European Economic and Social Committee

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Brussels, 11 December 2003

OPINION

of the European Economic and Social Committee

on the

Draft Commission Regulation on the application of Article 81(3) of the Treaty to categories of technology transfer agreements

OJ C 235 of 1.10.2003, p 11

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On 4 September 2003, the Commission decided to consult the European Economic and Social Committee, under Article 262 of the Treaty establishing the European Community, on the:

Draft Commission Regulation on the application of Article 81(3) of the Treaty to categories of technology transfer agreements
(OJ C 235 of 1.10.2003, p 11).

The European Economic and Social Committee instructed the Section for the Single Market, Production and Consumption to prepare its work on the subject.

In view of the urgency of the matter, at its 404th plenary session, held on 10 and 11 December 2003 (meeting of 11 December 2003) the European Economic and Social Committee appointed **Mr Metzler** as rapporteur-general and adopted the following opinion by 29 votes to 3, with 1 abstention:

1. Introduction

1.1 The proposal for a new block exemption regulation for technology transfer agreements (TTBER) is to replace block exemption Regulation no. 240/96. Application of this - with its white, grey and black lists of permitted and prohibited clauses - has in practice led to heavy restrictions in the drafting of contracts and has given rise to the oft-mentioned "strait-jacket effect". As a consequence, contracts have been drawn up which are not in line with economic reality, but solely in keeping with the guidelines laid down in these lists. The technology industry has been calling for a long time for the block exemption regulation to be revised in order to improve this situation.

1.2 In this connection, account should be taken of the new legal situation which will be created when Regulation 1/2003 on the implementation of the rules on competition comes into force on 1 May 2004. After this date it will no longer be possible to submit notification of competition-restricting contracts for the purposes of exemption by the Commission. In future, it is rather the firms themselves who must judge whether their agreements contravene antitrust Article 81 (1) of the EC Treaty, and whether the preconditions are met for an exemption from the antitrust provisions set out in Article 81 (3) of that treaty. This also creates a new situation for technology transfer agreements; in particular, in the interests of legal certainty, firms require different support than hitherto on offer from Regulation 240/96.

1.3 From an economic point of view, the following points should be taken into consideration: owners of exclusive intellectual property rights, such as patents, can prohibit a third party from any action impinging upon their rights. If they were however to grant a licensee the use of their innovation, this would in principle be pro-competitive. Technology licence contracts do in fact bring new products on to existing markets, or even create completely new product markets. Such contracts also make major investments in duplicate research unnecessary, provided that two or more firms have the same research objective and approaches. Only when agreements are reached which go

beyond the safe legislative haven protecting the right in question should competition law come into play.

1.4 If the EU is to become the most competitive economy in the world by 2010, it is not only important that new technologies be developed, but also that there be sustained efforts to disseminate them rapidly. Here, however, the strong position which legislators have wanted to give intellectual property right (IPR) holders must not be curbed unreasonably; rather, the right framework conditions must be created to allow IPR holders to transfer their technology to third parties. Licensors, as holders of an intellectual property right, must be given enough incentive to allow other parties to use their technology. In this connection, it should be borne in mind that even a limited amount of competition makes more sense economically than none at all in the case that an innovator grants no licences. The responsibility for deciding whether to allow others to use an innovation lies entirely with the licensor.

1.5 Compared to other kinds of contracts, the awarding of licences also involves much more risk, because if a contract falls through, once technical knowledge has been transferred it cannot be taken back. It is also for this reason that there is a strong need for licensors to have legal certainty.

2. Overview of the key components of the block exemption regulation for technology transfer agreements (TTBER) and the Committee's assessment

2.1 In many respects, the TTBER does not meet the general demands which have been made in this connection. This opinion will first list the main criticisms of the draft regulation and then examine them in greater detail in section 3.

