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The competition law treatment of no-challenge clauses in licence agreements: an unfortunate revolution?

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The Technology Transfer Block Exemption Regulation and accompanying Guidelines are among the denser of the Commission's instruments. Yet they provide valuable guidance for licensors and licensees as to the application of EU competition law, ensuring that many licences are either within the 'safe harbour' provided by the block exemption or are in line with the Guidelines.

The block exemption and Guidelines which applied since 2004 expired on 30 April 2014.[1] The Commission carried out two consultations on the reform of these instruments, concluding on the basis of its first review in 2012 that the licensing 'industry' was broadly content with the overall approach of the legislation. It therefore indicated that the revision, which was submitted for consultation in early 2013, would be relatively minor—an 'evolution' of the existing position, rather than a 'revolution'.[2] Yet the unusually long delay between the consultation draft being issued and the adoption of a final agreed revised version suggests that not all of the changes were as straightforward as this implies.

Indeed, now that the new TTBER and Guidelines are in place (since 1 May 2014),[3] we can see that at least one small but significant revolution has taken place in the area of no-challenge provisions. These clauses are typically included in licence agreements to avoid a licensee from 'biting the hand that feeds it' and challenging the intellectual property rights that have been licensed to it. Such clauses also form an intrinsic part of settlement agreements, which are unlikely to fulfil the purpose required of them—putting an end to litigation—if a no-challenge provision relating to the litigated patents is omitted.

This article looks at the competition law approach towards no-challenge clauses in licence agreements and what this means for licensors and licensees. The focus is primarily on the position for licences which were entered into at a time where no litigation was on-going or threatened, but reference is made to the position for settlement agreements where this provides a useful perspective.

This article first outlines the approach that has applied in this area under the 2004 TTBER and Guidelines, and the approach which now applies under the new TTBER and Guidelines. It then considers the stated and unstated

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This article

- This article looks at the Commission's treatment of no-challenge provisions in licence agreements. The new technology transfer rules, which came into force on 1 May 2014, adopt a stricter approach to such provisions than was previously the case.
- The Commission's new approach is driven by a policy objective of ensuring that invalid patents do not hamper competition. This article considers the implications of this policy, as well as competing policies such as freedom of contract.
- Finally, the article considers the intended and unintended consequences of the Commission's new policy in this area.

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1 Technology Transfer Block Exemption Regulation, 772/2004 ('2004 TTBER'); Commission Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements (2004/C 101/02) ('Technology Transfer Guidelines (2004)').

2 These terms were used in talks by Commission officials in early 2013 relating to reform of the TTBER/Guidelines.

3 Technology Transfer Block Exemption Regulation, 316/2014 ('new TTBER' or 'the TTBER'); Commission Guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to technology transfer agreements (2014/C 89/03) ('new Guidelines' or 'the Guidelines').

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justifications for the Commission's new approach before turning to the implications of US policies in this area. Following an examination of the limits to the Commission's policy on no-challenge clauses, the article reaches provisional conclusions about whether the Commission's approach is justified. Then, having explored other competing policy implications, it reviews some (possibly unintended) consequences of the Commission's approach, and concludes with a look at the relevance of the Commission's current caseload and recent decisions.

What was the position over the past 10 years?

Under the 2004 TTBER, no-challenge provisions in licence agreements were treated as 'excluded restrictions', listed in Article 5 of the exemption. This somewhat arcane terminology (which is retained in the new TTBER) simply means that, where such a provision is included in an agreement, its compliance with Article 101 of the Treaty on the Functioning of the European Union (TFEU), which contains the EU law prohibition on anti-competitive agreements, must be considered separately from the rest of the agreement, which remains unaffected.

In practice, however, such further consideration has been unnecessary in many cases as the 2004 TTBER itself contained a simple resolution to the problem, at least for agreements which met the market share thresholds. Thus, while absolute no-challenge provisions (which could give a right to damages in favour of the IP owner if breached by the licensee) were not automatically exempt, the 2004 TTBER did exempt agreements which allowed for 'the possibility of providing for termination of the technology transfer agreement in the event that the licensee challenges the validity of one or more of the licensed intellectual property rights'.

This simple arrangement—the so-called 'terminate-on-challenge' provision—has been widely adopted, including in licences which may not fulfil the other requirements for the TTBER, such as the market share thresholds. Few EU licences now include absolute no-challenge provisions except where a settlement of litigation is also involved. Equally, many licences *do* include a terminate-on-challenge provision. The arrangement appears to have provided a reasonable balance between not unduly punishing licensees from challenging rights which appear invalid, and not compelling licensors to continue dealing with parties with which they are in dispute.

The amended approach to terminate-on-challenge provisions in the new TTBER

The effective discouragement of absolute (ie punitive) no-challenge provisions might be regarded as a success. Nonetheless, this approach was swept away when consultation drafts of a new TTBER and Guidelines were published in early 2013. In place of the old regime, the Commission proposed that all no-challenge obligations, including terminate-on-challenge provisions, should be excluded from the scope of the exemption. The stated justification was that '[s]uch a termination right can have the same effect as a non-challenge clause, in particular where the licensee has already incurred significant sunk costs for the production of the contract products or is already producing the contract products.'[4]

This change was probably the most commented-on issue among the respondents to the consultation. While a few were in favour, the majority criticized the proposed change.[5]

Despite the criticism, the new TTBER and Guidelines maintain the approach of the consultation version for most agreements. However, one important concession has been made, which is to exempt terminate-on-challenge provisions in exclusive licences, provided the TTBER market share thresholds are fulfilled. Terminate-on-challenge clauses in non-exclusive licences, by contrast, are no longer protected.

