WILMER CUTLER PICKERING LLP

Antitrust and Competition Law Update

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New European Licensing Rules Require Fresh Assessment of Existing and New Intellectual Property Licenses

As of 1 May 2004, many licensors and licensees of patents, know-how and computer software in Europe will need to step up their efforts to ensure that they comply with European competition law. Companies without significant market power will enjoy greater flexibility than in the past to tailor licenses to their particular needs. But companies which license competitors or which have market power need to review their market position and licenses more carefully and more frequently.

This is a consequence of the completely revised Technology Transfer Block Exemption Regulation (the "Regulation") and new explanatory guidelines (the "Guidelines") that the European Commission published last month.[1] All licenses must conform to these rules immediately, save existing licenses which comply with the predecessor regulation.[2] These must be brought into compliance by 31 March 2006. The rules apply for the newly enlarged European Union of 25 Member States.[3]

The New European Competition Rules for Licensing Agreements

The new Regulation and Guidelines, which resulted from a lengthy evaluation and public consultation process,[4] replace a markedly different predecessor regulation adopted in 1996.[5] The most important changes include:

- Agreements between competitors can fall within the Regulation's "safe harbor", but under stricter conditions than agreements between non-competitors.
- The availability of the Regulation's "safe harbor" now depends principally on (i) the parties' market shares (combined market share not exceeding 20 percent in any affected product or technology market if the licensor and licensee are competitors, or individual market shares not exceeding 30 percent if the parties are not competitors); and (ii) the absence of "hardcore" restrictions.

1 Commission Regulation 772/2004, 2004 OJ L123/11 and Commission Guidelines, 2004 OJ C101/02.

2 Commission Regulation 240/96, 1996 OJ L31/2.

3 See, The Fifth EU Enlargement : Major Revisions to EC Competition Enforcement Practices, Wilmer EU Bulletin of May 1, 2004.

4 See our previous bulletins, European Commission Proposes New Competition Rules for Technology Licensing, Wilmer EU Bulletin of October 15, 2003, and Upcoming reform of the Transfer of Technology Block Exemption, Wilmer EU Bulletin of February 27, 2003.

5 Commission Regulation 240/96, 1996 OJ L31/2.

The old distinctions between "white" (legal), "gray" (probably legal) and "black" (generally illegal) listed clauses are eliminated. Accordingly, to assess how the new Regulation applies, parties will need much more information about relevant product and technology markets than was formerly the case.

- The Regulation's scope will extend beyond patent and know-how licenses to include licenses for computer software copyrights. The Regulation will also cover other patent-related rights, such as design rights, utility models and topographies of semi-conductor products.

Many licensing agreements fall outside the Regulation and therefore cannot benefit from the safe-harbor that it creates:

- Licensing agreements between parties that exceed the 20/30 percent market-share thresholds;

- Licensing agreements that contain a serious "hardcore" restriction as defined in the Regulation, including certain forms of allocation of markets or customers, limitation of output, or restrictions on pricing; and

- Licenses among more than two parties, agreements creating technology pools, settlement agreements of patent and other IP disputes and non-assertion agreements.

Agreements that fall outside the Regulation's "safe harbor" are not presumed to be illegal, but must be assessed individually under Article 81 EC Treaty (the general law against anti-competitive agreements in the European Union) in light of market conditions. Accordingly, if agreements are challenged in litigation, arbitration or competition authority proceedings, the parties may be required to offer specific, detailed evidence about their competitive effects. The Guidelines both provide a general framework for the assessment and discuss in more detail relevant considerations for assessing royalty obligations, exclusive licensing, sales restrictions, output restrictions, field of use restrictions, captive use restrictions, tying, and non-compete obligations. The greater the parties' market power in the relevant market, and the more restrictive the provision in question, the less likely it is that the provision will be upheld. Companies with very high market shares may therefore face more regulatory constraints under the new rules than under the old ones, where market shares were largely irrelevant.

Agreements containing one or more of the Regulation's enumerated "hardcore" restrictions receive intense scrutiny. Not only does the presence of such restrictions take the entire licensing agreement outside the Regulation's "safe harbor" (regardless of the parties' market shares), but the restrictions themselves are presumptively illegal and void under almost all circumstances. In the initial draft of the Regulation and Guidelines, the Commission had listed many common license terms as "hardcore" restrictions.[6] In response to strong criticism, the Commission narrowed the scope of the "hardcore" list. Even so, some commercially significant provisions -- such as absolute territorial sales restrictions on licensees -- are still considered "hardcore" in most cases, even if the parties are not competitors. In principle, "hardcore" restrictions may give rise to fines from the European Commission or Member State authorities. The concept of "hardcore" restrictions and the strict treatment thereof is one of the continuing divergences between EU and US licensing law. (US licensing law does not contain a presumption of illegality for most of these provisions.)

[6] *See*, European Commission Proposes New Competition Rules for Technology Licensing, Wilmer EU Bulletin of October 15, 2003.

Practical Impact for Companies and Their Legal Advisors

For companies and their legal advisors, the new rules have a number of significant practical consequences:

First, companies need to review licenses affecting Europe that were concluded before 1 May 2004 and will run beyond March 2006 for conformity with the new rules. As of 1 April 2006, these agreements are no longer covered by the old regulation. In some cases, it may be impossible to comply with the new rules without renegotiating the license.

Second, after 1 May 2004, the new rules in practice require companies and their legal advisors to assess, before finalizing the agreement:

(i) The parties' competitive relationship (competitors or non-competitors);

(ii) The market shares of the parties in the product and technology markets (*i.e.*, whether they are above or below the Regulation's 20/30 percent thresholds); and

(iii) Whether the draft agreement contains "hardcore" restrictions – which should be eliminated completely or made to apply only outside Europe.

If the agreement falls within the Regulation's "safe harbor", the entire agreement will comply with EU competition law, except for contract provisions that the Regulation specifically excludes from the "safe harbor" -- such as grant-back provisions for improvements and no-challenge clauses. These provisions always require individual assessment in light of market circumstances.

If the agreement falls outside the "safe harbor", a more detailed individual assessment is required. The licensor and licensee are well-advised thoroughly to self-assess draft licensing agreements. Doing so gives them an opportunity to consider amending the agreement to avoid the possibility of an unpleasant surprise if it is later challenged in court or by a competition authority. Furthermore, if the parties have demonstrated a good faith effort to comply with the Regulation, an authority may use the parties' assessment as a starting point for its own analysis or treat more leniently any violation it finds. The Commission will provide an advance review of a licensing agreement only in exceptional circumstances.

Third, companies will also need to review their licensing agreements periodically to ensure ongoing compliance with the new rules. That the agreement was in compliance when entered into does not immunize it from future review. The Regulation and Guidelines contemplate a review process based on market conditions at the time of the case or investigation, not just when the agreement was reached.

In practice, companies should review their license agreement whenever market circumstances change significantly, for example if one of the parties' few competitors exits the market. Absent such an event, the parties should carry out a review every two years -- since the Regulation provides a "safe harbor" grace period of two years beyond when the parties' market shares grow above the 20/30 percent thresholds.

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This Bulletin has been prepared by Axel Gutermuth, Thomas Mueller and John Ratliff. If you have any questions about the new technology transfer regime, please do not hesitate to contact them or any of the lawyers listed below.

Wilmer Cutler Pickering LLP has announced that it will be merging with Hale and Dorr LLP as of 31 May 2004. Hale and Dorr is recognized in the United States and Europe as a leading firm for advice on acquiring, licensing and litigating intellectual property rights.

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