# IP Rights and EU Competition Law: Can Your IP Licensing Agreement Benefit From Safe Harbour?

*Jean-Michel Coumes**

LT Block exemptions; Compliance; EC law; Licensing agreements; Technology transfer

## Why should I comply?

The European Commission has enacted a Block Exemption Regulation on IP licensing agreements. Agreements covered by the block exemption benefit from a safe harbour as regards the application of the European Union ("EU") competition rules.

## When should I comply?

In terms of implementation, the block exemption provides for a transitional period as regards agreements concluded before May 1, 2004. Parties to IP licensing agreements have until March 31, 2006 to make sure that these agreements are in compliance with the new rules. Companies will need to assess not only whether existing agreements are in compliance but also whether any pre-May 2004 IP licensing arrangements are in line with the new requirements or evaluate whether they would otherwise hold up against a competition law challenge or scrutiny.

* Counsel, Hogan & Hartson, JMCoumes@hhlaw.com.

## What are the risks in non-compliance?

The consequences of non-compliance can be severe. An IP licensing agreement not covered by the block exemption may be held unenforceable and give rise to private actions for damages based on the violations of EU law. In addition, the European Commission can fine companies up to 10 per cent of their group worldwide revenues. National competition authorities in the EU also have the power to impose fines for violation of EU competition law. For example, the French Competition Council recently imposed a fine of €16 million on companies involved in resale price maintenance.

## Assessing IP licenses under the technology transfer block exemption

## EU prohibition of anti-competitive agreements

Agreements between companies which may affect trade between EU Member States and restrict competition within the European Union are prohibited under EU competition law. IP licensing agreements often contain restrictions of competition, such as exclusivity or territorial restrictions, which normally result in efficiency gains at the production and distribution levels. On the other hand, licensing can also have negative effects on competition, in particular by fixing prices, limiting output, partitioning or foreclosing markets (so-called "black-listed" restrictions.)

Licenses which may restrict competition in the EU can be caught by the EU prohibition on anti-competitive agreements regardless of the location of the licensor and licensee. For example, a license between two US companies which grants the US licensee worldwide rights to exploit a particular technology, including the EU rights, and which contains provisions which are considered restrictive of competition under EU law, will expose the parties to sanctions and damages for breach of EU law. It will also render the restrictive provisions and potentially the license as a whole unenforceable in the EU.

## Block exemption for IP licenses—March 31, 2006 deadline

The European Commission can exempt categories of agreements from the prohibition on anti-competitive agreements, when these agreements involve efficiencies that outweigh their negative effects on competition. The exemption mechanism is implemented through the adoption of so-called block exemption regulations. Agreements covered by block exemptions benefit from a safe harbour as regards the application of the competition rules.

In 2004, the European Commission adopted a Block Exemption Regulation dealing specifically with IP licensing agreements (more specifically referred to by the Commission as "technology transfer agreements"). The block exemption applied with immediate effect to agreements entered into on or after May 1, 2004. However, agreements entered into before that date were given until March 31, 2006 to adapt to the new rules.

As a result, as of April 1, 2006 companies need to ensure that not only recent IP licensing agreements but also pre-May 2004 licenses, to the extent they contain restrictions on competition, are in line with the requirements of the block exemption.

## Importance of compliance

Too many in the business community are unaware of the growing risk in not complying with the EU block exemption governing technology transfer agreements ("the block exemption"). If a technology transfer agreement contains a "black-listed" restriction of competition, the entire agreement is excluded from the benefit of the safe harbour and may be held unenforceable. This can have dramatic consequences for the licensor and the licensee, given the considerable investment the development of new technology typically requires. In addition, the European Commission and national antitrust authorities in the EU have the power to impose fines for violation of EU antitrust law. The Commission can fine companies up to 10 per cent of their group worldwide revenues and although fines have not reached these levels, large fines are being imposed in a growing number of cases. Last, non-compliance may also give rise to private actions for damages based on the same violations.