The implications of this approach—which is at once more nuanced than the consultation draft, and stricter than in the 2004 TTBER—are considered further below.

The Commission's new approach: stated and unstated justifications

Despite the concession for exclusive agreements, the majority of no-challenge clauses, including those which merely provide for termination of the applicable licence, will remain outside the scope of the TTBER. Such clauses therefore require justification under Article 101(3) TFEU to be enforceable. This is an onerous requirement, necessitating proof of 'efficiencies' (contribution to technical/economic progress), indispensability, pass-on of benefits to consumers and no elimination of competition. From a legal certainty perspective, it is clearly preferable for the parties for a licence agreement to be within the 'safe harbour' of the TTBER, rather than relying on the possibility of exemption.

4 Draft amended Technology Transfer Guidelines, 2013, para 125. Available at http://ec.europa.eu/competition/consultations/2013_technology_transfer/guidelines_en.pdf (accessed 28 July 2014).

5 See Draft proposal for a revised block exemption for technology transfer agreements and for revised guidelines, Public Consultations. Available at http://ec.europa.eu/competition/consultations/2013_technology_transfer/index_en.html (accessed 28 July 2014).

Perhaps surprisingly, the Commission's primary justification for the new approach appears to be the Court of Justice judgment in *Windsurfing*, a case which pre-dates by some years the introduction of the 2004 block exemption. The Commission refers to this case in the new Guidelines, stating:

> The public interest of strengthening the incentive of the licensor to license out by not being forced to continue dealing with a licensee that challenges the very subject matter of the licence agreement has to be balanced against *the public interest to eliminate any obstacle to economic activity which may arise where an intellectual property right was granted in error*.[6]

Based on the somewhat laconic case report, *Windsurfing* appears not to have concerned a terminate-on-challenge provision, but an absolute prohibition on challenge. The Commission argued at the time that:

> [E]ven where a licensee is only able to challenge a patent because of the information which has become available to him as a result of his privileged relationship with the licensor, the public interest in ensuring an essentially free system of competition and therefore in the removal of a monopoly perhaps wrongly granted to the licensor must prevail over any other consideration,[7]

—an argument which the Court of Justice accepted. Although the Commission has deviated from this position in the intervening years, at least so far as terminate-on-challenge provisions are concerned, it has now brought the Guidelines back into line with its position in *Windsurfing*. The change is justified on the basis that 'licensees are normally in the best position to determine whether or not an intellectual property right is invalid',[8] and that

> [A] termination right can have the same effect as a no-challenge clause, in particular where switching away from the licensor's technology would result in a significant loss to the licensee (for example where the licensee has already invested in specific machines or tools which cannot be used for producing with another technology) or where the licensor's technology is a necessary input for the licensee's production.[9]

As well as reflecting the *Windsurfing* precedent, the policy embodied in these statements appears to be drawn at least in part from US case law.[10] In the USA, it was noted as far back as 1969 (ie well before all of the past 'generations' of the TTBER) in *Lear v Adkins* that 'muzzl[ing]' licensees, who 'may often be the only individuals with enough economic incentive to challenge the patent's validity' is contrary to 'the important public interest in permitting full and free competition in the use of ideas' and may result in 'the public [being] continually . . . required to pay tribute to would-be monopolists without need or justification'.[11]

A line of US cases has followed the rationale of *Lear v Adkins*. For example, in 2012, the Court of Appeal for the Second Circuit applied the *Lear* doctrine to a no-challenge obligation, coupled with a liquidated damages provision, in *Rates Technology v Speakeasy*.[12] The claimant's argument that the 'strong public interest in settling ongoing litigation can justify the enforcement of no-challenge clauses that might otherwise be deemed invalid under *Lear*' was dismissed by the Appeal Court. Even more recently, in its judgment in the 'pay-for-delay' patent settlement case *Actavis*,[13] the US Supreme Court cited *Lear* in holding that such agreements must be reviewed in the light of antitrust, as well as patent, laws.[14]

Relevance of the US cases to the EU context

None of the US cases referred to above concerns quite the same question as that raised by the Commission's proposal to prohibit terminate-on-challenge clauses. *Lear*, for example, was a claim for back royalties, and did not discuss the appropriateness of a clause providing for termination by the licensor in the event of patent challenge.

Rates Technology also concerned an absolute no-challenge provision: the terms of the agreement in question gave Rates Technology, the patentee, the right to liquidated damages of a value of over 24 times that of the licence fee. The licensee therefore faced not only losing its licence and the commercial consequences that entailed, but also severe financial consequences from breaching the contract, as well as patent damages if it continued working the invention. *Actavis* reviewed a 'pay-for-delay' settlement as a whole, with no specific discussion of no-challenge obligations.

These US cases do not deal specifically with the question of termination on challenge; moreover, they are also based on a different legal system. Indeed there are significant, relevant differences in the enforcement of patent law between the US and EU which perhaps makes

6 New Guidelines, above, n 3, para 138; Case 193/83 *Windsurfing International* [1986] ECR 611, para 92 (emphasis added).

