Joint Comments of the American Bar Association's Section of Antitrust Law, Section of International Law and Practice and Section of Intellectual Property Law on the Commission Evaluation Report on the Transfer of Technology Block Exemption Regulation No. 240/96 Technology Transfer Agreements Under Article 81

The Section of Antitrust Law, the Section of International Law and Practice, and the Section of Intellectual Property Law (collectively, the "Sections") of the American Bar Association welcome the opportunity to respond to the request of the European Commission for comments on the Commission Evaluation Report on the Transfer of Technology Block Exemption Regulation No. 240/96; Technology Transfer Agreements Under Article 81 (the "TTBE Report" or the "Report").[1] The views expressed herein are being presented jointly on behalf of the Sections. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the policy of the American Bar Association.

The membership of the Sections includes over 44,000 lawyers, most of whom are based in the United States. Given the increasingly global nature of business and in particular the worldwide provision of products and services that constitute or depend upon new technologies and the long history of competition law in the United States, the Sections have substantial familiarity with legal and economic analyses of the potential competitive effects of transfers of technology. These comments offer a perspective based upon the experience in the United States in the fields of antitrust and intellectual property law. The Sections hope and intend that these comments, from our perspective as U.S. practitioners and grounded in the historical development of U.S. antitrust law and practice regarding similar issues, will assist the Commission in its evaluation of current Regulation No. 240/96 (the "TTBE") and contemplated approaches to improving the methodology for the application of Article 81(3) to technology transfer agreements.

The Sections commend the Commission for undertaking a comprehensive review of its policies and practices in this important area. The Sections welcome the TTBE Report's proposal to shift from a legalistic to a more economic and effects-based analysis. In particular, the Sections believe that the proposal that competition law scrutiny be focused primarily on inter-brand competition issues and possible efficiencies created by certain licensing agreements is supported by most modern economics thought.

The Sections also support the TTBE Report's broad reassessment of the application of the TTBE to assignments, licenses and other agreements concerning

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[1] The full text of the English version of TTBE Report is set forth at http://europa.eu.int/comm/competition/antitrust/technology_transfer/en.pdf.

intellectual property rights (IPRs) that are ancillary to vertical agreements, specialization agreements and research and development (R&D) agreements, consistent with Regs. Nos. 2790/1999, 2658/2000 and 2659/2000. The Sections believe that the comprehensive review of the scope of the TTBE offers the Commission an opportunity to develop a simpler and broader block exemption for technology licensing agreements that is not only consistent with recently adopted regulations, but also further aligns EC law with the overarching goal of promoting consumer welfare (including the consumer benefits of innovation).

Moreover, the Sections applaud the Commission's contemplated expansion of the scope of the TTBE beyond its current application to certain exclusive licensing agreements between only two parties, regarding only pure or mixed patent and know-how licenses used solely for the purposes of manufacture, use and commercialization. The current narrow scope of the TTBE is understandable, given its origins in former Regulations Nos. 2349/84 and 556/89, creating block exemptions for licenses of know-how and patents, respectively. The proliferation of new technologies and the rapid spread of technologies throughout the world during the past twenty years, and the concomitant development of novel distribution and licensing regimes, many of which encompass IPR or licensing structures that fall outside the current scope of the TTBE, further demonstrate the timeliness of the Commission's reassessment of the exemption.

For the foregoing reasons, the Sections welcome the TTBE Report's proposed more lenient and economics-based approach to licensing agreements between "non-competitors" and regard the proposals set forth in the Report as constituting important progress that will serve all three of main objectives of the TTBE.[2] Without discounting the importance of the Report's proposals, in the Sections' view, those proposals do not address several important shortcomings of the current TTBE, and the Sections encourage the Commission to consider even broader reassessment of Reg. 240/96 at this important juncture in the development of EC competition law.

The Sections also support in principle the Commission's proposed future block exemption regarding licenses between "competitors," excepting licenses that violate an appropriate hardcore list of restrictions and subject to guidelines providing appropriate consideration of market share ceilings and considerations such as possible efficiencies promoted by such licenses.

The issues that the Sections believe bear further consideration by the Commission are summarized in the Executive Summary, below. Following the Executive Summary, we set out the Sections' detailed comments on the Commission's specific proposals.

[2] As recited in ¶ 10 of the TTBE Report, those objectives are: (1) "to simplify the rules governing licensing agreements . . . so as to 'encourage the dissemination of technical knowledge in the Community and to promote the manufacture of technically more sophisticated products;'" (2) "to guarantee effective competition in technologically new or improved products;" and (3) "to create a favourable legal environment for companies investing in the EU, by providing them with legal certainty and by reducing the administrative burden resulting from individual notifications."

Executive Summary

General Approach to the Antitrust–Intellectual Property Intersection. While there remains disagreement about the application of the antitrust laws to specific conduct by holders of IPRs, under U.S. antitrust law, IPRs are treated as property rights, and do not automatically confer monopoly power. The analysis of the antitrust-IP interface under EC law, proceeding as it does from the presumption that IPR law confers a "legal monopoly" on IPR holders,[3] is contrary to the current state of U.S. law and the *Antitrust Guidelines for the Licensing of Intellectual Property*, issued by the Department of Justice (DOJ) and Federal Trade Commission (FTC) (the "*IP Guidelines*" or the "*Guidelines*").[4] Under the *Guidelines*, there is no such presumption that IPRs confer monopoly power. The *Guidelines* also support broader recognition of the generally pro-competitive and efficiency-enhancing effects of licensing of IPR, including cross-licenses. While the Sections do not consider the *IP Guidelines* to be either a comprehensive or perfect statement of the appropriate antitrust analysis of intellectual property licenses, the Sections support the basic thrust of the *Guidelines* and believe that the *IP Guidelines* and the experiences of the Sections' membership with the *Guidelines* provide useful precedents.

Reliance on Market Share Measures. While the U.S. antitrust agencies continue to use market share measures, such as the Herfindahl-Hirschman Index (HHI), as a tool in analyzing market concentration that may be created by proposed mergers and acquisitions,[5] the HHI and similar tools of quantitative analysis are used in conjunction with more qualitative market analyses that take into account efficiencies (including dynamic efficiencies) and other competitive circumstances in a given industry. There is a perception that EU markets are defined more narrowly, and perhaps more rigidly, than in the U.S. The Sections oppose any presumption of illegality of licenses, or restrictive clauses therein, based solely on market share thresholds. We encourage consideration of a more flexible review of such agreements, consistent with the approach described in the *IP Guidelines*. Subject to the adoption of this flexible approach and subject to the detailed comments made below, the Sections generally support the TTBE Report's proposed application of stated market share thresholds to certain kinds of agreements and restraints, to make such thresholds consistent with those applied to similar agreements and restraints under Regulations Nos. 2658/2000, 2659/2000 and 2790/1999.

