Europe's tech transfer regime: headaches for IP licensees and licensors?

The EU's recently revised technology transfer rules were a missed opportunity, say **Pat Treacy** and **David George**

The European Commission has revamped the competition law regime applicable to technology transfer agreements. The Commission hopes that the new rules will facilitate the sharing of IP, while embodying a "prudent" approach towards clauses which might harm competition and innovation. This will "preserve a level playing field in the Single Market."[1] In reality the new rules are likely to alter the dynamics of IP licensing negotiations – making agreement harder to reach and IP disputes more common, especially following the expiry of the transitional period. IP licensors, licensees and their advisers should take note of the changes, which may cause some headaches while businesses re-adjust to the new status quo.

Some nitty-gritty details

Technology transfer agreements are licences of patents, know-how or software used in the production of goods or services. Agreements falling within the block exemption are automatically deemed to be in line with EU antitrust law, ie they are block exempted from the prohibition in Article 101(1) TFEU. Agreements outside the block exemption are not automatically exempted, but they may – and often do – benefit from an individual exemption under Article 101(3) TFEU. Indeed, the guidelines continue to recognise that most technology licences are pro-competitive.

The Commission adopted the revised technology transfer block exemption regulation and technology transfer guidelines on 21 March 2014.[2] They replace the previous block exemption and guidelines which have been in place since 2004.[3] The new rules apply to any licence agreement entered into on or after 1 May 2014 and will apply also to older licences once a one year transitional period expires in May 2015. During the transitional period older licences will continue to benefit from the old block exemption in the event that they do not qualify for exemption under the new regime. After that, they will need to be assessed against the individual exception criteria in Article 101(3).

The Commission began the process of revising the block exemption with an initial consultation between December 2011 and February 2012. The Commission published a draft revised block exemption and guidelines in February 2013 and conducted a further round of consultations from publication until May 2013. The initial proposals caused considerable consternation since each significant substantive change was to the detriment of IP owners, with the possible exception of the new patent pool provisions. It was anticipated that the finalised texts would be published in November 2013, but it seems that owing to the controversy the final adoption of the final texts was delayed until March 2014. The final proposals have been tempered somewhat, but on balance remain unfavourable to IP owners. This does not necessarily mean the changes are pro-licensee, rather it means IP licensors will wish to exercise greater caution before entering into new deals and may need to think creatively to avoid the pitfalls of the new rules. The key changes are discussed below.

Termination on challenge

A standard provision in many IP licences is that of termination on challenge. In the event that the licensee challenges the validity of the licensed IP right or rights, the licensor can terminate the licence, initiate infringement proceedings and seek an injunction to restrain future infringement. Essentially, the licensee must take its chances on succeeding in its challenge – it is placed in the same position as if no licence had been agreed. Under the previous rules such clauses are unremarkable and capable of block exemption. Under the new rules these clauses will now qualify for block exemption only when included in exclusive licences. Outside this category such clauses are now categorised as 'excluded restrictions' which means they will require individual exemption to be enforceable, even if the remainder of the agreement is block exempted.

The stricter stance means that licensees will have greater freedom to challenge the validity of licensed IP. Whether or not the termination clause is effective in an individual case will require an assessment which balances the public interest in encouraging out-licensing against the public interest in eliminating invalid IP rights. The guidelines indicate that such clauses are unlikely to be effective where the licensed IP is either standard-essential or commercially essential. IP licensors will need to be wary of licensees seeking a licence purely for use as a shield during a subsequent validity challenge; they may also seek to modify their terms of business to mitigate this risk – for example, by seeking upfront licence fees. IP licensed under existing licences containing termination on challenge clauses may also come under challenge once the transition period expires.

Exclusive grant-backs

Licence agreements frequently contain provisions under which the licensee must assign-back or license-back to the licensor on an exclusive basis any improvements of the licensed technology. The 2004 rules distinguish between 'severable' and 'non-severable' improvements, providing block exemption to exclusive grant-backs of the latter category only. An improvement is considered non-severable if it cannot be implemented without infringing the existing technology, ie if it would require a licence to implement in any event. The revised block exemption removes this favourable treatment of non-severable clauses. Henceforward, all exclusive grant-back clauses are categorised as "excluded restrictions" requiring individual exemption, even if the remainder of the agreement is block exempted.