7 Judgment in *Windsurfing International Inc. v Commission of the European Communities*, 193/83, EU:C:1986:75, para 91.

8 New Guidelines, above, n 3, para134.

9 Ibid, para 136.

10 Commission officials referred to the relevance US developments when discussing the draft TTBER in public fora, eg at the Office of Fair Trading (OFT)/Intellectual Property Office (IPO) IP and Competition Workshop on Technology Licensing, 7 May 2013.

11 *Lear v Adkins*, 395 US 653 (1969).

12 *Rates Technology Inc v Speakeasy Inc LLC and others*, 685 F 3d 163 (2nd Cir 2012), US Court of Appeals, Second Circuit, 2012. The US Supreme Court refused to review the decision.

13 *Federal Trade Commission v Actavis*, Inc. 570 US (2013).

14 *Rates Technology* at p.8 ('discussion').

the unquestioning import of US principles inappropriate. The new Guidelines refer to the idea that a terminating licensee may face 'significant risks which go far beyond its royalty obligations'. Yet unlike in the US, a licensee that terminates an agreement in the EU is not at risk of the vagaries of a jury damages award, or of possible treble damages if it continues working the invention.[15] If one assumes that a licensee would challenge the licensed right only if it believed it had a reasonable prospect of proving invalidity, the stakes of a possible ultimate validation of the patent are arguably lower in the EU. The prospect of the patentee obtaining interim injunctive relief being granted will often also be relatively low. In many cases, patentees will find it difficult to support such a claim as their loss will be purely financial. If the licensee was non-compliant with the terms of the licence at the time of the challenge (eg had not paid the royalties due in full), a factor which might increase the risk of an interim injunction being awarded, the new Guidelines recognize that the licensor may be justified in terminating on challenge in any event.

It appears, therefore, that the policy objective pursued by *Lear v Adkins* of ensuring that invalid patents are revoked may be achieved even without a blanket ban on all types of no-challenge provision. But is it justified in any event? IP rights are, after all, already a derogation from the free trade in ideas, granted because (so goes the theory[16]), innovation is encouraged by offering a period of protection against free-riding. Indeed, competition authorities in the EU and US explicitly recognize the benefits of IP protection for long-run competition.[17] By contrast, invalid IP rights are said to be a millstone on the economy, limiting innovation, competition and downward pricing pressure.[18]

It is widely accepted that invalid patents may have the potential to chill further innovation and the entry of competitors.[19] Patents are registered rights, the existence of which can be checked. Granted patents probably will sometimes deter market entry. In some cases, those patents would have been revoked if litigation had been brought and pursued to judgment.

What are the limits to the Commission's policy?

But is this possibility of a chilling effect sufficient to condemn any action which could maintain a potentially invalid patent? It is clear that it is not necessary to take every possible opportunity to seek patent revocation—if this were so, any licence grant (even leaving aside no-challenge clauses as such) would be viewed as a lost opportunity to litigate the validity of the patent. The Commission also explicitly endorses patent settlement agreements in general, provided there is no 'value transfer' (ie a payment or other value being transferred from a patentee to the alleged infringer).[20] As mentioned above, it now also accepts that terminate-on-challenge provisions are acceptable in exclusive licences between players which fulfil the TTBER market share thresholds. The reason given is that in such cases, the exclusive licensor is in a situation of dependency vis-à-vis the licensee. The Guidelines state:

> In this scenario, the incentives for innovation and licensing out could be undermined if, for example, the licensor were to be locked into an agreement with an exclusive licensee which no longer makes significant efforts to develop, produce and market the product.[21]

15 The liquidated damages provision in *Rates Technology* (supra), and equivalents in other contexts, relate only to the remedy for the breach of contract; any remedy for patent infringement would need separate consideration.

16 There are numerous alternative justifications for patent protection, as summed up by Nicolas Petit '"Stealth Licensing"—Or Antitrust Law and Trade Regulation Squeezing Patent Rights', Working Paper (19 April 2014). Available at http://ssrn.com/abstract=2426782 (accessed 28 July 2014).

17 See eg Technology Transfer Guidelines (2004), above, n 1, para7, stated:

> Innovation constitutes an essential and dynamic component of an open and competitive market economy. Intellectual property rights promote dynamic competition by encouraging undertakings to invest in developing new or improved products and processes. So does competition by putting pressure on undertakings to innovate. Therefore, both intellectual property rights and competition are necessary to promote innovation and ensure a competitive exploitation thereof.

18 For example, the Commission's contribution to the Organisation for Economic Co-operation and Development roundtable on Competition, Patents and Innovation (2009), DAF/COMP(2009)22 noted at p. 155: 'it is increasingly being recognised that patents and the patent system may not always stimulate innovation but may also be used for other defensive purposes and may retard (follow-on) innovation'. The Pharmaceutical Sector Inquiry report also recognized this.

