Pitfalls of licensing agreements from a competition law perspective

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Introduction

> The European Commission (‘Commission’) and national competition authorities increasingly challenge IP related transactions

> Most recent developments in the area focus on high-tech industries: pharma industry, telecommunications, etc.

> Today’s presentation: clauses in licensing agreements that restrict competition/merit further review before including them in an agreement.
Legal framework: general

> **Key provisions:**

- Article 101 (1) of the Treaty on the Functioning of the European Union (‘TFEU’)
- Article IV.1 § 1 of the code of economic law (‘CEL’)

> These provisions prohibit agreements or other arrangements between undertakings when such agreements appreciably restrict competition.

> Transactions involving IP rights, such as licensing agreements, can fall within the scope of Article 101 (1) TFEU

> Article 101 (3) TFEU/ Article IV.1 § 3 CEL: legal exception to the prohibition
Legal framework: risks

> Agreement/clauses null and void (Article 101(2) TFEU/ Article IV.1 § 2 CEL)

> Heavy fines on participating companies (up to 10 per cent of their group worldwide turnover)

> Action for damages compensation by 3rd parties with the competent civil court

> Under Belgian competition law, the employees of an undertaking can be held personally liable for up to EUR 10,000 for certain cases of serious cartel conduct
Legal framework: licensing agreements

> Specific framework for the assessment of technology transfer agreements from a competition law perspective

> Concerns the licensing of technology rights, meaning know-how and technology rights

> ‘technology rights’: patents, utility models, design rights, topographies and semiconductor products, supplementary protection certificates for medicinal products, plant breeder’s certificates and software copyrights
Legal framework: licensing agreements

> Two separate legal instruments:

1. Regulation 316/2014 of 21 March 2014 on the applications of Article 101 (3) TFEU to categories of technology transfer agreements (‘Technology transfer block exemption regulation’ or ‘TTBER’)

2. Guidelines on the application of Article 101 TFEU to technology transfer agreements (‘Technology transfer guidelines’ or ‘TT guidelines’)
Application of the TTBER

1. Licensing of technology rights for the production of goods and services

2. Differing rules for licensing agreements between competitors and non-competitors

3. Differing rules for reciprocal and non-reciprocal licensing agreements between competitors

4. The block exemption
Licensing of technology rights for the production of goods and services

> Purpose agreement: the licensing of technology rights to allow the licensee to exploit the licensed technology for the production of goods and services

> Often licensing agreements relate to more than one level of trade, e.g. distribution

- Rules regarding distribution: subject to a separate legal framework
  - Regulation 330/2010 of 20 April 2010 on the application of Article 101 (3) TFEU to categories of vertical agreements and concerted practices (‘Vertical block exemption regulation’ or ‘VBER’)

Differing rules for licensing agreements between competitors and non-competitors

> Agreements between competitors pose a greater risk to competition

> Competitors must be active in the same:

(i) *relevant product market*: the market for the contract products and their substitutes or

(ii) *relevant technology market*: the market for the licensed technology rights and their substitutes, in the absence of the agreement between them.

> Both actual and potential competition are relevant:
  - Actual and potential competition on the relevant product market
  - Potential competition on the technology market not taken into account
Reciprocal and non-reciprocal licensing agreements between competitors

> **Reciprocal technology transfer agreements**: agreements where two undertakings grant each other, in the same or separate contracts, a technology rights license and where those licenses concern competing technologies or can be used for the production of competing products.

> **Non-reciprocal technology transfer agreements**: agreements where one undertaking grants another undertaking a technology rights license or where two undertakings grant each other such a license but where those licenses do not concern competing technologies and cannot be used for the production of competing products.
Two conditions:

1. Market shares cannot exceed certain thresholds (Art. 3 TTBER)
   - For competitors, the combined market share of the parties cannot exceed 20% on the relevant product and/or technology market
   - For non-competitors, the market share of each of the parties cannot exceed 30% on the relevant product and/or technology market

2. Agreement cannot contain:
   - **Hardcore restriction** of competition (Article 4 TTBER)
   - **Excluded** restriction (Article 5 TTBER)
A license agreement that does not qualify for the block exemption is not presumed to be illegal.

Need for an individual assessment under Article 101 (1) and (3) TFEU.

