

# Patent Royalties And Competition Law: The *Genentech* Judgment Of The Court Of Justice Of The European Union

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On 7 July 2016, the Court of Justice of the European Union (“CJEU”), the highest court in Europe, held that a requirement to pay royalties for the licensed use of a patented technology for the entire duration of the license is not contrary to competition rules in the event of the revocation or non-infringement of the patent at issue (Case C-567/14, *Genentech v. Hoechst and Sanofi-Aventis*).<sup>1</sup> This ruling shifts the balance back in favour of the licensors, while recent case law as well as the Commission had emphasised that licensees must always remain free to challenge licensed IP rights. But what is the point of successfully challenging the licensed IP right if the royalties simply keep running?

### Background

Article 101, paragraph 1 of the Treaty on the Functioning of the European Union (“TFEU”) prohibits all agreements and other arrangements between undertakings that have as their goal and/or effect to appreciably restrict or distort competition within the EU internal market. Transactions involving intellectual property rights, such as licensing agreements, may fall within the purview of this Article. Paragraph 3 of the same Article contains an exception to the aforementioned prohibition if the licensing agreement/arrangement at issue is proportionate and in fact has procompetitive effects (as set forth in the Technology Transfer Block Exemption Regulation).<sup>2</sup>

In the context of licensing agreements, the prohibition set forth in article 101 TFEU entails several risks, such as the unenforceability of the license agreement, the possibility of having to pay private damages and the

threat of fines and administrative sanctions. Whether or not a license falls within the scope of this prohibition is therefore of paramount importance.

### The Facts of the Dispute Between Genentech and the Sanofi-Aventis Group

The German company Behringwerke AG, now part of the Sanofi-Aventis pharmaceuticals group, was the owner of a European Patent, granted in 1992, as well as two U.S. Patents, issued in 1998 and 2001, in relation to the use of a human cytomegalovirus enhancer (the “HCMV enhancer”). Behringwerke granted a worldwide non-exclusive license to this technology to Genentech. Genentech subsequently used the virus enhancer to facilitate the transcription of a DNA sequence for the production of a biological medicinal product, marketed by Genentech in the EU as well as the U.S.

In the license agreement, Genentech undertook to not only pay a one-off fee and a fixed annual research fee, but also a running royalty of 0.5 % on the net sales of so-called “finished products.”

On January 12, 1999, Behringwerke’s European Patent was revoked.

Genentech duly paid the one-off fee and the fixed annual research fee mentioned above but, in light of the revocation of the patent, refused to pay the running royalty to Hoechst, Behringwerke’s successor company.

In 2008, the licensor enquired about the finished products Genentech had marketed without payment of the running royalty. Following this enquiry, Genentech terminated the agreement unilaterally. The licensor then filed arbitration proceedings against Genentech. In the course of these proceedings, Genentech argued that it was not required to pay the running royalty, since, according to the terms of the license agreement, the payment of that royalty was based on the supposition (i) that the HCMV enhancer was present in the finished product at issue and (ii) that the manufacture or use of that enhancer had, in the absence of that agreement, breached the rights attached to the licensed patents. In the end, the arbitrator denied Genentech’s claim for reimbursement of the up-front and annual fees and forced Genentech to pay the running royalty. In this regard, the arbitrator reasoned that

1. CJEU, Judgment of 7 July 2016 in Case C-567/15 between Genentech Inc. and Hoechst GmbH and Sanofi-Aventis Deutschland GmbH, available at <http://curia.europa.eu/juris/document/document.jsf?jsessionid=9ea7d2dc30d52c476097d444421cb146ccb3dbd686b7.e34KaxiLc3qMb40Rch0SaxyKax50?text=&docid=181463&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=1150545>.

2. Communication from the Commission—Guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to technology transfer agreements, OJ C 89, 28.3.2014, p. 3-50, [http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52014XC0328\(01\)&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52014XC0328(01)&from=EN).

Genentech had agreed to pay the licensors in consideration for the certainty of averting patent litigation and that Genentech had subsequently received the benefit of this certainty.

In the context of proceedings for annulment of the arbitral award, brought by Genentech, the Paris Court of Appeal referred a number of questions to the CJEU regarding the compatibility of the agreement with competition law. More specifically, insofar as the license agreement required the licensee to pay royalties which did not serve any purpose in view of the revocation of the European Patent and Genentech's non-infringement arguments, the licensee was confronted with a competitive disadvantage (estimated at 169 million EUR by Genentech). This motivated the court to call into question the agreement's compatibility with the abovementioned Article 101 TFEU.

## A Question of Admissibility

Before delving into the substantive issues tackled by the CJEU in the *Genentech* decision, it should be noted that a considerable part of this judgment was devoted to a purely procedural element, namely the question of admissibility of the questions referred by the Paris Court of Appeal. Indeed, both the licensors and the French Government argued against admissibility, claiming *inter alia* that the arbitration clause agreed upon by the parties excluded the intervention of the CJEU in the present case. Indeed, under French rules of procedure, an international arbitral award may only be reviewed in case of flagrant infringement of international public policy. However, the CJEU dismissed their objections and declared the questions admissible.