Monopolization versus Abuse of Dominant Position. The divergence in practice between the EC and the U.S. in the determination of whether a particular technology license is anti-competitive stems in part from the difference in the fundamental elements between violations of Article 82 and Section 2 of the Sherman Act. A monopolization

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3 TTBE Report ¶ 28.

4 4 Trade Reg. Rep. (CCH) ¶ 13,132 (April 6, 1995), *available at* http://www.usdoj.gov/atr/public/guidelines/ipguide.htm.

5 *Department of Justice and Federal Trade Commission Horizontal Merger Guidelines*, issued April 2, 1992, § 1.5 (Revised April 8, 1997), 4 Trade Reg. Rep. (CCH) ¶ 13,200, *available at* http://www.ftc.gov/bc/docs/horizmer.htm.

violation under Section 2 requires proof of both the possession of monopoly power and the willful acquisition of that power, as distinguished from growth or development as a consequence of a superior product, business acumen or historic accident. In contrast, Article 82 is often said to prohibit mere exploitation of market power by a dominant firm, including, for example, excessive pricing. The Sections respectfully submit that this aspect of EC law, coupled with the presumption of monopoly power (or dominance), leads to condemnation of technology licenses that are competitively neutral, or that may even stimulate competition.

Horizontal versus Vertical Characterization. The Sections submit that there remain substantial differences between U.S. and EC practice in the characterization of certain IP licensing agreements. The consequences of these characterizations are often significant. In contrast to EC practice, which emphasizes the potential competitive relationship between the parties, the *IP Guidelines* recognize that IP licenses even between competitors are often properly analyzed as "vertical" licenses, such as instances in which one competitor licenses "far superior" technology to another competitor, or where the competitor is unable or unlikely to develop a competing technology without the license. In the Sections' view, and under the *IP Guidelines* ¶ 3.3, the analysis should turn on whether the license agreement substantially reduces competition that would have existed in the absence of the license. In fact, the Report (¶ 186) also considers the possibility of guidelines that focus on "the situation that would characterise the market absent the license." The Sections would welcome such guidelines.

Scope of the TTBE. As stated above, the Sections regard the Commission's current reassessment of the TTBE, coupled with the burgeoning of technology and technology licenses, as creating an opportunity to extend the block exemption to a number of additional types of licenses and restrictions in the ways we discuss below. Those include: non-exclusive licenses; exclusive licenses; multi-party licenses; cross-licensing and bilateral pools; tying arrangements; grant-back clauses; output restrictions; site licenses; non-compete clauses; no-challenge clauses; and customer restrictions, field-of-use restrictions, and territorial restrictions.

Territorial Restrictions. The Sections are mindful of the importance of the goal of market integration in the development of EC competition law. We respectfully submit, however, that in the current state of the highly integrated European market, placing severe limits on the ability of licensors to impose such restrictions on technology licensees may disserve both consumer welfare and the completion of the integration of the market. Absent the ability to impose such restrictions, many licensors will often be unable to provide sufficient incentive to licensees to make the investments necessary to exploit the licensed technology in many markets.

General Guidance on Procedural Approach Post-Reform and Post-Modernization; Ensuring Consistency. Firms doing business in the European Union need early, clear guidance on how the EC and the member states intend to enforce the TTBE following reform. Need for procedural clarity and uniformity is particularly important in light of the proposed modernization, and decentralization of the application of Articles 81 and 82. To avoid renationalization of competition policy, or discriminatory application of EC competition law by national authorities, the Commission should promulgate clear procedural rules and transparent substantive guidelines for the application of the TTBE throughout the Community.

Comments

Part I—
General Approach to the Antitrust – Intellectual Property Intersection

A. The Report's Characterization of the Relationship Between IPR Policy and Competition Policy

The TTBE Report starts from the proposition that the "relationship between IPR policy and competition policy is a longstanding topic of debate in economic and legal circles." The Report states that it is recognized that "it is not easy to marry the innovation bride and the competition groom and some have argued that such a marriage will unavoidably lead to divorce." (¶ 27).

The TTBE Report takes the position that "IPR laws grant certain monopoly rights" to innovators and that competition law may "take away what IPR law is providing." (¶ 28). The Report suggests that this is only an "apparent source of conflict" since "at the highest level" IPR and competition laws are complementary because they both "aim at promoting consumer welfare." According to the Report, IPR laws promote technical progress by striking a balance between over- and under-protection of innovators' efforts, to ensure a sufficient reward for the innovator to elicit creative or inventive effort while not delaying follow-on innovation or leading to unnecessarily long periods of high prices. (¶ 29). The Report concludes that "the relevant question is therefore not one of conflict but of complementarity and possibly adjustment in the individual case," suggesting that the question for competition policy is whether it should "intervene and try to improve the balance produced by IPR law?" (¶ 32). This conclusion rests upon the Report's assertion that there is agreement that "competition policy has to play its normal role where IPR rights are used to produce an anticompetitive effect beyond the exploitation of the IPR rights," but that there is no agreement as to "what extent competition policy should interfere with the exploitation of IPR rights in individual cases." (¶¶ 34-35).

B. Shifting Approaches to the Antitrust - Intellectual Property Interface: The Current U.S. Perspective

The TTBE Report discusses EC competition policy in the field of IPR (¶¶ 36-45), U.S. competition policy in the field of IPR (¶¶ 46-53), and offers a comparison between the EC and U.S. approaches (¶¶ 54-58). The Sections believe that the TTBE Report's characterization of the nature of IPR policy and antitrust policy fails to capture accurately in all respects current U.S. law and policy regarding these issues. A fuller understanding of current U.S. law and policy, and their evolution, supports broadening of the TTBE, even beyond the proposals in the Report

The historical view in the United States was that there is an inherent conflict between the intellectual property laws which were said to grant a "monopoly" to the intellectual property owner and the antitrust laws which were said to prevent the creation or enhancement of monopoly power. One leading case reasoned:

> "While the antitrust laws proscribe unreasonable restraints of competition, the patent laws reward the inventor with a temporary monopoly that insulates him from competitive exploitation of his patented art . . . [T]he patent and antitrust laws necessarily clash. . . . [T]he primary purpose of the antitrust laws – to preserve competition – can be frustrated, albeit temporarily, by a holder's exercise of the patent's inherent exclusionary power during its term."[6]

The view that patents were monopolies conferring market power to the detriment of competition led to restrictive views of the antitrust permissibility of intellectual property licensing practices, which culminated in the DOJ Antitrust Division enunciating guidelines during the 1970s that became known as the "Nine No-No's."[7] These No-No's are not dissimilar from practices prohibited under the TTBE.

The Nine No-Nos frowned upon:

(1) requiring a licensee to purchase unpatented materials;

(2) requiring a licensee to assign future patents;

(3) restricting a purchaser of a patented product in the resale of the product;

(4) restricting a licensee's ability to deal in products or services not within the scope of the patent;

(5) a patent holder agreeing with a licensee not to grant future licenses to others without licensee's consent;

(6) mandatory package licensing;

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6 *SCM Corp. v. Xerox Corp.*, 645 F.2d 1195, 1203 (2d Cir. 1981), *cert. denied*, 455 U.S. 1016 (1982).

