The New EU Technology Transfer Regime—Out of the Straightjacket into the Safe Harbour?

Marc Hansen and Omar Shah*

Introduction

On April 7, 2004, following nearly two and a half years of sometimes heated consultation and debate, the European Commission published the text of a new Regulation on the application of Art.81(3) of the EC Treaty to categories of technology transfer agreements (Technology Transfer Block Exemption Regulation or “TTBER”) and an accompanying set of guidelines on the application of Art.81 of the EC Treaty to technology transfer agreements (“Technology Guidelines”).1 These measures entered into force on May 1, 2004.

The publication of the new TTBER and Technology Guidelines concludes a five-year review of the Commission’s procedures and practice regarding the application of Art.81 EC Treaty. This process started in 1999 with the adoption of the Vertical Restraints Block Exemption2 and Vertical Guidelines3 and continued with its 2000/2001 adoption of the R&D4 and Specialisation5 Agreements Block Exemption Regulations and accompanying Horizontal Guidelines.6 The entry into effect of the new technology transfer rules also coincides with the fundamental changes introduced by Regulation 1/20037 (replacing the old Regulation 17/62)8—generally referred to as the “modernisation” of the enforcement of EC competition law. Taken together, these developments constitute a revolution in the application of Art.81 to technology transfer agreements.

This article will outline the differences in approach between the old and the new regimes focusing on the new regime’s practical implications for potential licensors. We conclude that the new regime will require a different approach on the part of licensors and their advisers: the legal certainty of the old Regulation 240/96 “straightjacket” will not be replicated by the new regime’s “safe harbours”. Similarly, the new decentralised system under Regulation 1/2003 of ex post enforcement by the Commission and national competition authorities as well as by third parties in national courts will mean that the legality of technology transfer agreements containing restrictions on competition will not be subject to the same degree of legal certainty as under the old centralised, ex ante notification/exemption system of Regulation 17/62.

Licensors and their advisers will thus need to carry out economic “self-assessment” using the principles set out in the Technology Guidelines. It is to be expected that the focus of practice under the new regime will therefore need to be based on (possibly repeated) counselling by reference to the Technology Guidelines rather than on a one-off drafting exercise to create a model agreement to fit into the safe harbours provided for in the TTBER and the Technology Guidelines. While assessment of technology transfer agreements in this

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1 See http://europa.eu.int/comm/competition/antitrust/legislation/entente3_en.html#licensing.

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* Marc Hansen is a partner, and Omar Shah an associate with Latham & Watkins, Brussels/London. The authors thank their colleagues John Kallaugher, Brian Sher and Gunnar Wolf for their comments.
sense becomes more complex, there is also a more positive side: the new Technology Guidelines bring the EU approach closer to the US analysis applied to similar agreements, thereby facilitating the negotiation of global licensing agreements.

**New effects-based approach replaces old formalistic regime**

The old regime under Regulation 240/96 required agreements to be structured according to a set of rather formalistic rules whereby only certain listed provisions were deemed to be capable of exemption (the so-called “straightjacket”). The formalistic approach of Regulation 240/96 appeared to be based on considerations of legal certainty and reflected the thinking, inspired by German law, that any restriction of the commercial freedom of the parties was caught by Art.81(1). Consequently, any block exemption regulation had to be drafted so as to only cover those (listed) restrictions which had been individually exempted under Art.81(3) in the past: as a result, guidelines setting out the Commission’s principles of interpretation in relation to a block exemption were previously not required.

This approach was also reflected in the old centralised notification/exemption system under Regulation 17/62 which gave the Commission a monopoly over the grant of exemptions under Art.81(3). If an agreement was individually notified to the Commission pursuant to Regulation 17/62, it was immune from administrative fines and, if the notifying party received a comfort letter or decision under Art.81(3) in respect of that agreement, it was effectively immune from further challenge under Art.81(1) provided that there was no change in the underlying factual circumstances.

When structuring its block exemptions, the Commission therefore attempted to replicate the legal certainty of the individual exemption system—parties to agreements should be able to determine ex ante whether their agreements were lawful for their entire duration. If one or more provisions of an agreement did not fall within a block exemption and could be considered to be restrictive of competition under Art.81(1), they would need to be notified individually to the Commission under Regulation 17/62 or they would be automatically void and unenforceable.