19 For example, Sir Robin Jacob notes that 'the longer a patentee can keep uncertainty going even for a patent ultimately shown to be invalid, the worse': see R Jacob, 'Patents and Pharmaceuticals–a Paper given on 29th November at the Presentation of the Directorate-General of Competition's Preliminary Report of the Pharma-sector inquiry', 2008, available at http://ec.europa.eu/competition/sectors/pharmaceuticals/inquiry/jacob.pdf (accessed 28 July 2014); similarly, a report prepared by Charles River Associates for the Commission on Multiparty Licensing notes: 'There is no doubt that invalid patents exist and that they can create a problem if they are enforced. This unnecessarily increases costs: see Robert C. Lind, Anya V. Kleymenova, Marie Miauton and Paul Muysert, (Charles River Associates), Report on Multiparty Licensing, 22 April 2003, p. 78. Available at http://ec.europa.eu/competition/antitrust/legislation/multiparty_licensing.pdf (accessed 28 July 2014)'.

20 For example, the New Guidelines, above, n 3, para 235, state:

> Settlement agreements in the context of technology disputes are, as in many other areas of commercial disputes, in principle a legitimate way to find a mutually acceptable compromise to a bona fide legal disagreement. The parties may prefer to discontinue the dispute or litigation because it proves to be too costly, time-consuming and/or uncertain as regards its outcome. Settlements can also save courts and/or competent administrative bodies effort in deciding on the matter and can therefore give rise to welfare enhancing benefits.

21 Ibid, para 139.

The new Guidelines add that there may be situations where even absolute non-challenge clauses are acceptable. The examples given are where 'the licensed technology is related to a technically outdated process which the licensee does not use, or if the licence is granted for free', wording drawn from the decision of the Court of Justice in *Bayer v Süllhofer*[22] but which is hard to reconcile with the general position that 'invalid intellectual property stifles competition rather than promoting it'.[23] Even if the particular licensee does not pay for the technology, it may act as an obstacle to others.

The rooting out of invalid patents is therefore not an absolute imperative, and such patents may not in fact be irredeemably bad for competition. This is probably a fair appraisal: even a patent which ultimately proves to be invalid has been placed in the public domain and may have inspired follow-on invention. It cannot therefore be excluded that inventions may be useful even if they do qualify as valid patents (just as the converse is probably also true: granted patents are not always useful for society). Patents are invalidated for a wide array of reasons, but only sometimes is the patentee is aware at the time of application of the likelihood of revocation. If it is accepted that patents are worth protecting (as signatory States to the Paris Convention[24] and the TRIPS Agreement[25] have), it must also be accepted that some measure of invalidity is inevitable.[26]

The policy in favour of the free circulation of ideas, and the consequential benefits for innovation, is thus evidently not absolute, but its limits are far from clear.

Is the Commission's policy direction justified?

The Commission's approach suggests it is justifiable to impede existing innovators from protecting the fruits of their innovation and investment against challenge by a licensee who is also a potential future innovator. But is this in fact an appropriate means for reducing the possible chilling effect of patents which are ultimately proved invalid? There are a number of reasons why it is arguably not:

- First, apart from in a few specific contexts (eg where a FRAND undertaking has already been given) licences are usually granted voluntarily, and not pursuant to some obligation to license. In the absence of a licence, licensors are usually entitled to enforce their exclusive rights against users, including by seeking injunctive relief and damages. Even dominant companies are obliged to license out their IP rights only in 'exceptional' circumstances;[27]
- Secondly, the granting of licences is recognized to be of broad benefit to the economy and to competition, as it disseminates the fruits of innovation more widely around society, allows for competition in the products implementing the technology, and may lead to follow-on innovation;
- Thirdly, licensees have a choice about whether or not to take a licence, or to risk infringing in the belief that the patent is invalid—and licensees are able to, and do, conduct due diligence in order to decide how to proceed before taking the licence and becoming 'locked in'. There is always an option for the licensee to seek revocation of the patent at this stage;
- Fourthly, the reference to 'invalid' IP rights suggests some measure of objective certainty about the validity of the right which is absent at any point in time before a final judicial decision has been reached: there are manifold examples of patent cases which have been decided in different ways at first instance and on appeal, or in different jurisdictions. While a patent which is ultimately invalidated is legally deemed to have been invalid throughout its putative life, the contrary is also true (ie a revocation at first instance followed by reinstatement means that the period of apparent invalidity is irrelevant to the patentee's ability to recover royalties/damages for that period). This has been described as the 'Schrödinger's Cat' problem,[28] and is perhaps the key reason why competition policy struggles to find coherent strategies for dealing with cases involving patents which might, or might not, ultimately have been revoked;

22 Judgment in *Bayer v Süllhofer*, 65/86, EU:C:1988:448. Treacy and Lawrance observed: 'The justification for these dicta is not obvious. . . . In fact, assuming the licensed technology is not in fact so outdated as to lack any objective value, granting a free licence might be seen as a "value transfer" (to use the words of the Sector Inquiry Report) to the licensee'. See P Treacy and S Lawrance 'IP Rights and Out of Court Settlements' in S Anderman and A Exrachi (eds), *Intellectual Property and Competition Law—New Frontiers* (Oxford University Press Oxford 2011) p. 277 at 285.

23 New Guidelines, above, n 3, para 134.

24 Paris Convention for the Protection of Industrial Property 1883 (last amended 1979), 21 UST 1583, 828 UNTS 305 ("the Paris Convention").

25 Agreement on Trade-Related Aspects of Intellectual Property Rights, Annex 1C of the Marrakesh Agreement Establishing the World Trade Organization, 15 April 1994, 1869 UNTS 299; 33 ILM 1197 (1994) ("TRIPS").