7 In a September 21, 1972 address, Bruce B. Wilson, then Deputy Assistant Attorney General, Antitrust Division, noted that the Department of Justice's nine rules had "quickly [become] known as the nine no-no's." Bruce B. Wilson, Address Before Michigan State Bar Antitrust Section and Patent Trademark and Copyright Section (September 21, 1972), *partial text reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,125.

(7) royalties on the total sales price of products containing unpatented items;

(8) restricting a licensee's sale of products made by use of the patented process; and

(9) requiring a licensee to adhere to any price with respect to the licensee's sale of the licensed product.[8]

By 1975, however, the Antitrust Division was beginning to acknowledge that the Nine No-No's would not always be given "wooden application."[9] Following an internal reappraisal, the then Deputy Assistant Attorney General, Antitrust Division, Ky Ewing, announced a significant modification of antitrust policy with respect to patent licensing on May 5, 1979.[10] The general approach of the Nine No-No's, and much of the specific guidelines it enunciated, were repudiated in the United States, in the early 1980s.[11]

The view that the two legal regimes are in conflict follows from the mistaken presumption that the intellectual property laws create monopolies. The prevailing view in the U.S. is that the IP laws confer property rights in the form of exclusive rights over technology, that may or may not give rise to monopoly power. A particular patent may offer one of several competing technological solutions and confer no market power on its owner, or it may offer the only solution and give its owner significant market power. In this respect, intellectual property rights are no different than real property rights, such as those conferring ownership of a manufacturing plant or a mine, which may be one of many competing plants or mines, or which may be the sole plant producing a product or sole source of some mineral and may therefore confer monopoly power to the extent there are no substitutes.

The modern view in the United States, as articulated in recent cases and most commentary, is that intellectual property laws generally authorize owners of IPRs to exclude others from using that property, and do not necessarily create monopoly power. The two legal regimes have the same ultimate objectives: promoting economic progress and consumer welfare. The two legal regimes also employ broadly consistent means. The antitrust laws, by protecting competition as it is understood in its fullest dynamic sense, also promote innovation. That is, "possession of unchallenged economic power

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8 *See* Bruce B. Wilson, *Patent and Know-How License Agreements: Field of Use*, *Territorial, Price and Quantity Restrictions*, *in* Antitrust Primer: Patents, Franchising, Treble Damage Suits 11, 12-14 (1970) *cited in* Sheila F. Anthony, *Antitrust and Intellectual Property Law: From Adversaries to Partners*, 28 AIPLA Quarterly Journal 1 (Winter 2000); Bruce B. Wilson, Address Before Michigan State Bar Antitrust Section and Patent, Trademark and Copyright Section (September 21, 1972), *partial text reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,125.

9 *See* Bruce Wilson, "Dep't of Justice Luncheon Speech Law on Licensing Practices: Myth or Reality?" (Jan. 21, 1975).

10 Ky P. Ewing, Deputy Assistant Attorney General, Antitrust Division, *Antitrust Enforcement and the Patent Laws: It is as Craftsmen that We Get Our Satisfactions and Our Own Pay,* Address Before the San Francisco Patent Law Association (May 5, 1979), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,128, at 20,717.

11 Abbott B. Lipsky, Jr., Current Antitrust Division Views on Patent Licensing Practices, 50 Antitrust L.J. 515 (1981). *See* Roger Andewelt, *The Antitrust Division's Perspective on Intellectual Property Protection and Licensing – The Past, the Present and Future* (July 16, 1985).

deadens initiative, discourages thrift and depresses energy; . . . immunity from competition is a narcotic, and rivalry is a stimulant, to industrial progress."[12] Similarly, intellectual property laws also stimulate competition, because innovation is the single most significant source of competition. The dynamic effects of innovation quickly outweigh even significant static inefficiencies.

As articulated in one leading case:

> "[W]hen [a] patented product is so successful that it creates its own economic market or consumes a large section of an existing market, the aims and objectives of patent and antitrust laws may seem, at first glance, wholly at odds. However, the two bodies of law are *actually complementary*, as both are aimed at *encouraging innovation, industry and competition*."
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> "[There is a] fine line between actions protecting the legitimate interests of a patent owner and antitrust law violations. On the one hand, the patent owner must be allowed to protect the property right given to him under the patent laws. On the other hand, a patent owner *may not take the property right granted by a patent and use it to extend his power in the marketplace improperly*, i.e. beyond the limits of what Congress intended to give in the patent laws. The fact that a patent is obtained does not wholly insulate the patent owner from the antitrust laws."
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> "When a patent owner uses his patent rights not only as a shield to protect his invention, but as a sword to eviscerate competition unfairly, that owner may be found to have abused the grant and become liable for antitrust violations."[13]

In addition, one fundamental area in which U.S. policy is founded on different principles than those suggested by the Report as being seriously considered, if not prevailing, in the European Union, is the role that competition policy plays with respect to the balance produced by IPR law and the exploitation of IPRs in individual cases. (¶¶ 32, 35). In the United States, antitrust law does not seek to "improve the balance" produced by IP law. Under the U.S. Constitution, these judgments are left to the legislature. The judgment of the legislature is final regarding the appropriate balance, as embodied in the IP law, of incentives for initial innovation, publication of innovations to foster follow-on innovations, and price competition. It is not considered appropriate, in the U.S., for antitrust enforcement agencies or the courts to attempt to improve the

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12 *United States v. Aluminum Co. of America*, 148 F.2d 416, 427 (2d Cir. 1945) (Hand, J.).

13 *Atari Games Corp. v. Nintendo of America. Inc.*, 897 F.2d 1572, 1576 (Fed. Cir. 1990) (emphasis added).

balance set by Congress by limiting IPRs in particular cases where some party believes that there is over-protection.

That is not to say that there is not ongoing tension at the intersection of antitrust and intellectual property law in the United States. Issues continue to arise in this area, there is substantial litigation, and continued debate, as reflected in cases such as *Intergraph Corp. v. Intel Corp.*,[14] and *In re Independent Service Organization Antitrust Litig. (CSU, LLC v. Xerox Corp.)*,[15] as well as the ongoing hearings being conducted jointly by the U.S. Federal Trade Commission and Department of Justice on "Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy."[16] The Sections welcome the Commission's continuing participation in the ongoing analysis of the antitrust-IP interface.

C. Fundamental Principles of the *IP Guidelines*

The *IP Guidelines*, adopted in 1995, articulate a coherent policy approach and state the U.S. government's enforcement intentions regarding the application of the antitrust laws to intellectual property licensing. While the Sections may not agree fully with every detail of the *IP Guidelines*, we believe that the *Guidelines* and the experience under the *Guidelines*, provide valuable precedent.