The TTBER and the Technology Guidelines explicitly break with this approach. The new solution is to exempt defined categories of technology transfer agreements between parties whose market share(s) on the relevant affected market(s) falls below certain market share thresholds (“positive safe harbour”) or where there are sufficient substitutable technologies (“negative safe harbour”) provided in each case that they do not contain certain “hard core” restrictions (previously “black list” provisions). These tests are together referred to as the “safe harbours”.

The principles of interpretation set out in the Technology Guidelines are designed to supplement the safe harbours by setting out the principles of the “effects-based” approach upon which the safe harbours are themselves based. The effects-based approach (which is also the basis of the Horizontal and Vertical Guidelines) is founded upon an analysis of the likely economic effects of particular agreements on the relevant affected markets.

The most explicit illustration of the effects-based approach in the TTBER is its use of (i) market share thresholds (in relation to the positive safe harbour) and (ii) an assessment of the number of competing technologies (in relation to the negative safe harbour) to delineate the boundary between presumptively lawful agreements and other agreements.

Moreover, the presumption in the positive safe harbour varies according to whether the parties to the agreement are competitors or non-competitors: the exemption applies in the case of non-competitors on condition that the market share of each of the parties does not exceed 30 per cent of the affected relevant

11 Although it could still be challenged in a national court, the court could not take a decision running counter to the Commission’s decision: see, e.g. Case C–344/98 Masterfoods and HB [2000] E.C.R. I–11369; [2001] 4 C.M.L.R. 14. Although the position was not as clear cut in respect of comfort letters, they might at least be taken account of as “factual elements”, Notice on Co-operation between national courts and the Commission in applying Arts 85 and 86 of the EEC Treaty [1993] O.J. C313/3, para.25.

12 TTBER, Recital (4): “It is appropriate to move away from the approach of listing exempted clauses and to place greater emphasis on defining the categories of agreements which are exempted up to a certain level of market power and on specifying the restrictions or clauses which are not to be contained in such agreements.”
13 Including, for the first time, software copyright licensing.
14 TTBER, Art.3. This confers a presumption that the net effect of the agreement is pro-competitive.
15 See accompanying guidelines, para.131. This confers a presumption that the agreement is not prohibited by Art.81.
16 Set out in the TTBER, Art.4.
17 See, e.g. Vertical Guidelines, para.7 and Horizontal Guidelines, para.19.
18 TTBER, Recital (4): “This is consistent with an economics based approach which assesses the impact of agreements on the relevant market.”
technology and product market, whereas it applies in the case of competitors only if their combined market share is below 20 per cent. This clear distinction between competitors and non-competitors was not found in Regulation 240/96 and its inclusion in the TTBER reflects the thinking (also found in the Horizontal and Vertical Guidelines) that the effect of agreements between competitors can be presumed to be more restrictive of competition than those between non-competitors.

Another important difference between the new and the old regimes is that there is now explicitly no presumption that a restriction that is not covered by the TTBER is caught by Art.81(1). Furthermore, there is now no requirement under Regulation 1/2003 to notify agreements that may contain restrictions for purposes of Art.81(1), in order to ensure that such agreements can be legally enforceable. Indeed, notification for exemption or negative clearance is no longer possible—potential licensors and their advisers must instead carry out their own assessment of whether the restrictions are likely to be restrictive under Art.81(1) and, if so, whether they would nevertheless be capable of individual exemption under Art.81(3).

Although the effects-based approach is generally more liberal in terms of treating restrictions (and thus agreements) as being lawful, there are certain restrictions for which its application will result in a more restrictive treatment. For example, the TTBER takes a more restrictive approach to territorial restrictions than Regulation 240/96. This appears to be based both on a desire for consistency with the Vertical Guidelines and also out of a renewed concern for market integration with the accession of 10 new Member States to the EU on May 1, 2004—another significant change in the regulatory and economic environment that is likely to have an impact on technology licensing relationships.

### Practical implications for licensors

Following the entry into force of the TTBER and Technology Guidelines, potential licensors and their advisers are likely to be faced with a number of practical issues on how to ensure that their existing and future licensing arrangements are lawful. Whereas, they might previously have focused on drafting model agreements that would fit within the Regulation 240/96 straight-jacket, this will no longer be appropriate in the context of the new regime. Instead, a dynamic risk assessment of the agreement in its market context will often be required.