However, safe harbour in TT guidelines (§ 157):

- Four or more independently controlled
- Substitutable with the licensed technology
- Comparable cost to the user
- No hardcore restrictions in agreement
Obligations in license agreements that are generally not restrictive of competition

Confidentiality obligations

1. For the purpose of this Agreement “Confidential Information” means any and all information disclosed by a Party (“Disclosing Party”) to the other Party (“Receiving Party”) of whatever nature (e.g. financial, commercial, technical or legal) and in whatever form (e.g. orally, digitally or in writing) and at whatever time (e.g. prior to or after the entry into force of this Agreement), including but not limited to any ideas, discoveries, inventions, non-published patent(s) (applications), specifications, formulae, programs, plans, drawings, models, samples, requirements, standards, presentations, software and supporting documentation, financial data, operational data, names of and relationships with customers or suppliers and the terms of any customer or supplier contracts, know-how and trade secrets.
C. LICENSEE recognizes that the rights which are granted to it hereunder are strictly personal (intuitu personae agreement) and LICENSEE undertakes not to enter into a subLICENCE agreement – not even for the purpose of manufacturing the PRODUCTS – nor to assign of pledge as security all or part of the rights which are granted to it, without the prior written approval of LICENSOR and AUTHOR. A direct or indirect change in the majority of stock of LICENSEE shall be deemed a non-authorized assignment of the present LICENCE.
Obligations not to use the licensed technology rights after the expiry of the agreement, provided that the licensed technology rights remain valid and in force.

6.1 [Redacted] acknowledges that [redacted] is the sole and exclusive owner of the Intellectual Property Rights in the Products. After termination of this Agreement for whatever cause, [redacted] shall not use these Intellectual Property Rights in whatever manner, form or for whatever purpose.
Obligations to assist the licensor in enforcing the licensed IP rights

COOPERATION AND ASSISTANCE

D. Licensee and its Affiliates agree to provide [redacted] with its reasonable cooperation and assistance with respect to any such infringement proceedings at no charge to [redacted].

12.7 In any event Licensee shall fully cooperate, at his own cost, in the event Licensor initiates legal proceedings against a third party alleging infringement of any of Licensor Intellectual Property or unfair competition related thereto.
> Obligations to pay minimum royalties

LICENSEE further undertakes to pay to LICENSOR a non-refundable guaranteed advance against royalties the amount and the due dates of which are specified in paragraph 23.

10.3 Licensee shall pay Licensor each year of the Term a guaranteed minimum royalty of 30,000 EUR.
> Obligations to produce a minimum quantity of products incorporating the licensed technology
Obligations to use the licensor’s trade mark or indicate the name of the licensor on the product

1. **WORKS AND TRADE MARK**

1. Notice

LICENSEE undertakes to affix on all PRODUCTS, including all promotional and packaging material and any other documents used in connection with the PRODUCTS the following notice:

© Licensed by [Name]—all rights reserved—(year of first use of particular PRODUCT) or any other notice that LICENSOR could reasonable request.
Common competition law pitfalls in IP licensing agreements

1. Royalty clause
2. Territorial restrictions
3. Non-compete clause
4. Grant-back clause
5. Non-challenge clause
Royalty clause

> **General principle**: parties are free to determine the royalty due and its mode of payment

> Following mode of payments are in any event not restrictive of competition:

>  > Where the licensed technology relates to an input which is incorporated into a final product, royalties can be calculated on the basis of the price of the final product, provided that it incorporated the licensed technology (§ 184 TT guidelines)

>  > Software licensing royalties based on the number of users (§ 184 TT guidelines)

>  > Royalties calculated on a per machine basis (§ 184 TT guidelines)

>  > Royalties that extend beyond the period of validity of the licensed IP rights (§ 187 TT guidelines)
Royalty clause: what type of royalty clauses are prohibited?

Between competitors

> Royalty obligations can amount to **price fixing**

> Price fixing is considered a hardcore restriction of competition (Art. 4.1 (a) TTBER)

> Types of royalty clauses that are considered illegal price fixing:

  > Reciprocal running royalties where the license is a sham, meaning that the agreement does not allow an integration of complementary technologies or another pro-competitive aim

  > Royalties that extend to products produced solely with the licensee’s own technology rights
Royalty clause: what type of royalty clauses are prohibited?