The *IP Guidelines*, by their terms, apply to "the licensing of intellectual property protected by patent, copyright, and trade secret law, and of know-how," but not to trademark licensing. The *Guidelines* follow the modern view of the antitrust/intellectual property interface:

> "The intellectual property laws and antitrust laws share the common purpose of promoting innovation and enhancing consumer welfare. The intellectual property laws provide incentives for innovation and its dissemination and commercialization by establishing enforceable property rights for the creators of new and useful products, more efficient processes, and original works of expression. . . . The antitrust laws promote innovation and consumer welfare by prohibiting certain actions that may harm competition with respect to either existing ways or new ways of serving consumers."

IP Guidelines ¶ 1.0.

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14 195 F.3d 1346 (Fed. Cir. 1999).

15 203 F.3d 1322 (Fed. Cir. 2000), *cert. denied*, 121 S. Ct. 1077 (2001).

16 *See also* T. Muris, *Competition and Intellectual Property Policy: The Way Ahead*, Remarks Before the ABA Antitrust Section Fall Forum (Nov. 15, 2001); R. Pitofsky, *Antitrust and Intellectual Property: Unresolved Issues at the Heart of the New Economy*, Remarks Before the Antitrust, Technology and Intellectual Property Conference (March 2, 2001).

As the TTBE Report notes, there are a number of fundamental guiding principles underlying the *Guidelines*. First, the U.S. agencies apply the *same general antitrust principles* to conduct involving intellectual property as to conduct involving any other form of tangible or intangible property. *IP Guidelines* ¶ 2.1. This principle has been reinforced by the U.S. courts, most recently in *United States v. Microsoft Corp.*,[17] where the Court of Appeals for the D.C. Circuit reiterated that "'Intellectual property rights do not confer a privilege to violate the antitrust laws.' *In re Indep. Serv. Orgs. Antitrust Litig.*, 203 F.3d 1322, 1325 (Fed. Cir. 2000)."

Second, the U.S. antitrust enforcement authorities *will not presume* that intellectual property necessarily confers *market power* despite the fact that courts historically have presumed that intellectual property gives an intellectual property owner a legal monopoly and market power. *IP Guidelines* ¶ 2.2. While there is some case law to the contrary on this point, the U.S. House of Representatives Judiciary Committee Subcommittee on the Courts, the Internet and Intellectual Property held a hearing on November 8, 2001 to address "Market Power and Intellectual Property Litigation." Legislation is likely to be introduced which would make it clear that, in any action in which the conduct of an owner, licensor, licensee, or other holder of an intellectual property right is alleged to be in violation of the antitrust laws, such right shall not be presumed to define a market, to establish a market, or to establish monopoly power. The American Bar Association House of Delegates has long endorsed such potential legislation in principle.[18]

The Sections submit that the lack of any presumption that IPRs confer market power is consistent with modern economic theory and fosters the protection of consumer welfare by requiring examination of whether, under specific market conditions, an IPR holder has market power and whether a license of such an IPR could have anticompetitive consequences.

Third, the U.S. antitrust enforcement agencies recognize that intellectual property licensing and cross-licensing can lead to integration with complementary factors of

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17 253 F.3d 34, 63 (D.C. Cir.), *cert. denied*, 122 S. Ct. 350 (2001).

18 In 1990, the House of Delegates of the American Bar Association adopted a policy position, which was reaffirmed in 2000, in support of H.R. 469, 101st Cong., a bill to provide that intellectual property rights shall not be presumed to define a market or to establish market power in actions under the antitrust laws. The ABA resolution states: "BE IT RESOLVED, That the American Bar Association favors in principle legislation such as H.R. 469, 101st Cong., 1st Sess. (1989) (Fish) and S. 270, 101st Cong., 1st Sess. (1989) (Leahy) which provides that intellectual property rights shall not be presumed to define a market or to establish market power in actions under the antitrust laws; RESOLVED, That the Association recommends such legislation cover specifically the licensing of or refusal to license such rights." *See* testimony of Norman P. Rosen in "Intellectual Property Antitrust Protection Act of 1989," Hearing on H.R. 469 Before the Subcommittee on Economic and Commercial Law of the House Judiciary Committee, 101st Cong., 2nd Sess., 59-70. In 1996, the ABA testified in support of H.R. 2674, which had essentially the same provisions as H.R. 469. *See* testimony of John R. Kirk, Jr., "Intellectual Property Antitrust Protection Act of 1995," Hearing Before the Committee on the Judiciary, House of Representatives, Serial No. 75, 104th Congress, May 14, 1996. Most recently, Charles P. Baker testified on November 8, 2001 before the Subcommittee on Courts, The Internet and Intellectual Property of the U.S. House Judiciary Committee on "Market Power and Intellectual Property Litigation" in support of similar legislation.

production and more efficient exploitation of the intellectual property, and are typically pro-competitive. *IP Guidelines* ¶ 2.3. Thus, U.S. law recognizes that restrictions in licenses may allow intellectual property owners to efficiently and effectively exploit their intellectual property, by, for example, protecting against free-riding, and may thus serve procompetitive ends. Restrictions may provide intellectual property owners with the incentive to invest in commercialization and distribution of products and to develop additional applications for their intellectual property. *IP Guidelines* ¶ 2.3.

These principles, together with the characterization of licenses as "horizontal" or "vertical" and consideration of whether the effect is to diminish competition that would have existed absent the license, guide U.S. antitrust analysis of IP licenses. *IP Guidelines* ¶¶ 3.1, 3.3. Contrary to the suggestion in the TTBE Report, U.S. law does not respect the right of the holder of intellectual property rights "to fully exploit it" by imposing in a licensing agreement the restrictions necessary to obtain the full benefit of the intellectual property right. (¶ 46). While there is case law in the United States that might support the idea that a holder of intellectual property has the "right" to obtain monopoly profits, those cases reflect the older view of intellectual property as granting "lawful monopolies" rather than the more modern view that intellectual property is like other types of property in that it grants its holder the right to exclude others, but not necessarily any market power. In any event, U.S. law recognizes that the owner of IP may generally exact royalties as high as can be negotiated.[19] In this respect, the Sections understand that U.S. law may differ from the law in the EU.

The TTBE Report suggests that if a licensor has a patent on the process of manufacturing but not on the product manufactured by the licensee, then fixing the licensee's sales price of the product is illegal price fixing. (¶ 47). The TTBE Report also suggests that restrictions concerning pricing may be a "rightful way[] of the licensor to try to maximise his income from the IPR" and suggests that the *IP Guidelines* provide that "the owner of a product patent may fix in a license to manufacture the licensee's first sales price of the patented product." (¶ 54). In fact, while there is old case law that holds that an owner of a patent may condition a single license to manufacture under that patent on the fixing of the first sale price of the product produced under that manufacturing license, *United States v. General Electric Co.*,[20] that decision has been narrowly construed. And in other arrangements, the *IP Guidelines* take the clear position that the DOJ and FTC "will enforce the per se rule against resale price maintenance in the intellectual property context." *IP Guidelines* ¶ 5.2. The Sections believe that the *IP Guidelines*' approach, tempered by the U.S. Supreme Court's ruling in *State Oil Co. v. Khan*,[21] applying the rule of reason to maximum resale price fixing, guides current counseling on this issue in the United States.