The principal factor necessitating this change of approach is the fact that the safe harbours are delineated by reference to potentially fluctuating market shares or number of substitutable technologies whereas the old Regulation 240/96 straightjacket was delineated by reference to the white list of exempted clauses.

Under the new approach, it will first be necessary to define the relevant affected market and then to assess the parties’ level of market power on that market in order to determine whether the agreement falls within either of the safe harbours (positive or negative). If the parties’ market shares exceed the thresholds at any time, the agreement will fall outside the positive safe harbour two years after that time. Similarly, where there are less than four or more independently controlled substitutable and comparably costly technologies at any time, the agreement will fall outside the negative safe harbour at that time. While these tests may sound complicated, they are well known from the application of the 1995 US Antitrust Guidelines for the Licensing of Intellectual Property. Many licensors will therefore be familiar with the practical application of these concepts.

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19 TTBER, Art.3(1).
20 TTBER, Art.3(2).
21 TTBER, Recital (12).
22 The Commission may no longer grant exemptions or comfort letters in respect of notified agreements. They may give informal guidance to parties in respect of agreements which novel or unresolved questions for the application of the competition rules (see Regulation 1/2003, Recital (38)) or may issue a decision finding Art.81 inapplicable to an agreement where the Community public interest so requires (see Regulation 1/2003, Art.10). However, the Commission has indicated that it will only issue informal guidance or decisions of inapplicability in exceptional cases.
23 Thus, for example, output restrictions between non-competitors are exempted (Technology Guidelines, para.176); customer restrictions between non-competitors are permitted where the licensor prevents active or passive sales to exclusive customer groups reserved to itself (TTBER, Art. 4(2)(b)(i)); obligations imposed on the licensee to license another technology or purchase another product from the licensor or someone designated by him (tying) and not to use third party technology (non-compete) are exempted (Technology Guidelines, paras 191–203); non-exclusive grant-back obligations are exempted even where they are non-reciprocal, that is, they are only imposed on the licensee and where under the agreement the licensor is entitled to feed on the improvements to other licensees (Technology Guidelines, para.109). See also Hansen and Shah, “European Commission Publishes Draft New Technology Rules: A Comment on Policy Directions”, PLC Competition Law, November 10, 2003.
24 The TTBER does not permit the restriction of active sales in reciprocal agreements between competitors (TTBER, Art.4(1)(c)).
25 If they last beyond May 1, 2006, the end of the transitional period for the old Regulation 240/96.
26 TTBER, Art.8(2).
Thus, although the parties can determine *ex ante* under the TTBER whether they are to be treated non-competitors for the duration of the agreement (even if that status changes subsequent to the agreement being concluded), they will often be unable to predict at the outset whether their market shares are likely to remain below the safe harbour thresholds or whether any technologies are likely to be substitutable or have a comparable cost to the user for the entirety of the duration of the agreement. As a result, many agreements cannot safely be deemed to fall into the safe harbours throughout their duration. Given that the legality of a particular restriction generally falls to be assessed at the time the licensor seeks to enforce it, *most agreements therefore need to be assessed not only under the TTBER, but also by reference to the Technology Guidelines.*

For those agreements which fall outside the safe harbours (or where it is difficult to determine whether the agreements will remain within the safe harbours), the Technology Guidelines set out the principles for assessment. In practice, such agreements are likely to be between established players with significant market power on technology or product markets. Such players often enter into agreements with their competitors to settle patent disputes, or at an earlier stage, secure their design freedom for their future R&D efforts. These agreements often involve practices such as reciprocal and non-reciprocal cross-licensing; running royalty obligations; field of use and customer class restrictions; and restrictions aimed at ensuring that licensed know-how is not commingled with the licensees’ own innovations (“clean room restrictions”). The Technology Guidelines set out the Commission’s current views on these issues, but the boundaries of what is lawful are likely to be worked out in future cases as the risk assessments carried out by parties to such agreements are tested in enforcement actions or in court.