**Between competitors**

> Other royalty mechanisms: block exempted if the market share of the parties does not exceed 20%

> If market share exceeds that threshold, following royalty scheme could be considered anti-competitive:

  > Running royalties in cross license agreements that are disproportionate compared to the market value of the license (§ 186 TT guidelines)
Royalty clause: what type of royalty clauses are prohibited?

BETWEEN NON-COMPETITORS

- Block exempted if the market share of both parties does not exceed 30%

- If market threshold is exceeded, one type of royalty scheme that will need further assessment to guarantee that it is not anti-competitive:
  
  > Royalties that are paid not just on the products produced with the licensed technology, but also on products produced with third party technology
Royalties and audit obligations

> Right to audit the licensee’s books/records/other documents to assess compliance with royalty obligation

11.2 Licensor shall have the right to have Licensee’s applicable books, records and documents audited by a certified public accountant or auditor during normal business hours for the purpose of verifying Licensee’s compliance with its obligations under this Agreement. The

> Risk of illegal exchange of information
  - Between competitors: books contain sensitive commercial info of the licensee
  - Between non-competitors: books can contain sensitive commercial info of other competing undertakings

> Precautionary measures
  - Only access to finance department/ Chinese wall
  - External, independent auditor
11.1. Licensor shall have the right to have Licensee’s applicable books, records and documents audited by a certified public accountant or auditor during normal business hours for the purpose of verifying Licensee’s compliance with its obligations under this Agreement.

11.2. Each audit shall be at Licensor’s expense, except in case the audit reveals a discrepancy in excess of 2% (two percent) between the amount of royalties actually paid to Licensor and that which was owed to Licensor.

11.3. In case of a discrepancy between the amount of royalties actually paid to Licensor and that which was owed to Licensor, Licensee shall pay to Licensor the amounts due plus interest calculated at yearly rate of 12 % (twelve percent), computed daily.

11.4. The operations of auditing include, but are not limited to the making of copies and extracts of the books, records and documents, to the extent such operations are relevant in order to assess whether Licensee has complied with its obligations under this Agreement. Licensor shall, prior to commencement of the inspection by the certified public accountant or auditor notify Licensee and state in writing the period to be covered by the inspection.
Territorial restrictions

> Two types of territorial restrictions

- **Territorial restrictions on production**: limiting the territory in which the licensor/licensee can produce with the licensed technology rights
  - Exclusive license
  - Sole license
Territorial restrictions on production

> **Exclusive license:** only the licensee can exercise the licensed rights in the territory covered by the license (not even the licensor)

2. Grant of Right. Licensor hereby grants to Licensee the exclusive license to manufacture, use and sell the Products in the Territory under the Patents and employing the Technical Information furnished by Licensor hereunder. In the event that Licensee desires to sell the Products outside the Territory, Licensee shall confer with Licensor concerned on terms and conditions therefore, including pros and cons.
Territorial restrictions on production

> **Sole license**: the licensed rights can be exercised in the territory covered by the license by the licensee or licensor but no one else
Territorial restrictions

> **Territorial restrictions on sales**: Restrictions imposed on the licensor or licensee as to where they may sell the products incorporating the licensed technology

> Prohibiting active (soliciting sales) or passive sales (responding to unsolicited sales) of the licensor/ licensee in the exclusive territory allocated to the licensee/ licensor/ another licensee

> Same rules apply to restrictions imposed on the licensor or licensee as to whom they may sell the products incorporating the licensed technology
Examples of territorial sales restrictions:

- Quantity requirements whereby the requirements are adjusted to local demand only
- Monitoring the destination to which the products are sold
- Differentiated royalties depending on the destination of the products
Territorial restrictions: what is prohibited?

Territorial restrictions on production

> Between competitors

  - **Exclusive licensing**
    
    • In reciprocal agreements: hardcore restriction of competition
    
    • In non-reciprocal agreements: block exempted if the combined market share is below 20%
    
    • If the market shares exceed the thresholds of the TTBER, an individual analysis is required to assess the anti-competitive effect taking into account the circumstances of the case, for example, the scope of the license (worldwide, limited).
Territorial restrictions: what is prohibited?

Territorial restrictions on production

> Between competitors

- *Sole licensing*
  
  - In reciprocal agreements: block exempted if the combined market share is below 20%
    
    - If the market shares exceed the thresholds of the TTBER, an individual analysis is required to assess the anti-competitive effect taking into account the circumstances of the case, for example, the scope of the license (worldwide, limited).
  