## The CJEU Judgment of 7 July 2016

According to the CJEU, who largely agreed with Advocate General Wathelet's Opinion in this case, the type of license agreements at issue are not necessarily problematic in view of EU competition law. In reaching this decision, the CJEU referred to the *Ottung* judgment (Case C-320/87).<sup>3</sup> In this judgment, the CJEU decided that an obligation to pay royalties after the expiry of the period of validity of a licensed patent could be compatible with 101 TFEU, provided that the licensee is at liberty to terminate the agreement by giving reasonable notice. The CJEU considered that such an obligation could reflect a commercial assessment of the value attributed to the possibilities of exploitation granted by the license agreement and that it was not *per se* anticompetitive.

In the *Genentech* decision, the CJEU applied the *Ot-*

*tung* judgment *a fortiori*, ruling that if an obligation to pay royalties may be compatible with 101 TFEU *after* the expiry of a patent (*Ottung*), the same applies before the expiry of the rights at issue. The CJEU concluded that the obligation to pay royalties for technologies that are not or no longer covered by a patent is not incompatible with article 101 TFEU, provided that the licensee is free to terminate the contract with reasonable notice.

The reasoning of the CJEU is based on the idea that the royalty payment is the price to be paid for the right to exploit the licensed technology commercially, with the guarantee that the licensor will not enforce its industrial property rights against the licensee. This was also the position of Advocate General Wathelet, set forth in his Opinion dated 17 March 2016: unlike other companies who had not concluded any license agreement, Genentech had actually benefited from this 'temporary truce' for the duration of the license agreement. Therefore, the payments due by Genentech under the agreement could not be reimbursed.

As long as the license agreement at issue is still in force and may be terminated freely by the licensee, the royalty payment is due and the agreement is acceptable under article 101 TFEU. In this case, Genentech had been free to terminate the license agreement at any time, with a notice period of two months. Furthermore, the agreement contained no supplementary obligations<sup>4</sup> nor any restriction on Genentech's freedom to act after its termination, to the extent that Genentech could challenge the validity of the U.S. patents at issue—an opportunity which it seized, however unsuccessfully. In view of this, the CJEU concluded that there had been no restriction of competition.

A final interesting remark in this regard was made by Advocate General Wathelet: he considered that the question here was not whether Genentech was commercially disadvantaged by the arbitrator's interpre-

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3. CJEU, Judgment of 12 May 1989 in Case 320/87 between Kai Ottung and (1) Klee & Weibach A/S and (2) Thomas Schmidt A/S, available at <http://curia.europa.eu/juris/showPdf.jsf?text=&docid=95732&doclang=EN>.

4. Which was the case in CJEU, Judgment of 25 February 1986 in Case C-193/83 between Windsurfing International Inc. and the Commission of the European Communities, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CEL:EX:61983CJ0193&from=FR>.

tation of the license agreement or whether, with the benefit of hindsight, it would not have entered into such an agreement. The Advocate General went on to observe that the aim of Article 101 TFEU is not to regulate commercial relations between undertakings in a general way; its prohibition should only apply to anticompetitive agreements or arrangements.

## Compatibility with the Huawei/ZTE Judgment

One might wonder whether this new ruling from the CJEU is compatible with the Court's previous holdings in the *Huawei/ZTE* judgment of 16 July 2015 (Case C-170/13).<sup>5</sup> For details about this judgment, readers are invited to refer back to the "Scoop from Europe" column in the *les Nouvelles* edition of July 2015.<sup>6</sup> In the *Huawei/ZTE* judgment, the Court emphasised that (potential) licensees of standards-essential patents should always have the option to challenge the validity and infringement of the patents they are licensing in. What good does this option do the licensee if—under the recent *Genentech* judgment—he may be required to keep paying royalties in the event of revocation or non-infringement of the patent anyway?

In fact, the two judgments are not as incompatible as a first reading would suggest. In the *Genentech* judgment, the Court stressed that the obligation to continue paying royalties complies with competition law only if the licensee is at liberty to terminate the agreement by giving reasonable notice. This liberty generally does not exist for a truly standards-essential patent, where the licensee has no choice but to continue the

license agreement if he is to continue commercialising a standard-compliant product. In that case, obtaining a finding of invalidity or non-infringement is the licensee's only option to discontinue the royalty payments. This aspect of dominance under Article 102 TFEU, so crucial in the standardisation context, is absent in the *Genentech* case, which was decided under Article 101 TFEU. This explains the apparent discrepancy between the two judgments.

## Conclusion

The one clear take-away from the *Genentech* judgment is that the parties should expressly set out the consequences of a possible revocation (or finding of non-infringement) of the licensed patent(s) in the original license agreement. The licensor may shift the risk of invalidation onto the licensee by requiring an upfront lump sum royalty. Conversely, the licensee may insist that running royalties will end in the event of revocation or a finding of non-infringement, especially if the license covers only a single patent. The negotiation position of the parties on this point will heavily depend on the perceived strength of the patent(s) and the licensee's need for the license. In any event, the parties should bear in mind that an obligation on the licensee to give a very long notice period to terminate the license, or any other onerous post-revocation obligations on the licensee, are possible red flags under EU competition law. ■

Available at Social Science Research Network (SSRN): <https://ssrn.com/abstract=2865736>

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5. CJEU, Judgment of 16 July 2015 in Case C 170/13 between Huawei Technologies Co. Ltd and ZTE Corp., ZTE Deutschland GmbH, available at <http://curia.europa.eu/juris/document/document.jsf?text=&docid=165911&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=941884>.

6. Available through log-in at <https://www.lesi.org/Login?ReturnURL=%2fles-nouvelles%2fles-nouvelles-archives>.