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19 *Brulotte v. Thys*, 379 U.S. 29 (1964).

20 272 U.S. 476 (1926).

21 522 U.S. 3 (1997).

The TTBE Report questions the fact that the *IP Guidelines* "seem largely to ignore the competition consequences" of the possibility that the relationship between licensees is horizontal by having "a very lenient policy towards territorial restraints as long as the licensor and licensee are not competitors." (¶ 55, n. 29). However, in the Sections' view, supported by U.S. judicial precedent and reflected in the *IP Guidelines*, so long as such agreements are between the licensor and licensee, and do not reflect a horizontal cartel among the licensees that is imposed upon the licensor, then such agreements are appropriately treated as vertical, even if the licensees are horizontal competitors.

Part II—
Strong Reliance on Market Definitions:
Flexibility of Analysis of Market Structures

A. The TTBE Report's Proposed Use of Rigid Market Share Tests: The Difficulty of Market Definition

The Sections submit that, while market share tests are useful indicators, they suffer from various shortcomings. In our view, any presumption of illegality based solely on market share tests, particularly in the context of intellectual property, disserves the goals of innovation and consumer welfare. The Commission's proposals to use a dominance threshold for license restrictions "related to exploitation" for licenses between "non-competitors,"[22] and a 30% market share threshold for other restrictions between "non-competitors," raise the issue of how "dominance" is defined and how markets are defined for purposes of share measurement. Even seasoned experts often disagree on market definitions, thus limiting the utility of this proposed approach.

In its Guidelines on Horizontal Cooperation, the Commission identifies three possible relevant markets in the case of R&D agreements: product markets, technology markets, and "innovation markets." Market definition is especially difficult with regard to "R&D/innovation markets," and with regard to product and service markets in which the influence of innovation is expected to be material. The Sections encourage the Commission to consider the adoption of a more flexible approach to market definitions in the application of the TTBE and greater caution in defining "innovation markets."

More specifically, the Sections respectfully suggest that the Commission give due account to the fact that, in the case of new technologies that represent significant breakthroughs, market shares may be very high until a competing technology comes onto the market. Second, the Commission should note that definition of the market might become a particularly speculative exercise as the focus moves away from existing products towards R&D activities. In this regard, we would urge the Commission not to place undue reliance on the approach it adopted with regard to market definition in the context of R&D agreements.

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22 As we noted in the Executive Summary and discussed in more detail later in these comments, there is also the issue of whether the distinction between "non-competitor" and "competitor" is the crucial one.

B. Markets Affected: The Theoretical Framework

The U.S. antitrust authorities believe there are three different theoretical markets that may be impacted by any licensing arrangement.

> "If a licensing arrangement may adversely affect *competition to develop new* or improved goods or processes, the Agencies will analyze such an impact either as a separate competitive effect in relevant *goods or technology markets*, or as a competitive effect in a *separate innovation market*."

IP Guidelines ¶ 3.2.3 (emphasis added).

Goods markets comprise goods or services and are the markets with which antitrust has been traditionally concerned, such as markets for pharmaceuticals, computer chips, or computer services. An intellectual property arrangement may affect competition in the sale of goods by restricting the licensee's rights to sell or use specified goods. A licensing arrangement may also affect competition in markets for final goods, or intermediate, upstream, goods that are used in conjunction with the intellectual property to manufacture a final product, by restricting competition that would have existed absent the agreement. *IP Guidelines* ¶ 3.2.1.

Technology Markets are markets in which companies compete in the licensing of intellectual property.

> "Technology markets consist of the intellectual property that is licensed (the 'licensed technology') and its close substitutes -- that is, the technologies or goods that are close enough substitutes significantly to constrain the exercise of market power with respect to the intellectual property that is licensed."
>
> "When rights to intellectual property are marketed separately from the products in which they are used, the Agencies may rely on technology markets to analyze . . . competitive effects. . . ."

IP Guidelines ¶ 3.2.2.[23]

"*Innovation markets*," sometimes called research and development or R&D markets, are markets in which firms compete in research and development, and are the most controversial. The *Guidelines* explain:

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[23] *See, e.g., United States v. Pilkington plc*, Civ. No. 94-345 TUC-WDB (D. Ariz. May 25, 1994); *Montedison S.p.A.,* 119 F.T.C. 676 (1995).

> "A licensing arrangement may have competitive effects on innovation that cannot be adequately addressed through the analysis of goods or technology markets. For example, the arrangement may affect the development of *goods that do not yet exist*. Alternatively the arrangement may affect the development of new or improved goods or processes in geographic markets where there is *no actual or likely potential competition* in the relevant goods."

IP Guidelines ¶ 3.2.3 (emphasis added). The Sections have doubts as to whether the concept of "innovation markets" reflects sound policy,[24] and believe that the concept may be prone to abuse. We urge the Commission to apply this concept cautiously.

C. Application of Flexible Analysis to Specific Proposed Uses of Market Share Tests in a Revised TTBE

1. Joint Ventures Between "Competitors"

The Report concludes (¶ 138) that it is necessary to reconsider the market share thresholds in the TTBE regarding licensing agreements relating to a joint venture between "competitors" in light of the changes in market share thresholds introduced in the new block exemptions Regulations No. 2658/2000 and No. 2659/2000.

As discussed above, the Sections believe that market share thresholds should be incorporated into a more flexible analysis that examines other factors as well. That being said, the Sections agree that it is sound policy to have the market thresholds be consistent across block exemptions regarding such closely related subject matter. The reasons supporting particular market share thresholds in Regulations No. 2658/2000 and No. 2659/2000 also support similar thresholds in a block exemption regarding licenses in joint ventures between "competitors." The Sections note below (Part II.C.2, Part IV), however, that the definition of "competitors" that applies in this context is very important.

2. Proposed Block Exemption for Licenses Between "Competitors"

The Report proposes a block exemption regarding licenses between "competitors" that would apply to situations involving market shares up to 25%, and would contain a hardcore list of restrictions that would not be eligible for exemption. (¶¶ 187-188). The Report also suggests that the exemption may contain a list of conditions that would exclude certain restraints from the coverage of the block exemption. Such a new block exemption would create coherence with Regulation 2659/2000.

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[24] *See*, *e.g.*, ABA Section of Antitrust Law, Comments on the "Antitrust Guidelines for Collaborations Among Competitors" Issued in Draft on October 1, 1999 by the Federal Trade Commission and U.S. Department of Justice at p. 16 (February 2000), *available at* http://www.abanet.org/antitrust/collaborations.html.

