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Current Intelligence

Technology licensing and settlements of IP disputes: implications of the European Commission's new regime

Matthew Warren and Osman Zafar*

Commission Regulation (EU) No 316/2014 of 21 March 2014 on the application of Article 101(3) of the Treaty on the Functioning of the European Union (TFEU) to categories of technology transfer agreements [2014] OJ L93/17; Commission Guidelines on the application of Article 101 TFEU to technology transfer agreements [2014] OJ C89/3.

The European Commission's revised technology transfer regime: an 'evolution' giving both licensors and licensees reasons to reconsider their approach to licensing arrangements and settlement of IP disputes.

Legal context

May 2014 sees the revised technology transfer regime of European Commission (the Commission) come into force, replacing the regime in place since 2004. The overall structure of the regime remains the same: the Technology Transfer Block Exemption (TTBE) and accompanying Guidelines will continue to cover bilateral licensing of technology for the manufacture of goods and services (including patents, know-how, and software licences, but excluding other forms of IP such as trade marks); the same market share thresholds will apply (ie a combined market share of 20% or less for competitors and individual market shares of 30% or less for non-competitors); and the familiar categories of 'hardcore' restrictions (eg price fixing) and 'excluded' restrictions (eg 'grant back' and 'no-challenge' provisions) are broadly retained. But that is not to suggest that the changes have been minor or uncontroversial, especially as they come during a period of sensitivity around Commission enforcement at the competition law/IP interface. The Commission's 'pay-for-delay' investigations into settlements in the pharmaceutical sector have certainly influenced its approach; the focus on the seeking of injunctions in the 'smartphone wars' has also brought to the fore issues around what a licensor can and cannot do with its IP rights. The Commission's enforcement activities have revealed some scepticism around the enforcement of IP rights by licensors. It therefore comes as no surprise that the new regime might be considered to tip the supposedly '*level playing field*' in favour of licensees.

However, the purpose of this article is not to muse on what 'could' or 'ought' to have been. Its modest aim is to highlight the practical significance of the changes for those involved in licence negotiations and settlements of IP disputes. We therefore limit ourselves to the changes in the treatment of: (1) grant back provisions; (2) no-challenge provisions; (3) passive sales; and (4) settlement agreements. Changes to (1)–(3) concern the TTBE itself, whereas for (4) the changes are to the Guidelines. It is worth noting that the Guidelines also introduce a 'safe harbour' for technology pools. Broadly, pools which allow open participation, select only IP rights which are essential (both commercially and technically) and ensure that no sensitive information beyond what is necessary for the creation and operation of the pool is shared, should not give rise to concern.

It is worth remembering that all block exemptions are intentionally drafted restrictively, aiming as they do to provide a 'safe harbour' for agreements/provisions that the Commission believes would be very unlikely to give rise to competition law concern. Although they cajole businesses to draft in line with the safe harbour in the interests of legal certainty, provisions outside the safe harbour may still be individually exempted in particular circumstances if they are not anti-competitive.

Analysis

(1) Grant back provisions: safe harbour removed for all exclusive grant backs

Exclusive grant back provisions give licensors the exclusive right to exploit any improvements made to the licensed technology by the licensee, thereby preventing the licensee from exploiting the improvement itself or licensing it to others.

* Matthew Warren is a partner in the Commercial IP practice, and Osman Zafar a senior associate in the EU & Competition Practice, Bristows LLP, 100 Victoria Embankment, London EC4Y 0DH, UK. Email: matthew.warren@bristows.com; osman.zafar@bristows.com.

The changes. Previously, exclusive grant backs of 'non-severable' improvements (which cannot be exploited without infringing the licensed IP rights) were block exempted, whereas those for 'severable' improvements were not. However, the Commission was concerned that this arrangement discourages follow-on innovation by licensees. The block exemption for all exclusive grant back obligations, whether relating to 'severable' or 'non-severable' improvements, has now therefore been removed. Non-exclusive grant back clauses (ie provisions which allow the licensee to exploit the improvements itself or license them to others) still fall within the TTBE's safe harbour.