26 Further informal considerations of these issues can be found in S Lawrance and O Zafar 'The revised technology transfer regime: is there more to patents than their validity?' The CLIP Board Blog 8 May 2014), available at www.bristowsclipboard.com/post/the-revised-technology-transfer-regime-is-there-more-to-patents-than-their-validity (accessed 28 July 2014).

27 Judgment in *RTE & ITP* v *Commission & Magill TV Guide*, C-241/91, EU:C:1995:98; Judgment in *Microsoft v Commission*, T-201/04, EU:T:2007:289.

28 That is, they might prove ultimately valid or invalid if litigated: R Stern '*FTC v Actavis*: Patent Validity, Schrödinger's Cat and Reverse Payments' (2013) 12 EIPR 743.

- Finally, removing a single invalid patent from the register will not always have any significant impact on the obstacles facing would-be implementers, or other innovators in the same area. Take the case of large portfolio licences in the IT/telecoms sectors. The revocation of a single right, or even a sizeable number of such rights, has minimal impact on the ability of the patentee to block third parties, since hundreds of further rights remain in force. Where licences involving tens or hundreds of patents are concerned, revocation of a few is also unlikely to have much impact on the licence fees. Indeed, the US courts have accepted in the patent pool context that the relationship between royalties and the number of patents licensed is not linear.[29]

More generally, innovators seek patent protection because it gives them a chance to obtain financial reward for their innovation. It is often argued that serious change to the patent system could risk unbalancing the complex interplay of incentives. Even new, disruptive innovators of the type which seem to be favoured by Commission policy (as evidenced by the approach of the new TTBER in relation to grant-back obligations as well as no-challenge clauses) may be discouraged if it becomes more difficult to maintain effective patent protection or to license out on terms acceptable to the right holder.

None of this would be so much of a problem for companies which wish to include a no-challenge provision in their licences, if justification under Article 101(3) TFEU were not so difficult. The new Guidelines provide some limited guidance on justifications for termination on challenge provisions which relate to know-how, notably where the know-how will be very difficult to recover once it has been disclosed and in particular where a licensor with a relatively weak market position is licensing a stronger licensee[30] (know-how also has relatively less potential to chill innovation than exclusionary, registered IP rights such as patents, which is surely a motivating factor for the Commission's more lenient treatment.)

There is, however, less clear guidance on what justification might be available for patents. The relevance of the licensor being in a situation of dependency vis-à-vis the licensee is a relevant consideration, as noted above.[31] The new Guidelines also state that a terminate-on-challenge provision

> can have the same effect as a no-challenge clause, in particular where switching away from the licensor's technology would result in a significant loss to the licensee (for example where the licensee has already invested in specific machines or tools which cannot be used for producing with another technology) or where the licensor's technology is a necessary input for the licensee's production.[32]

The concept of the technology being 'necessary' to the licensee is also a feature of the guidance on no-challenge provisions in the context of settlement agreements.[33] Given that a licence would normally be granted only where the licensee needs it, this either suggests that such provisions are hardly ever going to be justifiable, or that the yardstick is not a good one.

In any event, the Commission also notes that:

> Article 101(1) of the Treaty is likely to apply to no-challenge clauses *where the licensed technology is valuable* and therefore creates a competitive disadvantage for undertakings that are prevented from using it or are only able to use it against payment of royalties. In such cases the conditions of Article 101(3) are unlikely to be fulfilled.[34]

Given that terminate-on-challenge provisions are said to have the same effects on competition as absolute no-challenge clauses, it would be unwise, in the light of the Commission's guidance, to rely on the possibility of exemption, apart from for the limited category of exclusive agreements where the market share thresholds are fulfilled.

Equally, the nature of no-challenge provisions is not the same as that of hard-core restrictions of competition. Including such a clause in an agreement, even where the TTBER market share thresholds are not met, is unlikely to jeopardize the competition compliance of the agreement as a whole. Nor, taken alone, is it likely to give rise to abuse of dominance issues. The question is essentially one of enforceability and some licensors may consider that the risk of the clause being unenforceable is worth taking, given that it may have a deterrent effect on the licensee in any event. It is this deterrent effect that the Commission is concerned about but, given the treatment of such clauses as excluded rather than hard-core restrictions, the risk to licensors of including such provisions may be thought to remain relatively low. Well-informed licensees may also take the view that the prospects of the licensor successfully relying on such a clause is relatively

29 *Philips v ITC & Princo*, Case 04-1361, Court of Appeals for the Federal Circuit, 424 F.3d 1179 (Fed. Cir. 2005), 21 September 2005. It is possible that the aspects of this case relating to the joint licensing of essential and non-essential technologies would not be decided in the same way in the EU, given the rules on bundling by dominant undertakings and the Commission's position on this issue in the New Guidelines. However, the question of a reduction in the number of licensed rights must always reduce royalties has not been decided in the EU.

30 New Guidelines, above, n 3, para 140.

31 Ibid, para 139 n 67.

32 Ibid, para 136, emphasis added.

33 Ibid, para 243.

34 Ibid, para134, emphasis added.

low, thus (paradoxically) reducing the deterrent effect and the effect on competition.

Is freedom of ideas the only policy in play?

As well as the policy position on potentially invalid patents, there are a number of competing policies to be taken into account. One such policy is that which favours permitting the settlement of litigation, which appears to trump that in favour of the free circulation of ideas in some cases. This is true of US case law, at least where the settlement is confirmed by the court,[35] and is acknowledged in the new Guidelines.

