new technologies and new investments in the technology field, emphasising the crucial importance of ensuring that the licensor's efforts did not got unrewarded. The *Studiengesellschaft Kohle* case is another illustration of how the US courts commenced an era of analysing and evaluating the commercial and social effects of licensing agreements.

In comparison, the TTBER has been largely influenced by American considerations especially in comparison with the 1996 Regulation. This can clearly be seen in the Guidelines where all the above mentioned exceptions are motivated either by providing incentives to the licensor or licensee to engage in licensing activities or, to encourage developments and new investments, thereby enhancing the dissemination of new technology. The influence can also be noticed due to the fact that the TTBER is preoccupied with the economic effects of licensing agreements on competition, whether it is a question of the parties being competitors or non-competitors or whether the licensed technology could be used for the production of competing products or not.

For this reason, one could argue that there has been a policy shift with the adoption of the TTBER towards the introduction of a *rule of reason* as the very structure of the regulation is formed so as to consider the economic effects of licensing agreements on competition. The lawfulness of the various restrictions that can be imposed depends on the competitive relationship between the parties of the agreement, where TTBER clearly points out that agreements between competitors pose a greater risk to free competition within the Common market than agreements between non-competitors, therefore focusing on inter-brand competition.

It is therefore clear that the new TTBER is an economic and effect-based regulation focusing more on inter-brand competitiveness issues compared to the 1996 Regulation.

7 Conclusion

The EC has solved the crossing point between permitted respectively prohibited allocations on territories, customer groups and fields of use by partly relying on the preservation of free movement of goods, i.e. relying on the absolute territorial protection concept, and partly by relying on safeguarding free competition by analysing the restriction's economic effect on competition. The overall result is that under the TTBER it is possible to allocate as long as it does not prevent parallel trade preventing free competition or hindering free movement of goods. For this reason, the decisive factor when determining whether a restraint amounts to unlawful market sharing or customer allocation is not the mere shape of the patent licensing agreement but the restrictions' object and effect, where the underlying foundation is that horizontal restraints or restraints between competitors pose a greater risk to competition than the mere harmless vertical ones.

However, the question now is whether the TTBER and its corresponding Guidelines give clear and reasonable rules regarding allocation of territories, customers and fields of use, satisfying EU's overriding objective to provide a favourable economic environment where European industry can flourish. It is in this context that the economic analysis of law makes its entrance.

Rather than providing an in-depth analysis regarding law and economics it is my aim to make some preliminary observations which to me seems relevant in order understand the method used. Therefore, as in any legal analysis where law and economics is the main method, the point of departure will be from two main fixed economic assumptions, where the first one is that businesses in general are anticipated to be rational maximizers of their own profit.[168]

The proposition has to be viewed in the light of the economic theory's reasoning that all resources are limited and therefore have to be used efficiently, which in turn means that businesses have to make active choices in order to utilize their limited resources in the best possible way.[169] Consequently, as businesses attempt to use their limited resources as efficiently as possible they are by implication striving for the biggest possible returns with the least possible costs, maximizing their income. In other words, their choices are controlled by the prospect of gain.[170]

The second assumption is that businesses respond to incentives, which, according to *Richard Posner*, lies implicitly in the first stated proposition. That is to say, it is possible to alter companies' behaviour by changing the environment enabling them to increase their profits, and then most of them,

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[168] Dahlman, 2002: 14.
[169] Posner, 1973: 1.
[170] Dahlman, 2002: 37.

if not all, will do so. It is therefore possible to change businesses behaviour by altering their incentives.[171]

Worth mentioning is that representatives of law and economics generally view the protection of property law, in particular intellectual property rights, as an important tool to create incentives to use the resources efficiently.[172] More pointedly, focus lies on the fact that intellectual property functions as an incentive to invest and make new inventions and therefore benefits the society by stimulating investment and employment as valuable information will be disclosed to the public, ultimately increasing the wealth. It is therefore possible through intellectual property regulations and other legislation to control and direct companies' incentives making it possible to change businesses' behaviour.[173]

However, opponents of law and economic have argued that the creation of such exclusive rights, as intellectual property rights, implies an economic dilemma with the effect of creating an abundance of temporary monopolies, which in the end will obstruct the free market. Nonetheless, such negative after-effects could be reduced, for instance by limiting the scope of the protection enabling other businesses to make substitutes or by reducing the time limit for the granted right.[174] However, the issue lies well beyond the scope of the thesis and will therefore not be considered any further.

Thus, the TTBER appears to be influenced to a great deal of the basic ideas of law and economics as most of the permitted allocations on territories, customer groups and fields of use restrictions are justified on the ground that they provide a variety of incentives, for instance in regard of encouraging new developments and new investments. This is evident from the distinction the TTBER makes in regard of allocations among competitors and non-competitors. It can clearly be seen that the former pose a greater risk to competition, as such allocation will reduce the economic incentives for licensees to engage in innovative activities because of the risk of facing competition. In this way, by limiting the possibility to allocate among competitors the TTBER, or the Commission, tries to force businesses to undertake pro-competitive actions, which in turn lead to the upholding of free movement of goods, as well as to maintain free competition within the Community.

It is therefore no doubt that the TTBER's intention is to function as a tool to guide any company active in licensing, whether licensor and licensee, on what to include into a licensing agreement, thereby providing certainty about the legality and enforceability of permitted allocations.

[171] Posner, 1973: 1.
[172] Id. p. 10.
[173] Bently and Sherman, 2001: 3ff.
[174] Dahlman, 2002: 169.