Implications for licensors. Licensors may want to consider whether to maintain control over their technology by exploiting it themselves, rather than risk losing control over improvements to third parties. However, *first* licensors should remember that exclusive grant back provisions may still benefit from individual exemption, even if the lack of guidance on individual assessment means that their inclusion comes at the price of legal certainty. *Second*, if an exclusive grant back is found not to be individually exempt, under English law courts must apply the 'blue pencil' test to see whether any part of the clause can be salvaged (severance will be dealt with under the relevant national law). It ought to be possible to draft a licence so that only the part of the provision relating to exclusivity is invalid, enabling the licensor to retain the benefit of a non-exclusive licence. With robust severance provisions, licensors could therefore continue to seek exclusive grant backs, albeit with some doubts over their enforceability. *Third*, if the improvement is 'non-severable', licensors may still be able to sue for infringement of their IP if the licensee licenses the improvement to third parties.

Implications for licensees. In relation to non-severable improvements, licensees may still face challenges from licensors as a consequence of using their own improvements if they make use of the original licensed technology in a way not provided for in the licence, or after the licence has been terminated.

(2) No-challenge provisions: safe harbour removed for 'terminate-on-challenge' provisions in non-exclusive arrangements

A 'no-challenge' provision obliges licensees not to challenge the validity of an IP right. 'Terminate-on-challenge' provisions allow licensors to terminate if the other party mounts such a challenge. Licensors often wish to include such provisions in case a licensee decides that it would prefer to try to knock out the licensed IP rights, rather than continue to pay royalties under the licence agreement.

The changes. No-challenge provisions were previously 'excluded restrictions' requiring individual assessment, although terminate-on-challenge provisions were within the TTBE's safe harbour. The Commission's position on no-challenge clauses remains unchanged. Terminate-on-challenge clauses in *exclusive* licensing agreements are still block exempted, as licensors may otherwise find themselves '*locked into an agreement with an exclusive licensee which no longer makes efforts to develop, produce and market the product*'.

However, terminate-on-challenge clauses in *non-exclusive* licensing agreements are no longer block exempted and must now be individually assessed. The Guidelines make clear that whether a terminate-on-challenge clause is enforceable will require an assessment which balances the public interest in encouraging out-licensing against the public interest in eliminating invalid IP rights. The Guidelines stress that such clauses are unlikely to be enforceable where the licensed IP is either standard essential or commercially essential.

Implications for licensees. Licensees now have more freedom to challenge the validity of licensed IP, with a greater degree of certainty that the underlying IP will continue to be licensed until the outcome of the challenge is determined. This may encourage licensees to challenge IP in order to negotiate lower royalties, particularly towards the end of a licence when the residual IP rights may be weak. Licensees should ensure that they have fulfilled their obligations under the licence at the time of the challenge, in particular concerning royalties, as the Guidelines note that the behaviour of the licensee may be a relevant factor in assessing no-challenge provisions.

Implications for licensors. For licensors exploiting through exclusive arrangements, there is some comfort that they can be contractually protected from any 'lock-in' with a hostile licensee who is challenging the validity of the licensed IP rights. This may be especially important for small- and medium-sized enterprises (SMEs) who often license out to larger licensees on an exclusive basis. Licensors who exploit technology through non-exclusive arrangements will now face greater uncertainty over the enforceability of exclusive grant backs.

(3) Passive sales: safe harbour removed for any restrictions on passive sales

A 'passive' sale takes place when a customer approaches the seller, rather than a seller 'actively' seeking out customers. The old regime block exempted restrictions on passive selling by existing licensees for up to 2 years, into territories exclusively reserved to a new licensee. The ability to grant absolute territorial protection was intended to encourage investment on the part of licensees exploiting the technology in new territories.