2.2 In practice, it will be more difficult to determine market share than has been the case to date, because not only the product market, but also the technology market and possibly the innovation market too, have to be included in the equation. It is too much to expect of firms that they should take the situation on three different markets into account when assessing whether or not licence agreements comply with antitrust legislation.

2.3 At 20 to 30%, market share thresholds have been set too low for licensing purposes. In order to disseminate technologies comprehensively, an extension of the "safe haven" concept is required, or even better, complete abolition of these thresholds. In practice, the concept used to date in Regulation 240/96 has proved its worth, whereby only isolated cases of competition-restricting agreements are picked up on.

2.4 Licence agreements between competitors are to be more strictly assessed than those between non-competitors. This principle has been taken from the 1995 USA Antitrust Guidelines for the Licensing of Intellectual Property. Europe does not yet, however, have any practical experience with this concept which would justify adopting it. In many cases, licences actually promote competition between competing firms. This happens when, for example, a firm acquires the patent licence of a competitor with a view to using it to develop a product of its own and then placing it on the market. Here it does not seem appropriate to judge licences between competitors more strictly.

2.5 The TTBER guidelines highlight the main dangers of certain clauses in licence contracts, and refer less to their economic value. Experience to date with licence contracts does not, however, provide any reason for adopting such a critical stance. Rather, when licensors allow other parties to share in their technological knowledge, it should be thoroughly welcomed. Licensors reading the guidelines will probably get the impression that the licensing process itself entails a highly problematical legal procedure for them.

3. The key clauses in the proposal for a TTBER

3.1 Definitions

3.1.1 According to Article 1(1)(b), the scope of the proposed regulation covers patent licensing agreements, know-how licensing agreements and mixed patent and know-how licensing agreements. Software copyright licensing agreements are also covered. In the Committee's view, licensing of other intellectual property rights should be dealt with separately because, due to the considerable differences between patent law and copyright law in particular, it is exceedingly difficult to deal with the subject matter in a single regulation. In addition, for patents and know-how, which Regulation 240/96 deals with exclusively, there is already legislation with which the EU has gained experience; this is not the case with other intellectual property rights. Including software copyright licences in the TTBER is to be welcomed, as in practice a great deal of software is licensed which can be used exclusively to operate the patented product - a machine, for example - and constitutes more than just an insignificant part of an overall package.

3.1.2 Article 1(1)(g) limits the definition of know-how considerably in relation to the definition set out in Regulation 240/96. Know-how is now only described as "substantial" provided it includes information which is indispensable for the manufacture or provision of the contract products. Hitherto it was described as "useful" know-how. The Committee sees no reason to change the definition in this way.

3.2 Market share thresholds

3.2.1 Article 3 of the proposed new regulation stipulates that there are no exemptions for agreements between non-competing firms, provided that the market share of each of the parties concerned in the relevant technology and product markets does not exceed 30%. For competing firms, the combined market share should not exceed 20% of the market.

3.2.2 Information about market share on product markets, technology markets and, in keeping with Guideline 22 of the TTBER, in some cases on innovation markets, can therefore be necessary. It is, however, already extremely difficult for many firms to define the product market, especially since they also have to take account of potential competitors here. When licensing contracts are being concluded, the extent to which products can be replaced by other products is regularly left open, particularly since the contracts often concern innovations for which there is no substitute. It is even more difficult to ascertain whether this might be the case in the future with regard to potential

competitors. This creates considerable legal uncertainty. The Commission's decisions to date are evidence of the fact that there is often a sharp difference between firms' ideas of their market share and that of the competition authorities.

3.2.3 The licensing of patents and know-how is, on the other hand, covered by the technology market concept. Here, just as on the product market, a hypothetical monopolist is to be created, who gradually raises the royalties by 5 to 10% (SSNIP test). The way that markets are to be defined in practice, however, is not adequately explained in the guidelines.