  - In non-reciprocal agreements: permitted
Territorial restrictions: what is prohibited?

TERRITORIAL RESTRICTIONS ON PRODUCTION

> Between non-competitors

- Exclusive licensing: generally permitted with the exception of a few limited circumstances included in the TT guidelines (§§ 195-196 TT guidelines)
- Sole licensing: permitted
Territorial restrictions: what is prohibited?

TERRITORIAL/CUSTOMER SALES RESTRICTIONS

> Between competitors

  - Reciprocal agreements
    - ALL restrictions on active or passive sales are a hardcore restriction of competition
Territorial restrictions: what is prohibited?

TERRITORIAL/CUSTOMER SALES RESTRICTIONS

> Between competitors

- Non-reciprocal agreements
  - Restrictions on active or passive sales on the licensor/licensee into the exclusive territory/customer group granted to the other party
    - Block exempted if the combined market share is below 20%
    - If the market shares exceed the thresholds of the TTBER, an individual analysis is required to assess the anti-competitive effect taking into account the circumstances of the case.
Territorial restrictions: what is prohibited?

TERRITORIAL/CUSTOMER SALES RESTRICTIONS

> Between competitors

- Non-reciprocal agreements
  
  - Restrictions on active sales by the licensee into the exclusive territory/customer group granted to another licensee provided that the latter licensee was not a competitor of the licensor when it concluded the license agreement

  - Block exempted if the combined market share is below 20%

  - If the market shares exceed the thresholds of the TTBER, an individual analysis is required to assess the anti-competitive effect taking into account the circumstances of the case.
Territorial restrictions: what is prohibited?

TERRITORIAL/CUSTOMER SALES RESTRICTIONS

> Between competitors

- Non-reciprocal agreements
  - Restrictions on passive sales by licensee into the exclusive territory/customer group granted to the another licensee

  - Hardcore restriction of competition
Territorial restrictions: what is prohibited?

**TERRITORIAL/CUSTOMER SALES RESTRICTIONS**

> Between non-competitors

- **Sales restrictions between the licensor and licensee**
  - Block exempted if the market share of each of the parties does not exceed 30%
  - If the market shares exceed the thresholds of the TTBER, an individual analysis is required taking into account the circumstances of the case
  - Sales restrictions on the licensor are generally permitted
Territorial restrictions: what is prohibited?

TERRITORIAL/CUSTOMER SALES RESTRICTIONS

> Between non-competitors

- Sales restrictions between licensees
  - Active sales
    - Block exempted if the market share of each of the parties does not exceed 30%
    - If the market shares exceed the thresholds of the TTBER, an individual analysis is required
Territorial restrictions: what is prohibited?

TERRITORIAL/CUSTOMER SALES RESTRICTIONS

> Between non-competitors

- Sales restrictions between licensees

  - Passive sales
    - Hardcore restriction of competition (vs. TTBER 2004)
    - Exception: if they are (temporarily) necessary for the protected licensee to penetrate a new market (up to two years after product is put on the market)
Non-compete clauses

> An obligation on the licensee not to use its own technology or third party technologies to produce products which compete with the licensed technology.

Upon Expiration or termination under Article X or upon termination of this Agreement under Article Y, [Licensee] shall not, directly or indirectly, for its benefit and/or for the benefit of any third party, (i) make, use, sell and offer to sell, render services employing the [Licensor] Process or [Licensor] Process Information in the Territory for a period of ten (10) years following the Expiration or termination; (ii) develop alone or in cooperation with any other company a process similar to [Licensor] Process.

4.1. → The Parties agree not to manufacture, have manufactured, Commercialize and/or have Commercialized in the Territory any product identical, similar and/or equivalent to the [Product] during the term of this Agreement.
Non-compete clauses: what is prohibited?

- A non-compete clause is block exempted by the TTBER both in agreements between competitors as well as non-competitors if they do not exceed the market share thresholds.

- Market share thresholds exceeded: individual analysis under Article 101 TFEU taking into account the circumstances of the case.

  - **Main competition law problem**: risk of foreclosing third party technologies.

  - **Alternative options**
    - Minimum output requirements
    - (Minimum) royalty obligations
Non-compete clauses: what is prohibited?

> No disguised restriction on the licensor or licensee to conduct own R&D or restrictions on the exploitation of own technology rights by the licensee.