The change. There is no longer any block exemption for restrictions on passive sales. In providing guidance on when such restrictions may be capable of individual exemption, the Guidelines reveal that the change of policy is subtle rather than absolute; they still recognise that passive sales restrictions may be tolerated if they are '*objectively necessary for the licensee to penetrate a new market*'. The change therefore puts the onus on parties to assess more thoroughly whether '*substantial investments by the licensee are necessary to* [. . .] *develop a new market*'. If so, the Guidelines still accept that restrictions on passive sales by other licensees might be tolerated '*for the period necessary for the licensee to recoup those investments*', which in most cases would be '*for a period of up to two years*'.

Implications for licensees and licensors. The change in Commission policy, the inherent uncertainty around individual exemption, and the particular risk in relation to 'hardcore' provisions might well be enough to deter most from considering any passive sales restrictions. However, two points should be borne in mind. *First*, in cases where licensee investment is clearly required, parties may still consider absolute territorial protection as long as they: (i) consider the extent of the investment required to facilitate successful exploitation in the new territory; (ii) make a genuine and objectively justifiable estimate as to how long it would take to recoup that investment and limit any restrictions on passive sales accordingly (it remains risky to agree a period beyond two years from the date the product was first put on the market in the exclusive territory, although in principle the Guidelines now recognise that recoupment may take longer); and (iii) document their reasoning at the time of entering into the relevant licence.

Second, licensors may want to explore alternative ways to incentivise licensee investment in a new territory, such as providing technical support and/or marketing/advertising support. Alternative incentives should ideally not relate to the activities of other licensees (especially not to whether passive sales take place into the new territory), but rather should focus on genuine support for the licensee. It may well make commercial and legal sense to limit any incentives to a maximum period of 2 years from the date the product was first put on the market; limiting incentives would help to maintain relationships with pre-existing licensees, as well as be in line with the Commission's general guidance on the periods typically acceptable for recoupment (see above).

(4) Settlement agreements: guidance on 'pay-for-delay' and 'pay-for-restriction' settlements of IP disputes

Most disputes and litigation over the infringement and/or validity of IP rights do not proceed all the way to a court or arbitration determination, but are usually settled earlier by means of settlement agreements. Such agreements often involve the grant of a licence by the owner of the IP rights to the alleged infringer. It is generally recognised that it is in the public interest for disputes to be settled by agreement, rather than proceed all the way through costly and time-consuming litigation. However, the Commission has become concerned about a particular type of settlement that is mainly found in the pharmaceutical sector—so-called pay-for-delay settlements. In these, the IP owner may want to avoid a final determination in litigation, for example, because during the course of the litigation: (i) the alleged infringer may have provided evidence that causes the IP owner to reassess the strength of its IP right and/or the likelihood that it is actually infringed by the relevant product; or (ii) the market for the product concerned may have changed, for example by the introduction of a new product from another competitor that renders the dispute irrelevant commercially. In such circumstances, the IP owner may agree a licence with the alleged infringer, but in return for a payment from the IP owner to the (then) licensee, the licensee agrees not to enter into the market immediately. The Commission has concluded two investigations into these types of settlement arrangements: *Lundbeck (Case COMP/ AT. 39226)* and *Johnson & Johnson/Novartis (Case COMP/ AT. 39685)*. As well as continued monitoring of pharmaceutical patent settlements, it also has two ongoing 'pay-for-delay' investigations: *Servier (perindopril)* (Case COMP/AT. 39612); and *Cephalon and Teva* (Case COMP/AT. 39686). The new Guidelines reflect the Commission's approach in these cases, although the Guidelines will of course apply across all sectors.