Recent reforms of EU law have substantially strengthened the role of national competition authorities and national courts in the enforcement of EU competition rules. In addition, they have done away with the system whereby companies could notify a proposed technology transfer agreement to the European Commission and obtain its assessment of whether it complied with EU competition law. These reforms have opened the door to a rise in private antitrust litigation in national courts. Another consequence of these reforms is that it is now up to businesses to assess the legality of their agreements with the assistance of their counsel.

## Who should assess?

Companies who have licensees active in the EU, or who are themselves licensees active in the EU need to assess their agreements for compliance with EU competition rules. This should include an assessment of whether any potential restrictions on competition can benefit from the block exemption.

## What types of licenses may benefit ?

The European Commission defines technology transfer agreements as agreements for the licensing of patents, know-how, software copyrights or any combination thereof, whereby a licensor allows a licensee to use a licensed technology for the manufacture of products or the provision of services. Mere licenses to sell a product are not covered by the block exemption (there are other block exemptions which cover certain restrictions in sales licenses).

## The benefit of the block exemption?

Agreements that comply with the terms of the block exemption are considered automatically exempt from the prohibition of anticompetitive agreements contained in the EC Treaty.

## Block exemption applies only below certain market share thresholds

The application of the block exemption is subject to several conditions. First, the market share of the companies involved must be below certain thresholds, i.e.:

- a combined market share of 20 per cent on the relevant technology and product market if the parties to the agreement are competitors;
- individual market shares of 30 per cent on the relevant technology and product market if the parties to the agreement are non-competitors.

## No "black-listed" restrictions

Secondly, the agreement should not contain any "black-listed" restrictions. So-called "black-listed" restrictions remove the whole agreement from the benefit of the safe harbour created by the block exemption. The list and type of restrictions vary depending on whether or not the parties are competitors. When the parties are competitors, the block exemption further distinguishes between non-reciprocal and reciprocal licenses, the "black-listed" restrictions being stricter in the case of reciprocal licenses.

If the parties are competitors, the "black-listed" restrictions are (subject to some exceptions):

- the restriction of a party's ability to determine its prices when selling products to third parties;
- the limitation of output except when imposed in a non-reciprocal agreement or only on one of the licensees in a reciprocal agreement;
- the allocation of markets or customers with some exceptions, in particular regarding field-of-use restrictions or restrictions of active and certain passive sales in non-reciprocal agreements and under specific conditions;
- the restriction of the licensee's ability to exploit its own technology; and
- the restriction of the parties' ability to carry out research and development unless the restriction is indispensable to prevent the disclosure of the licensed know-how.

If the parties are not competitors, the "black-listed" restrictions are (subject to some exceptions):

- the restriction of a party's ability to determine its prices when selling products to third parties, with the exception of maximum or recommended prices;
- the restriction of the territory into which, or of the customers to whom, the licensee may passively sell the contract products. This is subject to some exceptions. In particular, licensees can be restricted from passively selling: (i) into an exclusive territory or to an exclusive customer group that the licensor allocates to itself; and (ii) during two years into an exclusive territory or to an exclusive customer group that the licensor allocates to another licensee;
- the restriction of active or passive sales to end-users by a licensee which is a member of a selective distribution system at the retail level. However, the licensor may prohibit the licensee from operating out of an unauthorised place of establishment.

## Excluded restrictions

Certain restrictions are excluded from the benefit of the block exemption but are not considered as "black-listed" restrictions. Unlike "black-listed" restrictions that are almost per se restrictions, excluded restrictions must be assessed on a case-by-case basis to weigh their pro and anti-competitive effects. Another important difference is that the inclusion of an excluded clause does not prevent the block exemption from applying to the rest of the agreement.

Excluded restrictions are:

- exclusive grant-back clauses on the licensee's severable improvements;
- licensee's obligation to assign to the licensor severable improvements;
- no-challenge clauses;
- when the parties are not competitors, limitation on the licensee's ability to exploit its own technology or limitation on any party's ability to carry out research and development unless the restriction is indispensable to prevent the disclosure of the licensed know-how (if the parties are competitors, this becomes a "black-listed" restriction).