

# Reforming The Technology Transfer Regulation

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**A** new Technology Transfer Block Exemption Regulation is likely to enter into force on 1 May 2004. If it enters into force as drafted, it will be much more restrictive than the current Regulation.

The European Commission sent a draft of the new Regulation to member state governments in June, together with lengthy explanatory guidelines. Like the Regulation that is currently in force (No. 240/96), it will exempt certain patent and know-how licensing agreements that are arguably anti-competitive. Such agreements potentially “affect trade between Member States and ...have as their object or effect the prevention, restriction or distortion of competition within the [EU] common market” and accordingly infringe Article 81(1) of the EC Treaty. The principal consequence of infringement is that it makes the agreement, or at least the offending provision, unenforceable. Fines and damages are also possible.

The most important changes in the new draft Regulation are that no block exemption will be available for competitors or potential competitors whose combined market share exceeds 20 percent; and that even competitors or potential competitors with a very low market share will have no assurance that exclusive licenses, or licenses containing territorial, field-of-use or customer restrictions, will not infringe Article 81(1).

It is intended that the new Regulation will enter into force on the same day as the Modernisation Regulation (No. 1/2003). This will abolish the procedure for seeking exemption (or assurance of non-infringement) by notifying agreements to the Commission.

## Key Features

The most notable feature of the new Regulation is the introduction of market share limits. Other key features are:

- The regulation will still only cover two-party agreements, that is, between a single licensor and a single licensee. The Commission considered broadening the scope of the current Regulation to cover multi-party agreements. It has not pursued this.

- The new Regulation is broader than the current one in that it covers software copyright licensing, as well as patent and know-how licensing. It will cover copyright licenses granted for the purpose of allowing the production of copies for resale. It will not cover the licensing of performance copyrights.

- If exemption is available under the new Regulation, then the period of exclusivity may continue for as long as the licensed intellectual property right remains valid or the know-how remains secret. By contrast, the current Regulation exempts exclusivity provisions in know-how licenses for up to ten years from the date when the licensed product was first put on the EU common market by a licensee.

- The new Regulation does not contain the lists of clauses which are identified as being exempted or generally non-problematic in the current Regulation. However, similar information (albeit not in a binding Regulation) is set out in the Guidelines.

## Difficult hurdles

In considering whether they may benefit from the new Regulation, parties will have to assess: (i) wheth-

er they are competing undertakings; (ii) if so, whether their combined market share is and will remain less than 20 percent; if they are not competitors, whether each party's market share is and will remain less than 30 percent; (iii) whether their agreement contains any of the ‘hardcore’ restrictions listed in the separate black-lists for competing and non-competing undertakings; and (iv) whether it contains any of the problematic clauses described as ‘conditions.’

### (i) Competing undertakings

‘Competing undertakings’ is defined broadly to include ‘technology market’ competitors and ‘product market’ competitors, as well as ‘potential competitors’ on the product market.

If both parties are involved in licensing the relevant technology, or substitutes for it, they will be treated as competitors in the technology market. Defining what is or is not a ‘substitute technology’ can be difficult.

Determining whether parties are competitors on the product market is less difficult, but defining the relevant market is often not straightforward.

Potential competitors are those who “would, on realistic grounds” gear up to enter the other party's market “in response to a small and permanent increase in relative prices.” What does “on realistic grounds” mean? How is this hypothetical po-

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sition to be assessed? These criteria will make it very difficult for parties to be certain as to which side of the line they fall.

In assessing whether parties are competitors, the activities of connected undertakings, such as subsidiary or controlled entities, must also be taken into account.

The competitive relationship between the parties is not something that can be considered at the outset and then forgotten. The Guidelines note that the relationship may change during the life of the agreement. Even if the parties can rely upon the block exemption when the agreement is executed, they may cease to be able to do so after a few years or even months.

#### (ii) Market shares

Having decided whether the parties are competitors, the next step is to consider their respective market shares.

Market shares are difficult to calculate in relation to technology, particularly where the technology relates to new products which may be creating new markets. In that situation the parties may arguably have a market share of 100 percent.

Various methods of defining the relevant markets and calculating market shares are suggested in the Guidelines. The approach suggested by the Commission is to attempt the calculation "*on the basis of sales of [the licensor's and its licensees'] products incorporating the licensed technology on downstream product markets.*" But "*in individual cases outside the safe harbour of the TTBER*" it may be necessary also to consider the "*share of total licensing income from royalties, representing a technology's share of the market where competing technologies are licensed.*"

Once again, the assessment cannot be done once and for all when the license is being negotiated. Just as the competitive relationship may change after the agreement has been signed, so may the parties' market shares. There is therefore ample potential for licensees to be penalized for success.

Where the market share criteria are exceeded, the block exemption will either be unavailable from the start, or will become unavailable when or shortly after the limits are exceeded. The Regulation provides that the 20 percent and 30 percent limits may be exceeded by 5 percent for up to two calendar years or (if exceeded by more than 5 percent) for one calendar year before the exemption ceases to apply.

The Guidelines do say that there is "*no presumption of illegality*" merely because the market shares of the parties exceed the specified thresholds, but these limits are bound to create uncertainty.

#### (iii) Black-lists

For those parties that satisfy the market share criteria, the next hurdle is the black-list. In fact there are separate black-lists for competitors and non-competitors.

The non-competitors' black-list is similar to, but a little shorter than, the black-list in the current Regulation. Unlike the current Regulation, it does not authorize a ban on passive-sales into other licensees' territory. The current Regulation expressly exempts a 5-year passive-sales ban. The Guidelines merely indicate that a 2-year passive-sales ban will "*normally*" be tolerated.

The dramatic change lies in the black-list for agreements between competitors. While the list is shorter, it is more sweeping. Most restrictions on either party's output, sales, market or customers are treated as hardcore restrictions.

It appears from the Guidelines that exclusive licenses and licenses containing restrictions on territories, fields-of-use or customer groups will infringe the new Regulation. There may be may exemptions for sole licenses between competitors who satisfy the market share limits.

#### (iv) Conditions

The new Regulation provides that obligations to assign improvements, obligations not to challenge the validity of the licensed intellectual property and obligations to grant exclusive licenses of sever-

able improvements shall not be block-exempted, although the rest of the agreement may potentially be exempt.

#### Implications

If the Regulation enters into force as drafted, many commercially significant entities will need to think carefully before entering into exclusive licenses or licenses with territorial, field-of-use or customer-group restrictions. Few will be able to say with confidence that they are not, and will not during the life of the agreement become competitors or potential competitors and that their combined market shares do not and will not exceed 20 percent. No longer will competitors confidently be able to settle patent litigation disputes on the basis of exclusive licenses enabling the parties to focus on the field-of-use that is of particular concern for each.

Existing agreements still in force after October 2005 must be re-examined and possibly re-negotiated. The exemption that any agreements now enjoy under the current Regulation will cease after 31 October 2005. This will be most unwelcome where the bargaining positions have changed.

In considering whether they may benefit from the new Regulation, parties will have to assess: (i) whether they are competing undertakings; (ii) if so, whether their combined market share is and will remain less than 20 percent; if they are not competitors, whether each party's market share is and will remain less than 30 percent; (iii) whether their agreement contains any of the 'hardcore' restrictions listed in the separate black-lists for competing and non-competing undertakings; and (iv) whether it contains any of the problematic clauses described as 'conditions.'