3.2.4 The innovation market takes even less account of licensing practice, which relies on simple standards. This concept is foreign to European law and is rooted in American antitrust law. The guidelines lack both a definition of the innovation market and also precise guidance as to how to differentiate between markets. The innovation market in the USA covers the development of new, as yet non-existent or improved products and processes, where the competition parameter of R&D is seen as a product of the innovation market. In practice however, if the market is determined in this way, the results of a particular research process can scarcely be anticipated *ex ante*, neither can their timing. Research project results often depend on many random factors which might not even come into play. In addition, discoveries can also occur spontaneously and unintentionally. It may scarcely be possible to ascertain potential competitors in this connection, since firms are normally very secretive about their research and development activities.

3.2.5 Also to be taken into account is the fact that new products which are regularly covered by licence agreements very quickly acquire a large share of the market, if not a monopoly. Such a market situation is typical when a licence contract is concluded and does not necessarily lead to a position of market power in terms of antitrust law. This is particularly the case when the introduction of new products and processes creates niche markets which do not have any impact on competition. Introducing rigid market share thresholds is therefore to the Committee's mind inappropriate.

3.2.6 The twelfth whereas clauses of the TTBER stipulates that above these market share thresholds there can be no presumption that technology transfer agreements falling within the scope of Article 81(1) will usually give rise to objective advantages. Nowhere is there any proof, however, for this highly general and economically unfounded statement. Rather, the market share thresholds seem to be arbitrarily set at 20 or 30%. Clearly the Commission would like to align the rules on technology transfer on the block exemption regulation for vertical agreements. The background to the two regulations is however quite different and the two situations are not comparable. Fixed market share thresholds may be a suitable instrument for the assessment of distribution contracts, but this does not hold true for technology transfer contracts, where, as has already been explained, it is very hard to know where to set these thresholds.

3.2.7 The Committee feels that such strict, schematic rules run the risk of slowing down the flow of technology within the EU, and with it the dissemination of scientific and technical progress. Licensors could also decide to transfer their technologies to licensees outside the EU, where they can benefit from more flexible rules. Alternatively, licensors could decide to keep the technology for

themselves, which would mean major losses to national economic prosperity. Taking as a basis the market share threshold used in other block exemption regulations does not take into consideration the fact that licence agreements warrant particular support, and is more restrictive than Regulation 240/96 which went further. Also with a view to the introduction of the new antitrust Regulation 1/2003, which encumbers firms with the decision on the admissibility of a competition-restricting agreement, a technology transfer regulation should be adopted which is simpler to deal with, and not one which makes the assessment of the subject matter much more complicated.

3.2.8 Consequently, the Committee considers that market share thresholds should be dispensed with completely. If they are retained, they should be raised to 40 to 50% at least. Only in this way can the uncertainties arising from the definition of the relevant market be at least minimised.

3.3 **Hardcore restrictions**

3.3.1 Article 4(1)(b) stipulates that the limitation of output or sales is generally not admissible. The regulation should, however, allow for an explicit exemption for licensors who undertake an obligation not to use their own technology. There should also be exemption from "field-of-use" limitations in point (c), as long as this entails no restriction on licensors for using their own technology, as provided for also in Regulation 240/96. In parallel, an explicit exemption should be allowed for "second source" limitations, since in practice such clauses are of major importance. The wording of point (d), whereby licensees may not be restricted in their ability to exploit their own technology, is too restrictive, unless such a restriction is "indispensable" for preventing the disclosure of the licensed know-how to third parties. The term "indispensable" should therefore be replaced by "suitable."

3.3.2 As regards the territorial restriction set out in Article 4(2)(b), the regulation should also state that passive sales in another contract area may be prohibited. This provision has proved its worth in Regulation 240/96, since it enabled protected licensees to penetrate the market with the product concerned. Only Guideline 93 stipulates that the restrictions on passive sales fall outside Article 81(1) for a period of two years from the date on which the licensed product was first put on the market. For the sake of legal certainty, the Committee recommends that an equivalent clause be incorporated directly into the TTBER. The two-year period is too short for this. The Committee advocates using the tried and tested rule contained in Regulation 240/96, which provides for a five-year period.