In contrast, the most striking feature of the TTBER is the very complex structure with its many general rules and exceptions totally lacking the straightforwardness that European companies were desperately in need of. This is due to the fact that almost every provision of the regulation has to be thoroughly examined in order to assure that a licensing agreement fall within the block exemption.

It comes as no surprise that the industry has argued that these rules are *at best uncertain* and *at worst irrelevant*. Some critics have argued that the reference to 'allocation of markets and customers' in Article 4.1(c) TTBER is very broad although the exemptions are very narrow and do not seem to allow easily for exclusive licensing as it causes withdrawal of the licensor from the market. In many cases this have no practical consequences, for instance when a competitor licence another competitor to commercialise early stage technology. In such case, it would create competition rather than a restraint.[175]

Other opponents have emphasised that the TTBER's division between competitors and non-competitors is so unclear and ambiguous that one of many effects is to render the whole of Article 4.2(b) TTBER useless. The consequence is that it would be unwise for any company to include any of the permitted territorial or customer restrictions among non-competitors because of the slightest risk of becoming competitors in the future.[176]

Thus, as the negative effects seems to outweigh the positive it is my view that the TTBER is not setting an example by providing clear and reasonable rules for the European industry. The reason is that the legal rules do not totally exclude the 'one size fits all' of the type of box-ticking which was common under the 1996 Regulation. In fact, the structure and the procedure companies have to undertake in order to assure that their agreement does not amount to illegal market or customer allocation is, if not very expensive, highly time-consuming.

For this reason, the rules on market and customer allocation do not satisfy EU's overriding objective. Because, and it is quite simple, they do not provide a favourable economic environment where European industry can flourish.

[175] Cefic, December 2003, p. 4.
[176] Vinge, November 2003, p. 3.

Supplement A

<u>Article 4 TTBER 772/2004</u>

Hardcore restrictions

1. Where the undertakings party to the agreement are competing undertakings, the exemption provided for in Article 2 shall not apply to agreement which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object:

   a) the restriction of a party's ability to determine its process when selling products to third parties;

   b) the limitation of output, except limitations on the output of contract products imposed on the licensee in a non-reciprocal agreement or imposed on only one of the licensees in a reciprocal agreement;

   c) the allocation of markets and customers except:

   (i) the obligation on the licensee(s) to produce with the licensed technology only within one or more technical fields of use or one or more product markets,

   (ii) 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 product markets or one or more exclusive territories reserved for the other party,

   (iii) the obligation on the licensor not to license the technology to another licensee in a particular territory,

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

   (v) the restriction, in a non-reciprocal agreement, of active sales by the licensee into the exclusive territory or the exclusive customer group allocated by the licensor to another licensee provided the latter was not a competing undertaking of the licensor at the time of the conclusion of its own licence,

(vi) the obligation on the licensee to produce the contract products only for its own use provided that the licensee is not restricted in selling the contract products actively or passively as pare parts for its own products,

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

d) the restriction of the licensee's ability to exploit its own technology or the restriction of the ability of any of the parties to the agreement to carry out research and development , unless such latter restriction is indispensable to prevent the disclosure of the licensed know-how to third parties.

2. Where the undertakings party to the agreement are not competing undertakings, the exemption provided for in Article 2 shall not apply to agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object:

a) the restriction of a party's ability to determine its prices when selling products to their parties, without prejudice to the possibility of imposing a maximum sale price, provided that it does not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties;

b) the restriction of the territory into which, or of the customers to whom, the licensee may passively sell the contract products, except:

(i) the restriction of passive sales into an exclusive territory or to an exclusive customer group reserved for the licensor,

(ii) the restriction of passive sales into an exclusive territory or to an exclusive customer group allocated by the licensor to another licensee during the first two years that this other licensee is selling the contract products in that territory or to that customer group,

(iii) the obligation to produce the contract products only for its won use provided that the licensee is not restricted in selling the contract products actively and passively as spare parts for its own use,

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

(v) the restriction of sales to end-users by a licensee operating at the wholesale level of trade,

(vi) the restriction of sales to unauthorised distributors by the members of a selective distribution system;

c) the restriction of active and passive sales to end-users by a licensee which is a member of a selective distribution system and which operates at the retail level, without prejudice to the possibility of prohibiting a member of the system from operating out of an unauthorised place of establishment.

Supplement B

<u>Article 4 Regulation on Vertical Agreements 2790/99</u>

Hardcore restrictions

The exemption provided for in Article 2 shall not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object:

a) the restriction of the buyer’s ability to determine its sale price, without prejudice to the possibility of the supplier’s imposing a maximum sale price or recommending a sale price, provided that they do not amount to a fixed or minimum sale price as a result of pressure form, or incentives offered by, any of the parties;

b) the restriction of the territory into which, or of the customer to whom, the buyer may sell the contract goods or services, except:

- the restriction of active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer, where such a restriction does not limit sales by the customer of the buyer,
- the restriction of sales to end users by a buyer operating a the wholesale level of trade,
- the restriction of sales to unauthorised distributors by the members of a selective distribution system, and
- the restriction of the buyer’s ability to sell component, supplied for the purpose of incorporation, to customers who would use them to manufacture the same type of goods as those produced by the supplier;

c) the restriction of active and passive sales to end users by members of a selective distribution system operating at the retail level of trade, without prejudice to the possibility of prohibiting a member of the system from operating out to an unauthorised place of establishment;

d) the restriction of cross-supplies between distributors within a selective distribution system, including between distributors operating at different level of trade:

e) the restriction agreed between a supplier of components and a buyer who incorporates those components, which limits the supplier to selling the components as spare parts to end-users or to repairs or other service providers not entrusted by the buyer with the repair or servicing of its goods.

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