The Sections support the goal of coherence with Regulation 2659/2000. We also agree with a more nuanced approach toward pooling arrangements, cross licensing agreements, license agreements relating to joint ventures and restraints that do not relate directly to the exploitation of the IPR itself (however the restraints are defined). The Sections support the principle of limiting the prescriptive character of the new regulation and concentrating on a limited hardcore list (¶178).

The Sections urge the Commission to pursue a future block exemption in this area that will apply also to multi-party arrangements. To the extent such an exemption is not possible without amendment of Council Regulation No. 19/65, the Sections encourage the Commission to seek such an amendment, while in the meantime issuing guidelines for multi-party arrangements that are consistent with the approach toward bilateral agreements.

As discussed in further detail below, a fundamental issue in such a future block exemption is what types of parties will be considered "competitors" that will be covered by the exemption. For example, if a patent holder grants a license to a party that would otherwise be unable to enter the market, and retains the right to practice the patent, so that both patent holder and licensee will be market participants using that technology, should the license agreement be considered one between "competitors" covered by such a future block exemption? Or should such a license agreement be covered by a future block exemption between "non-competitors"? Or, suppose the parties hold complementary or blocking patents, so that neither have been able to enter the market because they either do not have all the technology needed or do not have patent clearance. A license between these parties will enable them to enter the market and compete with each other. Should such a license be considered one between "competitors" or "non-competitors"? Or suppose that the parties are competitors in the market place, but hold complementary or blocking patents for the next generation products? Therefore, the Sections suggest that a more useful approach is to categorize the licenses themselves as "vertical" or "horizontal," not to consider initially the nature of the parties as "competitors" or "non-competitors," and to provide block exemptions of differing scopes to the different types of licenses.

In arrangements where more than a single IPR is involved, such as in the case of cross-licenses and pools, the Sections consider an important threshold issue to be the relationships among the IPRs involved. For example, if the IPRs involved are not complementary or blocking, then there are the fundamental questions of whether there should be any cross-license or pool at all, and whether the arrangement is a pretext for an anti-competitive restraint. Moreover, even if some of the IPRs are complementary or blocking, but others involved are redundant or substitutes, there may be an issue of whether the underlying IPR scope of the agreement is appropriate. The context of the arrangements, such as the settlement of litigation or a merger, should also be part of the analysis.

For arrangements that include only either complementary or blocking IPRs, the Sections support a future block exemption that is limited by a market share threshold up to 25% and contains a hardcore list for restrictions which directly or indirectly fix prices or limit output or sales. However, the Sections believe that, in such arrangements, certain exclusivity provisions, including the allocation of territories or customers, may have efficiency-enhancing and pro-competitive effects and that, therefore, the allocation of territories or customers should not be included in a hardcore list. In this respect the Sections do not believe that less protection to territorial restraints between "competitors" in exclusive licensing agreements is appropriate. Such restrictions might more appropriately be treated in the manner in which Article 4 of the current TTBE treats certain agreements. The Sections agree that a list of conditions that would exclude certain restraints from the coverage of the block exemption might be appropriate, but are unclear as to what such conditions might be.

In this instance, as in others, as discussed in greater detail below, the Sections support the issuance of guidelines to clarify competition policy in situations involving market shares greater than the thresholds provided in the block exemption regulation.

3. Proposed Block Exemption for Licenses Between "Non-Competitors"

The TTBE Report considers a future block exemption for licensing agreements between "non-competitors" that is far broader in scope than the existing TTBE. The Sections support such a broader exemption, subject to our reservations (discussed below) regarding the categorization of "non-competitors."

Of paramount concern in the approach proposed in the TTBE Report is the determination of whether a particular licensing agreement is between "competitors" or "non-competitors" that is covered by the proposed exemption. The Report notes the broad definition of "competitors" in Article 10(17) of the TTBE (¶ 43), and then sets forth the Commission's view of what constitutes "vertical" licensing agreements (¶ 125):

> - The licensor does not exploit the technology itself, i.e. he is present only in the relevant technology market, and the licensee does not operate as a supplier in the relevant technology market. In that situation, the parties operate, for the purposes of the agreement, at different levels of the economic process and are therefore in a purely vertical relationship.
>
> - The licensor does exploit its technology, i.e. he is present on both the relevant technology and product market, while the licensee does not operate in either market. Also in this situation, the license does not remove any competition which could have taken place between the licensor and the licensee absent the license.
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> - The licensor and the licensee were producing competing products before the innovation but the licensed manufacturing process or patent product represents such a sweeping breakthrough that there would no longer be any competition between them absent the license. This situation may also be regarded as vertical in nature.

- The IPRs owned by the licensor and the licensee are in a mutual blocking position.

As noted in the TTBE Report (¶ 126), the TTBE treats the third and fourth examples as being “horizontal” in nature. The re-assignment of the latter two categories to the “vertical” class represents a significant narrowing of the definition of “competitor” when compared to the definition currently contained in the TTBE. The Sections support such a narrowing of the definition of “competitor” in principle, subject to our concerns over the use of the categorizations of “competitor” and “non-competitor.” The Sections submit that an analysis of the competitive interplay, vel non, between the technologies, is preferable to a rigid rule regarding this issue.

For example, one issue raised by the third category concerns what is meant be a “sweeping breakthrough.” It may be difficult for the parties to know in advance whether a given technology represents a “sweeping breakthrough,” particularly when the technology has yet to be exploited on the market. In the Sections’ view, the fact that a process or product appears to be a sweeping breakthrough is a relevant and important factor in the analysis, but the key question remains whether the old technology continues to be competitive with the breakthrough. The similar test of “far superior” in the *IP Guidelines* has raised similar questions in the United States.

Moreover, with regard to the fourth category, the Sections respectfully question whether this would be meaningful in practice. In the majority of cases, a mutual blocking position would suggest that the licensor and licensee are competitors as it is likely that their technologies overlap. In some cases, however, they may have mutual blocking positions because of the complementary relationship of the two technologies, i.e. each is essential for the operation of the other. In such cases, mutual blocking positions are not necessarily indicative of a competitive relationship.

Under the approach proposed in the TTBE Report, the specific treatment for licensing agreements between “non-competitors” would depend on whether the restraints relate to the exploitation of the licensed IPR. It is clear that restraints that relate to the exploitation of the licensed IPR include territorial, customer, and field of use restrictions, and that restraints that do not relate to the exploitation of the licensed IPR include tying. How other types of restrictive clauses would be categorized is unclear. The Sections submit that the Commission should clarify the types of practices and clauses that will be regarded as related to the exploitation of licensed IPR and those that will be regarded as not related to the exploitation of licensed IPR, and the basis for such a classification leading to distinctive treatments under the competition laws. In all cases, if market share thresholds and dominance thresholds are adopted, the Sections agree with the Report that the withdrawal mechanism should be maintained.

a. Restraints that do not relate to the exploitation of the licensed IPR

Subject to further clarification regarding the scope of restraints that relate to the exploitation of licensed IPR versus restraints that do not relate to the exploitation of licensed IPR and to further clarification of the basis for any distinction in treatment between these two categories of restraints, the Sections believe that there is substantial merit in treating tying arrangements and restraints that are analogous to tying arrangements concerning IPR in the same manner as such restraints are treated in the block exemption for vertical agreements. We believe that this is a significant step in the right direction. Such restraints would be subject to: (i) a thirty percent (30%) market share threshold; (ii) certain hardcore restrictions; and (iii) certain conditions. The Sections urge a more flexible approach to market definition, as discussed above. As noted in the TTBE Report, for restraints that do not relate to the exploitation of the licensed IPR, this approach would "create coherence" with the block exemption for vertical agreements, a consistency that the Sections regard as an important goal.