The Commission's position on this issue has, however, been somewhat watered down in the new Guidelines, compared with its previous position. The 2004 Guidelines contained a clear statement that, '[i]n the context of a settlement and non-assertion agreement, no-challenge clauses are generally considered to fall outside Article [101](1)'.[36] This gave way in the draft Guidelines to the rather more mistrustful '[i]n the context of a *bona-fide* settlement agreement, no-challenge clauses are generally considered to fall outside Article 101(1)'.[37] The reference to '*bona fide* legal disagreement[s]'[38] is retained in the final text of the new Guidelines. It should also be recalled that the Commission's apparent endorsement of no-challenge clauses in settlement agreements if of limited application. As the name suggests, the Technology Transfer Guidelines are relevant only for analysing agreements providing for the transfer of technology by licensing. The new Guidelines specifically point this out in the context of the discussion of no-challenge arrangements in settlement agreements. It is therefore understood that the Commission claims to give guidance only in the situation where a settlement of litigation also involves a licence agreement.[39]

Two other competing policies appear to be less favoured. First, as already discussed, the policy in favour of encouraging innovation is drawn directly into question. This is arguably the equal and opposite of the freedom of ideas policy, save that proponents would argue that the granting of a limited patent monopoly right to the first to invent is what drives the currency in ideas in the first place. The Commission acknowledges the importance of encouraging innovation, but appears to focus only on direct impacts on future innovation, not on broader effects on incentives if doubt is cast upon the ability of existing innovators fully to protect their technologies.

Secondly, the policy in favour of freedom of contract (at least between businesses) is also in play. The possibility for licensors to include terminate-on-challenge clauses in an agreement is a manifestation of the concept of freedom of contract in its purest form: the right of a company to agree to deal with another, and the circumstances in which this willingness to deal may come to an end.

In order to assess how this policy should be balanced against that in favour of the free trade in ideas, it is worth briefly considering the role of freedom of contract in EU law. Freedom of contract is a legal principle recognized by many EU Member States and which therefore has special status in EU law.[40] It is an essentially liberalist principle which treats companies as competent and well advised, in contrast with more protectionist principles which approve of intervention designed to assist the weaker counterpart to an agreement. Even in its least interventionist form, competition law (at least Article 101 TFEU and national equivalents) necessarily represents an incursion on freedom of contract. Nevertheless, competition law does respect the principle to some degree—for example, an obligation to license exists only in 'exceptional circumstances',[41] and in *Oscar Bronner*, Advocate General Jacobs noted that 'the laws of the Member States generally regard freedom of contract as an essential element of free trade'.[42] He emphasized the importance of ensuring that companies' incentives to invest in innovation are not affected.

While some deference is thus shown to freedom of contract, it never attains the quality of an absolute rule. This is clear also outside the competition law context, for example in the various efforts to establish pan-EU contract law principles. The Principles of European Contract Law (PECL), for example, a project developed in response to European Parliament resolutions of 1989 and 1994, provide that parties should be free to enter

35 See the discussion in *Rates Technology*, above, n 12, 170.

36 Technology Transfer Guidelines (2004), above, n 1, para 209.

37 Draft Amended Guidelines, above, n 4, para 226.

38 Technology Transfer Guidelines (2004), above, n 1, para 235.

39 A further complexity is that licences granted in the context of settlement of litigation count as 'value transfers', which are liable to make the settlement unlawful (cf European Commission, 4th Report on the Monitoring of Patent Settlements (period: January–December 2012), published 9 December 2013, available at http://ec.europa.eu/competition/sectors/pharmaceuticals/inquiry/patent_settlements_report4_en.pdf (accessed 28 July 2014), para 12: 'A value transfer could furthermore consist in granting a licence to the generic company enabling it to enter the market'). It is therefore unclear when this guidance might be applicable.

40 Judgment in *AM&S Europe Ltd v Commission* 155/79, EU:C:1981:29, para 18: 'Community law, which derives from not only the economic but also the legal interpenetration of the Member States, must take into account the principles and concepts common to the laws of those States.'

41 Judgment in *Magill*, above, n 23, and Judgment in *Microsoft*, above, n 23.

42 Judgment in *Oscar Bronner GmbH v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH*, C-7/97, EU:C:1998:569, para 53.

into a contract and to determine its contents. However, these rights are subject to requirements of good faith and fair dealing and other mandatory principles established by the PECL.[43] Similarly, the Guiding Principles of European Contract Law (GPECL),[44] a comparative law study examining how principles of freedom of contract, contractual certainty and contractual fairness are dealt with (inter alia) in the laws of selected EU Member States and Switzerland, point out that the laws of all of the states in question apply similar mandatory rules limiting the application of freedom of contract.[45]

Freedom of contract is thus clearly not an absolute justification for patentees' right to include no-challenge provisions, but nor is it a principle which can/should be entirely disregarded in EU law. Given that a balancing seems appropriate, it is worth turning to look at how an effective prohibition on (most) terminate-on-challenge provisions will work in practice.

Unintended consequences of the Commission's new approach?