3.4 **Protection for established rights**

3.4.1 Contracts that have hitherto been exempt are, under Article 9(2) of the TTBER, to be inadmissible as of May 2004 if they do not meet the conditions set out in the new regulation. It is unreasonable to deny protection of established rights to existing contracts. If this were to happen, it would be necessary to renegotiate licence agreements just because of minor clauses in contracts in order to avoid calling into question the agreements as a whole. Because this creates considerable uncertainty, the Committee recommends protection of established rights for existing contracts as long as they are valid.

3.5 **Guidelines**

3.5.1 Essentially it is to be welcomed that the Commission, particularly now that it is relinquishing its exemption monopoly, is providing firms with comprehensive guidelines to help them determine whether or not a licence agreement complies with antitrust legislation. However, in many parts of the guidelines – particularly the part on exclusive licence contracts - the Commission gives the impression of being highly critical of such agreements, if not considering them per se as restricting competition. For example Guideline 156 states that exclusive licences are only warranted in exceptional circumstances; they are seen as being more dangerous than positive in their effect. However, the far greater danger is that no more licences might be handed out if the granting of exclusive licences is only possible under such difficult conditions. In practice, a market opening or the launch of research and development projects is often only possible when licensees receive an exclusive licence. Therefore the guidelines should state the economic benefit of technology agreements which do not come under the TTBER, but which nevertheless promote competition. This would make it easier for potential licensors to decide on the granting of licences. In no way should they be given the impression that in granting a licence they are getting entangled in a legally problematical procedure.

3.5.2 That apart, not only is the definition of the relevant markets (Guideline 17) too vague, as already mentioned, but the definition of potential competitors is likewise too vague. Guideline 24 stipulates that the parties to a contract are deemed to be potential competitors on the product market if, in the absence of the agreement, they would likely have undertaken the necessary additional investment to enter the relevant market. This wording does not however make it sufficiently clear when a firm would normally undertake such investment costs.

3.5.3 Guideline 144 f.f. sets out the various types of restraints that are common to licence agreements. Guideline 146 lists, albeit only concisely, the obligations contained in licence agreements that, irrespective of the case, do not restrict competition within the meaning of Article 81(1). For the purposes of legal certainty, certain points contained in Article 2 of Regulation 240/96 should be added to this "white" list. This would be of considerable help in the actual drafting of a licence agreement, as doubts about the admissibility of such kinds of clauses could be cleared up.

4. **Conclusion**

4.1 The Committee welcomes the greater flexibility for drawing up contracts which the TTBER provides by being restricted to a number of key "black-list" clauses. Moreover, technology transfer contracts can be concluded for longer periods than to date, in line with the period for intellectual property rights. The relatively arbitrary ten-year period now no longer applies in this connection.

4.2 Because of the particular nature of the product, technology and innovation markets and the associated difficulties in defining them, the Committee recommends that a revision of this proposal should abandon the system of market share thresholds and focus first and foremost on the

product market. At the very least, the market share thresholds need to be raised to between 40 and 50% in order to provide firms with greater legal certainty. This would also prevent the licensing of new technologies with competition-promoting effects from being automatically classified as restricting competition. This would make it easier for potential licensors to be more flexible in their approach to contracts under the new technology transfer regulation, and would encourage them to grant licences accordingly. The Committee believes that the TTBER guidelines should also help to create certainty about the fact that technology licensing is an essentially positive process. This is in keeping with economic realities and can help ensure that licensors do not keep their technologies only for themselves or pass them on to licensees outside the EU, where they can benefit from more flexible rules.

Brussels, 11 December 2003

The President of the European Economic and Social Committee	The Secretary-General of the European Economic and Social Committee
Roger Briesch	**Patrick Venturini**