According to the TTBE Report, compared to the current TTBE, the proposed exemption would exempt restraints currently in the "black" or "grey" lists up to the specified market share. Again the Sections would support such a market share approach, subject to it being applied in a flexible manner, as discussed above. The Sections do not support the alternative discussed in the Report, under which those restraints would simply not be covered in the new exemption.

b. Restraints that relate to the exploitation of the licensed IPR

The TTBE Report notes that the block exemption for restraints that relate to the exploitation of the licensed IPR could include a limited hardcore list composed of certain pricing restrictions and possibly certain territorial restraints. The block exemption could also contain conditions under which certain restraints would be excluded, which are referred to as "severability." The Sections are unclear as to what such "conditions" might be that could trigger exclusion, and urge the Commission to clarify this area if it should adopt a block exemption incorporating them.

The TTBE Report suggests that restraints that relate to the exploitation of the licensed IPR, such as territorial, customer and field of use restraints, would be subjected to a dominance threshold under the proposal presented in the Report. The Report reasons that a dominance threshold would be necessary for restraints that relate to the exploitation of the licensed IPR, because of the requirement in Article 81(3), and "to take account of possible foreclosure risks." (¶ 186). The dominance threshold would only apply to restraints covered by the broad scope of Article 81(1).

The Sections support a "dominance" threshold approach, subject to the need to provide for flexible market definition analysis, as discussed above. However, the Sections do not believe that this "dominance" threshold should necessarily differ from the market share threshold that will be applied to other types of restraints, because, based on our analysis presented here, we do not believe that a distinction in treatment of restraints based on a distinction of their "relationship" to the exploitation of the licensed IPR is a valid one.

A more limited "hardcore" list would be provided in such an exemption, based on the hardcore list in the vertical block exemption, that also takes into account "the specific characteristics of licence agreements." (¶ 186). The TTBE Report is considering no longer regarding as per se illegal "quantity restrictions, certain customer restrictions and maximum and recommended prices." (¶ 186). The Sections support the creation of a clearly defined, more limited "hardcore" list based on the vertical block exemption, and provision for taking into account the specific characteristics of license agreements. The Sections also support the removal of certain customer restrictions, as well as maximum and recommended prices, from the hardcore list.

Part III—
Monopolization Versus Abuse of Dominant Position: Fundamental Statutory Differences

The Sections submit that important differences between the U.S. and EU approach to assessment of anticompetitive effects generally, and the appraisal of such effects in technology transfers in particular, flow in part from differences in statutory language and construction. In the United States, what is condemned is the act of "monopolization," while in Europe, what is condemned is "abuse of a dominant position."

The offense of monopolization under U.S. law requires both the possession of monopoly power and "the willful acquisition . . . of that power as distinguished from growth or development as a consequence of a superior product, business acumen or historic accident."[25] It is not sufficient to demonstrate that a firm obtained a monopoly position if it did so through ". . . superior skill, foresight, and industry."[26] While antitrust law abhors monopoly power because of the danger that it will lead to higher prices, lower output, poorer quality, and less innovation, it is recognized that a firm that competes through lower prices, higher output, better quality or more innovation may well thereby achieve or maintain a monopoly. It is fundamental under U.S. antitrust law that "[t]he successful competitor, having been urged to compete, must not be turned upon when he wins."[27]

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[25] *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966).

[26] *United States v. Aluminum Co. of America*, 148 F.2d 416, 430 (2d Cir. 1945).

[27] *Id.*

In the context of IP licenses, U.S. antitrust law recognizes that a patent or other IPR may convey monopoly power, but that the mere existence of such power resulting purely from IPR that is properly acquired, without other conduct, is not per se suspect and is not a basis for antitrust enforcement. The simple possession of market power, whether derived from IPRs or otherwise, does not ipso facto violate the antitrust laws. Instead, the same analysis under the antitrust laws is applied to the acquisition, maintenance or exercise of monopoly power, whether or not IPRs are involved. Therefore, where there is monopoly power derived from the IPR, restrictive clauses in licenses of such IPR should be viewed with caution. However, care must also be taken to ensure that innovation is not discouraged in developing standards for restrictions in such licenses. And when there is no monopoly power derived from the IPR, and the license of such IPR is a "vertical" one, then there is little cause for concern generally from restrictive clauses in such licenses. The approach in the *IP Guidelines* is generally that restraints in "vertical" licenses should be treated as vertical restraints generally; those in contexts of little market power generally raise few concerns while those in contexts of market power may require closer scrutiny but may nonetheless often be inoffensive.

In the Sections' view, greater clarification of what conduct constitutes an "abuse" of a dominant position would be beneficial, especially in "innovation markets," where first-movers may gain a dominant position by virtue of the introduction of new technology to a given market.

Part IV—
Horizontal versus Vertical Characterization

The U.S. approach to intellectual property licensing flows directly from its analysis as to whether in a given situation the licensing arrangement is horizontal or vertical, and from its approaches to horizontal and vertical restraints. The distinction between horizontal and vertical relationships is significant in the analysis of intellectual property licensing restrictions. While a license between firms with competing technology would be considered horizontal, most intellectual property licenses are considered vertical. The *IP Guidelines* recognize that even among direct competitors, the intellectual property relationship may be vertical. For instance, if technology protected by the intellectual property is "far superior" to a competitor's technology and the competitor is not likely to develop a competing technology in the absence of the license, the relationship may be considered vertical. *IP Guidelines*, Example 5.

Competitive concerns may arise where an arrangement harms competition among entities that would have been actual or likely potential competitors in the absence of the license. Antitrust concerns are far less likely where licenses do not interfere with competition that would likely have taken place absent the license. *IP Guidelines* ¶ 3.1. A license between horizontal competitors may raise competitive concerns because it may be used to conceal collusive behavior such as an agreement to allocate markets. More generally, restrictions in licenses among competitors may increase the likelihood of coordinated interaction in the market. It would not be correct, however, to suggest that the *IP Guidelines* "are mainly worried about sham license arrangements intended to cloak a cartel." (¶ 50). The risk of such behavior depends upon market structure, including concentration, barriers to entry, and other market characteristics that bear upon the ability of market participants to collectively exercise market power. *IP Guidelines* ¶ 4.1.1.