In choosing to limit freedom of contract by prohibiting terminate-on-challenge clauses in most cases, the Commission indicates a preference for protecting licensees. This is also true of another change to the 'excluded restrictions' section of the TTBER. Under this amendment, all contractual provisions requiring the grant back of licensee innovations to the licensor are now excluded from the safe harbour. This is a step-change from the old position which allowed licensors to require 'non-severable' improvements to be licensed back. The New Guidelines note that the purpose of Article 5 of the TTBER is to 'avoid block exemption of agreements that may reduce the incentive to innovate'.[46] The aim seems to be to ensure that licensees get what they bargained for, and that the licensor should not be able to take back something which it had handed voluntarily to the licensee, in case this has an adverse impact on the licensee's own innovations.

It is worth comparing these provisions with the position under Article 102. It has been observed that a number of types of abuse of dominance case, such as refusal to supply, can be analysed by reference to the English law doctrine of estoppel:[47] the dominant company is 'estopped' from behaving to the detriment of the other party once a particular course of conduct has been established. The proposed prohibition on terminate-on-challenge provisions has something of this flavour. Yet a licensor is not necessarily dominant. Indeed, it is of necessity *not* dominant if it qualifies under the TTBER market share thresholds.[48]

One of the more powerful objections to the revised approach to no-challenge clauses in the Draft Technology Transfer Guidelines (2013) raised by respondents to the Commission's latest TTBER consultation related to the Commission's assumption that, when licences are being negotiated, it is always the licensor which holds the bargaining chips, and the licensee which is in need of protection.[49] In fact, the opposite may equally be true. If it is the licensee that holds the stronger position at the negotiation stage, it is likely to continue to do so when the licence has been granted. There is scope for significant gamesmanship by a licensee which is party to a licence without a terminate-on-challenge provision: it may easily find itself in the protected position of being licensed, while gaining the real possibility of being able to cease paying the licensor if it secures the revocation of the licensed right. Indeed, provided the licensee is compliant with the terms of the licence, including royalty payments, as at the date of challenge, it may even be able to stop making payments while the challenge is ongoing. This possibility is not excluded in the new Guidelines,[50] although well-advised parties would ensure as a minimum that the royalties due during the period of challenge should be set aside, for example in an escrow account, in case the challenge is unsuccessful.

This scope for such gamesmanship has been at least partially acknowledged by the Commission, which has offered the possibility for terminate-on-challenge provisions to be included in exclusive licences where the TTBER market share thresholds are met. Even with this concession, designed to protect smaller licensors who are reliant on the

43 Principles of European Contract Law, Art 1:102 (PECL). Available at http://frontpage.cbs.dk/law/commission_on_european_contract_law/PECL%20engelsk/engelsk_partI_og_II.htm (accessed 28 July 2014).

44 B Fauvarque-Cosson and D Mazeaud (eds), *European Contract Law. Materials for a Common Frame of Reference: Terminology, Guiding Principles, Model Rules* (Sellier Munich 2008). Available at http://www.legiscompare.fr/site-web/IMG/pdf/CFR_I-XXXIV_1-614.pdf (accessed 28 July 2014).

45 Guiding Principles of European Contract Law, Pt II, para 12 (GPECL).

46 New Guidelines, above, n 3, para 128.

47 K Coates 'The Estoppel Abuse' 21st Century Competition Blog (28 October 2013), available at http://www.twentyfirstcenturycompetition.com/2013/10/the-estoppel-abuse/ (accessed 28 July 2014).

48 TTBER, above, n 3, Art 3.

49 See eg European Commission Public Consultation on Draft Proposal for a Revised Block Exemption for Technology Transfer Agreements and for Revised Guidelines, UK BioIndustry Association Response, 2013, available at http://ec.europa.eu/competition/consultations/2013_technology_transfer/bia_en.pdf (accessed 28 July 2014).

50 New Guidelines, above n 3, para 138, state: 'it should be taken into account whether the licensee fulfils all the obligations under the agreement at the time of the challenge, in particular the obligation to pay the agreed royalties', but are silent on whether royalties remain payable pending outcome of the challenge.

income stream from licensing, it remains the case that there will be licensors who wish to grant non-exclusive licences or which may be active in very narrow markets (and so will not meet the TTBER market share thresholds) which will now be uncertain about their ability to enforce a terminate-on-challenge provision.

The disadvantages for licensors of this policy development are fairly clear. There may, however, also be several less obvious disadvantages for licensees. For example, as challenging licensees would potentially stop paying royalties if the challenge is successful (or, as discussed above, potentially even during the period of the challenge) licensors have a strong incentive to 'front-load' royalty payments. Until now, where a licence was granted in circumstances where the licensee has to do some development work in order to have a product ready for market, royalty payments were likely to be structured so that they increased towards the end of the term of the licence, when the licensee has an income stream (although milestone payments may be made earlier). The new policy alters this incentive.

Licensors may also seek to reserve broad general rights of termination to compensate for the lack of a specific right associated with a challenge to the licensed IP. This raises the question of how other types of termination provisions in commercial agreements should be dealt with. Termination provisions are usually regarded as competitively benign, and it would normally only be a prohibition on termination (ie a lock-in type situation) which would risk giving rise to competition concerns.[51] However, it must be assumed that, if a terminate-on-challenge provision is invalid, a broad, no-fault termination right in favour of the licensor would be similarly problematic. The Commission's approach involves the idea that the existence of a terminate-on-challenge clause discourages the challenge to innovation, and does not rely on the clause being exercised. The same would presumably apply to expansive termination provisions, yet licensors might regard these as commercially essential for completely different reasons. Where is the line going to be drawn?