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Non-exclusive grant-back provisions remain capable of being block exempted. If an exclusive grant-back provision is found incapable of exemption, the English courts will apply the 'blue pencil' test to see whether a portion of the clause can be salvaged. It ought to be possible to draft the licence such that only the portion of the clause relating to 'exclusivity' is invalid, meaning that the licensor can retain the benefit of a non-exclusive licence. Thus IP licensors may wish to continue seeking these clauses, while being wary that they may turn out not to be fully effective. Unfortunately, the Commission provides very little guidance as to how to evaluate whether an exclusive grant-back is capable of individual exemption.

Passive selling

A passive sale is one made to a customer who approaches the seller. By contrast an 'active' sale occurs where the seller seeks out the customer. The old rules block exempt short duration (up to two year) restrictions on passive selling by existing licensees to a territory or customer group exclusively reserved to a new licensee.[4] The intention of the block exemption of this short duration restriction is to help IP owners encourage licensees to sink funds into the exploitation of the technology in new territories. The restriction aims to shelter the new licensee from existing licensees' sales long enough for the investment to be recouped.

The block exemption of this form of short duration restriction has now been removed. An agreement containing such a restriction can still qualify for individual exemption, but this requires the parties to demonstrate that the restriction is "objectively necessary for the protected licensee to penetrate a new market."[5] Risk-averse companies may now be less willing to include such a restriction in new IP licences. This may ultimately slow the dissemination of technology into new territories.

Settlement agreements

The revised guidelines retain a general statement that a settlement containing a licence is likely to be pro-competitive "where, in the absence of the licence, it is possible that the licensee could be excluded from the market".[6] Despite this, the Commission's new guidance on the treatment of settlement agreements is substantially more hawkish than the guidance it replaces.

The block exemption makes an important distinction between the treatment of agreements between non-competitors (where at least one party holds a blocking technology) and the treatment of agreements between competitors. Agreements between competitors are subject to a longer list of 'hardcore' provisions, which take the entire agreement outside the block exemption. Under the new guidance, parties who settle litigation via licensing are treated as if they were competitors despite the existence of potential blocking positions. It appears that market sharing is a significant concern to be considered in the evaluation of settlement agreements.

The hardening of the Commission's stance reflects the development of the Commission's thinking in so-called "pay-for-delay" cases in the pharma sector. The publication of a non-confidential version of the Commission's *Lundbeck* decision[7] will likely shed further light on the Commission's reasoning. It certainly seems at present that EU competition law has not yet fully elucidated how to deal with the issue of uncertainty over the validity of an IP right.

Is it all bad news?

The revision of the technology transfer rules has led to some more minor clarifications which are to be welcomed. For example, the Commission has restated its informal safe-harbour for technology pools and clarified that essentiality covers both 'commercially' as well as 'technically' essential technologies. The guidelines are now also more user-friendly, with a handy table of contents upfront. However, every key substantive change has increased uncertainty for IP owners. This is not to say that the changes are 'pro-licensee'. In the short term existing licensees may receive a 'windfall' from new freedoms arising on the expiration of the transitional period. However, in the longer term the dynamics of licence negotiations are likely simply to shift such that fewer licences are agreed and, when they are agreed, the licence is on terms modified to mitigate the less generous treatment of the restrictions. Overall then, the revision of the technology transfer rules will be considered a missed opportunity by many in industry. The new rules will stay in place for the next 12 years, they are likely to cause headaches all round at least until licensees and licensors have become accustomed to the new (but not necessarily more level) 'playing field' on which negotiations take place.

Footnotes

1. See Commission Press Release IP/14/299 and Memo/14/208.
2. Commission Regulation (EU) No 316/2014 OJ [2014] L 93/17 (the "TTBE 2014"); Commission Communication OJ [2014] C 89/3 (the "TT Guidelines 2014").
3. Commission Regulation (EC) No 772/2004 OJ [2004] L 123/11 (the "TTBE 2004"); Commission Communication OJ [2004] C 101/2 (the "TT Guidelines 2004").
4. TTBE 2004, Article 4(2)(b)(ii).
5. TT Guidelines 2014, paragraph 126.
6. TT Guidelines 2014, paragraph 236.
7. Case Comp/ AT.39226 – Lundbeck, Commission Decision C(2013) 3808 final of 19 June 2013. Annulment action pending T-472/13.

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