The Technology Guidelines are particularly significant in this regard because they address the application of Art.81(1) to arrangements that fall outside the safe harbour provisions of the TTBER and that have not been covered under the old block exemption regime. An example of this expanded coverage involves multilateral “pooling” agreements which are often implemented to facilitate efficient licensing of technologies required to comply with a standard. Given the importance of standards commercially, pool agreements are likely to proliferate in the future. Consequently, the Technology Guidelines set out in a systematic manner the Commission’s views on such arrangements for the first time (previously these views were generally confined to press releases in individual cases). Whilst the Technology Guidelines appear generally to have incorporated the Commission’s practice in previous cases (such as the requirement that pools include only “essential technologies” and that licensing should be on fair, reasonable and non-discriminatory terms), in certain areas the Commission appear to be trying to break new ground. These views are again likely to be tested in future in the context of individual cases.

Another example of the broad scope of the Technology Guidelines is the coverage of the parallel conduct of license negotiations and standard setting. The Commission, possibly having been exposed to several “patent ambush” cases in recent years, has indicated that it may be more efficient if royalties are agreed *before* a standard is agreed so as to avoid that the standard setting process confers significant market power on the prospective licensors. In this regard, the Commission takes a more progressive and pro-standards approach than the US authorities. The Commission position may change the dynamics in standard setting situations and legal certainty on the issue may lead to changes in the IPR policies of some standard setting organisations.

There are likely to be certain agreements in respect of which licensors will be unable to derive sufficient comfort from the Guidelines as to their legality: for example, where agreements contain hard core restrictions. Such agreements must then be assessed by reference to the recently published Commission Guidelines on the interpretation of Art.81(3) EC Treaty: in principle any

28 TTBER, Art.4(3).
29 In previous drafts of the Guidelines, the Commission has taken a more hostile approach to certain practices, e.g. asymmetrical field of use restrictions contained in cross licenses between competitors regarding them as merely a cloaked cartel arrangement.
30 For example, para.222(d) of the Technology Guidelines appears to come close to suggesting that licensors of pooled technology may, where substitute technologies are involved, be required to license partial packages of such technology (e.g. their own patents) at a lower price than that of the joint pool license. The legal basis for this is not clear—and certainly questionable—outside of the scope of pools with substitute technologies (where foreclosure concerns could justify the concern)—as such a requirement would be tantamount to ordering a compulsory license for a different pool (a separate product). Moreover, it is difficult to see the legal or economic justification for any “bundling” theory as expressed in paras 221 and 222(c); where at least one essential patent is included in a pool there would seem to be no basis for intervention in pricing of the pool licenses (other than under Art.82). In other words, whether the pool includes one, two or twenty patents, the licensors remain free to set the price according to market conditions.
restriction (including price fixing) may be exempted under Art.81(3). Such exemptions will of course be exceptional and will require very strong justification.33

Conclusion

The TTBER and Technology Guidelines in combination with modernisation under Regulation 1/2003 will give less legal certainty in respect of technology transfer agreements containing restrictions on competition but will be better founded in economic theory. The new regime will thus not mirror the old Regulation 240/96 in allowing potential licensors to model their technology licenses to fall into the safe harbours as Regulation 240/96 previously allowed them to fit such agreements into the straightjacket. Although some agreements may deemed to be presumptively lawful under the safe harbours (more perhaps under the negative safe harbour than the positive safe harbour), many agreements will still need to be assessed by reference to the principles of interpretation set out in the Technology Guidelines.

Self-assessment of risk as required under the new regime needs a different approach: potential licensors and their advisers will need to focus rather more on the market context in which the license is to be offered and rather less on the actual drafting of particular clauses to fit within a narrow legal definition. Self-assessment needs to be dynamic and to change with market circumstances: for example, the risk profile of an agreement may become lower with the entry into the market of a new substitutable technology—this may in turn allow the licensor to impose more onerous restrictions on licensees. Equally, the legality of a model license agreement may be called into question by the acquisition by a third party which owns one substitutable technology of another third party which owns another substitutable technology.

33 In order to obtain some degree of legal certainty and avoid future enforcement actions or lawsuits in respect of such potentially contentious agreements, parties may be able to request that the Commission consider issuing a finding of inapplicability of Art.81 to the agreement, pursuant to Art.10 of Regulation 1/2003 which is reserved for exceptional cases of Community interest.