9.1 Licensee shall not have the right to perform or have performed any research and/or development activities (including reverse engineering) with regard to the Technology without the prior written consent of Licensor.
Non-compete clauses: what is prohibited?

Examples:

- Royalties calculates on the basis of all product sales irrespective of whether the licensed technology is being used is a hardcore restriction.

- Restriction on third parties in licensing its own technology rights to third parties.
Non-compete clauses: what is prohibited?

**Restriction on the licensor or licensee to conduct own R&D or restrictions on the exploitation of own technology rights by the licensee**

> Between competitors

- hard core restriction of competition (Article 4.1 (d) TTBER)
- one exception: indispensable to prevent the disclosure of the licensed know-how to third parties
  - Necessary and proportionate
Non-compete clauses: what is prohibited?

Restriction on the licensor or licensee to conduct own R&D or restrictions on the exploitation of own technology rights by the licensee

> Between non-competitors

- Excluded restriction of competition (Article 5.2 TTBER)

- Exceptions:

  - indispensable to prevent the disclosure of the licensed know-how to third parties

  - number of technologies available and the parties do not possess special assets or skills to develop a competing technology of the licensed technology (§ 143 TT guidelines)
Grant-back clause

> Licensee might develop improvements to the licensed technology or additional know-how

> Grant-back = a direct or indirect **obligation on the licensee to grant an exclusive license or to assign rights**, in whole or in part, to the licensor or to a third party designated by the licensor in respect of the licensee’s improvements to, or its new applications of, the licensed technology
Grant-back clause

> Examples:

3.1 In case LICENSEE develops an improvement or new application of the LICENSED PATENTS which cannot be exploited without infringing the LICENSED PATENTS, all commercial and intellectual rights pertaining to such improvement, including the right to file a patent application, shall be vested with LICENSOR.

9.3 Any and all rights, title and/or interest in and/or to (i) the Improvements of the [redacted] and/or (ii) the Intellectual Property related thereto shall be vested in Licensor.

9.4 Any improvement of the [redacted] shall fall under the terms and conditions in this Agreement.
Grant-back clause: what is prohibited?

> **Exclusive grant-back obligations are an excluded restriction** (Art. 5 (1) (a) TTBER)

- Improvements to the same application of the licensed technology as well as new applications
- Irrespective of the consideration paid to licensee
- Irrespective of whether these improvements are severable or not (vs. TTBER 2004)

3.3 In case LICENSEE develops an improvement or new application of to the LICENSED PATENTS which is severable and can be exploited without infringing the LICENSED PATENTS, LICENSOR and her AFFILIATED UNDERTAKINGS, will have a right of first refusal to, at their choice, a sole or non-exclusive license for [territory]. In case LICENSOR or an AFFILIATED UNDERTAKINGS exercises her right of first refusal, the parties shall discuss in good faith the terms and conditions of such non-exclusive license. LICENSEE shall inform LICENSOR of any improvement or new application of the LICENSED PATENTS within reasonable time limits, upon which LICENSOR and/or AFFILIATED UNDERTAKINGS shall have a period of three months to decide whether they wish to exercise their right of first refusal.
No-challenge clause

> Direct or indirect contractual obligation on a party not to challenge the validity of IP rights which the other party holds in the Union

[Licensee] shall not directly or indirectly challenge the validity of the intellectual property rights which [Licensor] holds during the execution of this agreement and during a period of 5 years after termination of this agreement.
No-challenge clause

> Example of indirect obligation: termination of the agreement in case of challenge (vs. TTBER 2004)

8.4 Should LICENSEE and/or any of its AFFILIATED UNDERTAKINGS challenge the validity of LICENSED PATENTS, LICENSOR has the right to immediately terminate the AGREEMENT without prior notice.
No-challenge clause: what is prohibited?

> Excluded restriction of competition (Article 5.1 (b) TTBER)

> Exceptions:

- **Exclusive license** can be terminated in case the licensee challenges the validity of any of the licensed technology rights

- Technically **outdated process** that the licensee does not use (§ 134 TT guidelines)

- License that is granted **for free** (§ 134 TT guidelines)

- A clause obliging the licensee not to challenge the ownership of the technology rights (§ 135 TT guidelines)

- Non-challenge and termination clauses **solely concerning know-how** (§ 140 TT guidelines)
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