The changes. The Guidelines still recognise that settlements remain a '*legitimate*' way to resolve *a* '*bona fide*' disagreement over IP rights. If under a simple settlement the infringer agrees to respect the rights of the IP owner, perhaps with a payment from the infringer to the IP owner to compensate for past infringement, no competition law issues should arise. The Guidelines make clear, however, that any 'pay-for-delay' settlements will come under particular scrutiny. Although not every settlement of an IP dispute will include a licence of a relevant IP right, if it does this brings it under the ambit of the Guidelines, which make clear that if the parties '*are actual or potential competitors and there was a significant value transfer from the licensor to the licensee, the Commission* *will be particularly attentive to the risk of market allocation/market sharing*'. The Commission goes further, by expressing concern also for 'pay-for-restriction' arrangements, where there is a value transfer in exchange for which the licensee accepts some restrictions on its ability to launch the product on any market concerned.

At the heart of any such settlement is a no-challenge provision, whereby the alleged infringer agrees not to challenge the IP rights covered by the settlement. Without such a provision there could be no real settlement of the dispute, as otherwise the alleged infringer would remain free to continue its counterclaim to invalidate the IP right. Although acceptable in '*bona fide*' settlements, the Guidelines note that scrutiny may be necessary if the licensor induces '*financially or otherwise, the licensee to agree not to challenge the validity of the technology rights or if the technology rights are a necessary input for the licensee's production*'.

Implications. Any party contemplating a settlement where there might be any form of value transfer from licensor to licensee, together with any restriction on exploitation by the licensee, must consider competition law risk carefully. *First*, it will be important to identify whether the settlement is one giving rise to concerns of the type identified by the Commission: (i) is there any form of '*value transfer*' from the licensor to the licensee (it is clear the Commission will interpret this broadly, possibly even including licence grants and non-assertion promises); and (ii) is there any delay or other implication for the licensee's ability to launch any relevant products. It is worth noting that settlements of disputes where exclusive territories had been allocated in the EU are more likely to give rise to '*market allocation/market sharing*' concerns, given that the terms of the settlement are likely to distinguish between territories allocated to the licensee and those reserved to the licensor or others.

Second, care should be taken in contemporaneous documents to avoid language which might suggest intent to exclude the licensee from exploiting the technology. Documents/correspondence should also avoid making any link between the value conferred to the licensee and any restrictions imposed on the licensee's ability to exploit.

Third, care should be taken to maintain legal privilege over documents assessing the strength and infringement of IP rights and litigation prospects. The unfortunate exclusion of advice from in-house lawyers from the scope of privilege in EU investigations must be borne in mind, as should the prospect that patent attorneys' advice will not be covered. It is always sensible to identify clearly legal advice and to consider in advance how it falls within the scope of the protection provided by EU law, bearing in mind the Commission's narrow approach to privilege, so as to protect its position should any investigation arise.

Transition period: 1 year to adapt

The transition. Agreements in force on 30 April 2014 which satisfy the conditions of the previous safe harbour will continue to be exempt for another year. After 30 April 2015, these agreements will be subject to the new regime and will either need to be amended to ensure they comply with the new safe harbour or will have to be assessed against the individual exemption criteria.

Implications. First, it is worth considering carefully any arrangements which have just been signed and/or are about to be signed, to ensure that any of the above issues have been identified and considered from the perspective of the new rules. *Second*, any long-term licensing arrangements which are due to expire beyond April 2015 should be revisited. Assuming that these arrangements were considered under the old regime, it would be worth checking to see if any of the types of provisions outlined above were included and if so, whether they are compliant with the new regime or might be considered capable of individual exemption.

Parting thoughts

The new regime will certainly affect the dynamics of licensing negotiations, as all concerned try to take advantage of, or mitigate the risks arising from, the changes introduced. In the short term, this may make agreement harder to reach and may even increase the number of licensing disputes. In the longer term, the pro-licensee nature of the changes may well mean that fewer licences are agreed, and those that are agreed are narrower in scope to mitigate the risks to licensors. As well as drawing up the battlegrounds for licensing negotiations and disputes, the changes outlined above inevitably indicate the types of provisions that the Commission, national authorities, and also national courts will focus on in the coming years. For practitioners, the new regime is therefore certainly worth getting to grips with.

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