There are further potential consequences for the scope of licences. Smaller licensors may well want to consider exclusive licensing, although this will impact on the licensor's ability to use the right itself (except in reserved territories, etc). This may affect licensees if licensors wish to secure higher income from the only licensee, rather than to obtain income streams from a number of licensees.

There may also be an increased tendency for licensors to seek to license out a number of patent rights simultaneously, in order to reduce the likelihood of the licensee raising challenges to all of the licensed rights, and stopping royalty payments in consequence. The practicality of this will vary depending on the technology being licensed. In any event, the dynamics are different in industries were the licensing of one or a handful of patents is the norm (eg the pharmaceutical industry) and those where broad licences of patent portfolios are more common (eg IT, telecommunications). In the latter context, the policy downsides of permitting licence termination in circumstances where a licensee challenges one out of many licensed patents are much clearer, in particular if the technologies involved are standard essential, as the Commission notes in the Guidelines.[52] Equally, the competition problem is arguably solved by limiting termination rights to the challenged patent only, and leaving other licensed rights in place.

Competing policies: which is right?

There are a number of competing policies in this area, and it is not easy to be certain that the policy that the Commission has elected to favour is the right one.

The Commission's approach in this area has been driven not only by policy in the abstract, but arguably also by its current case load. The 10 years following the implementation of the 2004 TTBER did not throw up many EU level cases about patent licensing. Only the investigation into Qualcomm indirectly concerned this area, albeit within the framework of abuse of dominance, and that case was closed following a settlement between Qualcomm and the complainants.[53]

However, more recently, the Commission has been considering at least two types of cases which do raise significant issues relating to licensing and no-challenge: the pharmaceutical settlement agreement cases (notably *Lundbeck*, in which a decision was announced by the Commission in June 2013[54]), and the cases concerning the assertion of standard essential patents.[55] The *Motor-*

51 That is, a similar concern to non-compete provisions which last for a period over five years, or where a licensee is forced to keep paying royalties for technology which it does not need. Cf Technology Transfer Guidelines (2004), above, n 1, para 264(d).

52 New Guidelines, above, n 3, para 136.

53 'Antitrust: Commission closes formal proceedings against Qualcomm', MEMO/09/516, 24 November 2009.

54 European Commission, 'Antitrust: Commission fines Lundbeck and other pharma companies for delaying market entry of generic medicines' Press Release IP/13/563 (19 June 2013); *Lundbeck and others* (Case COMP/AT 39226), Commission decision of 19 June 2013, not yet published.

55 Investigations into Samsung and Motorola were closed by commitments and infringement decisions (without fine, due to the novelty of the case) respectively on 29 April 2014. *Samsung* (Case COMP/AT 39939), Commission decision of 29 April 2014; *Motorola* (Case COMP/AT 39985),

ola decision announced at the end of April 2014 reveals that the ability of implementers to maintain challenges to patent rights is regarded by the Commission as of fundamental importance in the context of standard essential patent licensing. The Commission therefore decided that it is a breach of Article 102 TFEU for Motorola to insist, under the threat of the enforcement of an injunction, that an implementer/would-be licensee give up its rights to challenge the validity or infringement of Motorola standard essential patents in order to receive a licence. The press release issued by the Commission explains that

> Implementers of standards and ultimately consumers should not have to pay for invalid or non-infringed patents. Implementers should therefore be able to ascertain the validity of patents and contest alleged infringements.[56]

The Commission appears with this decision to seek to maintain a balance between licensors and licensees, while also supporting the policy in favour of the revocation of invalid patents. But if companies such as Motorola, which necessarily grant non-exclusive licences to their standard essential patents, are unable to include any no-challenge provision in their agreements, this surely risks the perpetual continuation of the smartphone wars, even after a settlement has apparently been reached.

Any appeals arising from the *Motorola* and *Lundbeck* decisions[57] may provide an opportunity for the General Court to consider some of these issues and, potentially, to update the position in the rather old cases such as *Windsurfing*, and *Bayer v Süllhofer*, discussed above. Ultimately, if the European Courts take a different approach to the Commission, the new TTBER and Guidelines would be undermined, since the case law of the European Courts takes precedence over Commission guidance.

In the meantime, licensors have a choice between including no-challenge provisions in their agreements, relying on their deterrent effect but taking the risk that they may be unenforceable, or accepting the commercial risks of licensing without the protection afforded by such clauses.

Commission decision of 29 April 2014 (published 9 July 2014). Cf. 'Antitrust: Commission accepts legally binding commitments by Samsung Electronics on standard essential patent injunctions', press release IP/14/490, 29 April 2014; 'Antitrust: Commission finds that Motorola Mobility infringed EU competition rules by misusing standard essential patents', press release IP/14/489, 29 April 2014; and Antitrust decisions on standard essential patents (SEPs) – Motorola Mobility and Samsung Electronics – Frequently asked questions, MEMO/14/322, 29 April 2014.

56 'Antitrust: Commission finds that Motorola Mobility infringed EU competition rules by misusing standard essential patents', press release IP/14/489, 29 April 2014.

57 Outline details of Lundbeck's grounds of appeal can be found at *H. Lundbeck and Lundbeck v Commission*, (Case T-472/13), OJ [2013] C325/47.