European Commission Proposals on Technology Licenses and Patent Pools: A Summary of the Main Changes the Commission is contemplating

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As part of its ongoing review of how competition law should apply to licensing,[1] on 20 February, the European Commission published a *revised draft Technology Transfer Block Exemption Regulation* (the draft BE) and a revised draft of its *Guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to technology transfer agreements* (the draft Guidelines).[2] The current technology transfer block exemption expires at the end of April 2014 and the Commission is seeking comments on the draft BE and draft Guidelines by 17 May 2013. WilmerHale intends to comment on the draft documents. Here we summarise the main changes the Commission is contemplating.

Main Issues

There are three areas that are likely to provoke the majority of comments:

Relationship with Research and Development Block Exemption (R&D BE). Ascertaining whether the R&D BE or the technology transfer block exemption applies to a given agreement is often problematic. The draft documents propose that normally the R&D BE should be applied, to the exclusion of the technology transfer block exemption, if the R&D BE is applicable to the "subject matter" of the license (Recital 7 and Article 9 draft BE and paragraphs 46 and 58 *et seq* of the draft Guidelines). Nonetheless, the draft BE provides that it can still apply even if the licensee is carrying out "further research and development by the licensee" provided this leads to the production of contract products (Recital 7).

"Pay-for-Delay" Patent Settlements. The draft Guidelines contain a new paragraph stating that "scrutiny is necessary" when a licensor provides an "inducement, financially or otherwise, for the licensee to accept more restrictive settlement terms than would otherwise have been accepted based on the merits of the licensor's technology" (paragraph 223). This is primarily targeted at the pharmaceutical industry and payments from brand owners to generics manufacturers. The reference to the "merits of the licensor's technology" suggests that the Commission proposes to

examine the strength of the underlying patent to determine if the payment infringes Article 101. This is controversial, given the difficulties inherent in assessing a patent's strength.

Patent Pools. Like the current technology transfer block exemption, the draft BE would not cover patent pools. These are only addressed in the draft Guidelines, which propose at least three notable changes.

First, while currently a license from a patent pool to a third party licensee could in theory fall under the block exemption, the draft Guidelines exclude this (on the basis that such licenses are multi-party rather than bilateral agreements) (paragraphs 231 and 249).

Second, the guidance on what constitutes "essential" technology has been revised to cover not only technology that is essential to producing a product, but also technology that is essential to complying with a standard (paragraph 236).

Third, the Guidelines introduce what they term a "safe harbour" for pools that:

- allow open participation in the standard and pool creation process;
- contain sufficient safeguards to ensure that only essential technologies are pooled;
- contain sufficient safeguards to limit the exchange of sensitive information to what is necessary;
- require licensing of the pooled technologies into the pool on a non-exclusive basis;
- envisage licensing of the pooled technologies to third parties on FRAND terms;
- allow both contributors and licensees to challenge pooled technologies' validity and essentiality; and
- allow both contributors and licensees to develop competing products and technology.

(See paragraph 244.)

While none of these conditions is particularly controversial, some give rise to considerable discussion (e.g. what safeguards are "sufficient" to ensure that only essential technologies are in the pool?), so it may be difficult to be certain that a pool falls squarely within the safe harbour.

The draft Guidelines provide some guidance on pools that are outside the safe harbour and usefully they acknowledge that it can be pro-competitive to include non-essential technologies in a pool, if, for example, the cost of assessing whether all the technologies are essential is high due to the number of technologies involved (paragraph 247).

Other Points to Note

In addition to these three changes, there are a number of more technical amendments proposed:

- **Market share thresholds.** The 20% threshold normally applicable to agreements between

competitors would also apply to agreements between non-competitors if the licensee already owns a technology that can be substituted for the licensed technology, but does not license this out and rather uses it for in-house production (Article 3(2)). This could be complicated to apply in practice. Otherwise, the draft documents resist other changes to the market share thresholds.

- **Raw material and equipment purchase provisions in license agreements.** There are new rules providing that if such provisions are "directly and exclusively related to the production of the contract products" they can be covered by the BE (Article 1(c)). As the Commission notes, this would mean that even if the raw material/equipment is worth more than the licensed technology, the BE would still apply.
- **Passive sales.** Currently agreements between non-competitors can restrict passive/unsolicited sales by a licensee into another licensee's exclusive territory or customer group during the first two years of the agreement. This will no longer be possible and such restrictions will therefore be hardcore and result in the whole agreement falling outside the block exemption. (The draft Guidelines note that if such restrictions are objectively necessary, they can be allowed, but it may be difficult to show such objective necessity in practice (paragraph 116)).
- **More restrictive rules for exclusive grant-backs.** The existing block exemption distinguishes "severable" exclusive grant-backs (i.e. those capable of being exploited without infringing upon the licensed technology) and "non-severable" exclusive grant-backs of improvements to the licensed technology, and excludes only the former from the automatic exemption. The draft BE proposes to exclude *all* exclusive grant-backs from the exemption, so they would all have to be analysed individually for compliance with Article 101. This proposed tightening of the block exemption regarding non-severable improvements appears therefore to ignore the distinction between severable and non-severable improvements, and that the licensor can, in any case, prevent the licensee from using non-severable improvements.
- **No-challenge and termination provisions.** The current block exemption excludes provisions that prevent the licensee from challenging the validity of the licensed technology from its scope, but allows for the agreement's termination if the licensee challenges the licensed technology's validity. The draft BE proposes to exclude provisions allowing the licensor to terminate the BE (so these have to be analysed individually for compliance with Article 101). This is controversial since the existing balance is reflected in many licenses and indeed in the R&D BE. There are also statements in the draft Guidelines suggesting a more cautious approach to accepting no-challenge clauses even in the context of settlements (paragraph 227).
- **Software copyright licenses.** Under the draft Guidelines the licensing of software copyright merely for the purpose of the software's reproduction and distribution would no longer be covered by the technology transfer block exemption (because reproduction is not deemed to be production of a contract product). Instead, licenses allowing for reproduction of copyright would have to be assessed under the generic rules governing vertical restraints (Recital 7 and Guidelines, paragraph 52).

This client alert has been prepared by Cormac O'Daly, John Ratliff, Hartmut Schneider and Svetlana Chobanova. It does not constitute legal advice. For specific matters, appropriate advice should be sought.

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[1] The Commission's earlier consultation document and the responses to this, including WilmerHale's, are available at http://ec.europa.eu/competition/consultations/2012_technology_transfer/index_en.html.

[2] The consultation documents are available at http://ec.europa.eu/competition/consultations/2013_technology_transfer/index_en.html.

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