The *IP Guidelines* establish *two* safe harbors or "safety zones" for "horizontal" intellectual property licenses. The agencies will not, absent extraordinary circumstances, challenge a restraint in an intellectual property license agreement if the restraint is not one that is "facially anticompetitive" and normally warrants per se treatment (such as price fixing or market allocation), if:

- the parties to the license collectively have *a market share of 20 percent or less* in each of the relevant markets affected by the restraint. *IP Guidelines* ¶ 4.3;

or

- for purposes of technology or "innovation" market analysis where market data is unavailable or does not accurately represent competitive significance, there are *four or more independent entities* that are not parties to the license that compete in the respective technology or "innovation" markets.

The more recent joint venture guidelines provide a slightly wider safety zone for research and development competition analyzed in terms of "innovation markets":

> "Absent extraordinary circumstances, the Agencies do not challenge a competitor collaboration on the basis of effects on competition in an innovation market where *three or more independently controlled research efforts* in addition to those of the collaboration possess the required specialized assets or characteristics and the incentive to engage in R&D that is a close substitute for the R&D activity of the collaboration."

DOJ/FTC *Antitrust Guidelines for Collaborations Among Competitors*, 4 Trade Reg. Rep. (CCH) ¶ 13,161 (April 2000).

Where a license is vertical, rather than horizontal, the principal concerns are that the license may foreclose access to a necessary input or raise rivals' costs or may facilitate coordination among competitors. *IP Guidelines* ¶ 4.1.1.

In sum, the Sections submit that differences in the identification of the relevant relationship and their characterization for antitrust analysis as "vertical" or "horizontal" persist between U.S. and EC practice, frequently leading to significant consequences. The Sections commend to the Commission the approach adopted in the *IP Guidelines*, which recognize that IP licenses between horizontal competitors are often properly analyzed as vertical licenses, and the potential competitive effects of a license in a given market and the relationships among the IPRs involved, not the fact that the licensor and licensee may compete, should inform the characterization decision. The key question under U.S. analysis is whether the licensing agreement eliminates competition that would have existed in the absence of the license. The TTBE Report in fact notes (¶186) that such a question is crucial in analyzing at least some licenses.

Part V—
Broadening the Scope of the Exemption Under the TTBE

As noted above, the Sections generally support the TTBE Report's proposed broadening of the coverage of the block exemption for technology licenses. As discussed in detail below, the Sections not only support the expansion of the exemption specifically proposed in the Report, but others as well.

A. Non-Exclusive Licenses

The Sections support the extension of the scope of the TTBE to include non-exclusive licenses. Such licenses rarely raise competition concerns, and their exclusion from the TTBE creates an unnecessary administrative burden for those who decide to notify their agreements to the Commission for approval, and undesirable uncertainty for those who do not.

B. Exclusive Licenses

The Sections support the suggestion made in the TTBE Report to revise the approach towards exclusive licenses to include not only those where the exclusivity is linked to a territory, but also where it is linked to a specific field of use or customer group. (¶ 117). In all three cases, exclusivity serves to protect the licensee against competition from the licensor or other licensees, enhancing its incentive to accept and exploit a license. Similarly, in all three cases, an exclusive license allows the licensor to retain residual rights outside the scope of the license, which it could exploit itself or license to other licensees.

For the reasons set forth in the TTBE Report and subject to the points set forth in the section of these comments regarding the proposed block exemption for licenses between "non-competitors," above, the Sections agree with an approach that would treat exclusive licenses differently according to whether they are entered into by "competitors" as opposed to "non-competitors." (¶¶ 121-131). Clearly, a critical issue in this respect will be where to draw the line between "competitors" and "non-competitors."

C. Multi-Party Licenses

The TTBE Report notes that the TTBE covers only bilateral license agreements. However, multi-party licenses have become increasingly important for industry. (¶¶ 132-135). The Report notes that multi-party licenses may be pro-competitive or anti-competitive, depending on the circumstances. It asks whether, and to what extent, multi-party licensing agreements should be covered by a revised block exemption.

The Sections agree with the TTBE Report that multi-party licenses are significant factors in the market place, and that they are often pro-competitive. (¶ 133). They also believe that the omission of such licenses from the TTBE may have limited the usefulness of the TTBE and have increased the burden on the Commission and parties with notifications of agreements that are clearly pro-competitive.

The Sections support a revised block exemption that covers multi-party licensing agreements. The TTBE was intended to encourage the dissemination of knowledge and innovation, promote competition, and stimulate investment in the EU marketplace. The Sections believe that including multi-party agreements in a future block exemption is consistent with these goals.

Fundamentally, there are no analytical reasons not to extend coverage of the TTBE to multi-party licenses. Whether more than two parties are involved in an arrangement is not dispositive to the analysis of the competitive effects of the arrangement. The key questions that must be answered regarding the competitive impact of a license do not turn so much on the number of parties or even perhaps the nature of the parties involved, as on the type of agreement at issue and on the relationships among the technologies that are the subjects of the licenses.

Efficiency-enhancing and pro-competitive effects are likely when a licensing arrangement brings together complementary inputs or clear blocking positions. This is the case whether it is a bilateral or a multi-party license. Similarly, agreements that require cross licenses at minimal cost or on an exclusive basis may have anti-competitive effects whether or not they are bilateral or multi-party agreements. Moreover, licenses that cover mainly competing technologies, i.e., technologies that are substitutes for each other, may have anti-competitive effects or enable anti-competitive conduct such as price fixing. (¶ 134). However, the Sections are unclear on what the TTBE Report contemplated in commenting that multi-party licenses involving "non-competitors" may have anti-competitive effects.[28] In any event, the potential anti-competitive impact of all such agreements is not based on their multi-party versus bilateral status.

Therefore, the Sections support covering multi-party licenses in the same manner as bilateral licenses are covered, in any revised block exemption. There is no reason for the Commission to treat multi-party licenses fundamentally differently from bilateral licenses. The Sections recognize that a block exemption addressing multi-party licenses may require an amendment to Council Regulation No. 19/65. It is certainly desirable to have the Commission's position regarding multi-party licenses be established with the same authority as its position on bilateral licenses. We encourage the Commission to

[28] It is true that a license pool may grant an exclusive license to a third party of all the technology in the pool, thus perhaps giving the third party market power as a result of exclusive access to this pooled technology that the licensee's competitors lack. However, this is a function of how the pool is operated vis-à-vis third parties, and not a function of the creation of the pool itself. It is also true that a patent pool may make it more difficult for others who are not members of the pool or who do not have access to the technology in the pool to enter a market in which the pooled technology competes. In those situations, the "outsiders" may need to accumulate a comparable technology portfolio before being able to enter the market. Again, this effect is more the result of the nature of the license and the parties rather than the number of parties.

seek such an amendment to the Council Regulation to achieve that authority. However, in the meantime, the Sections see no reason for the Commission not to offer guidance in this area in Commission guidelines.

D. Cross-Licensing and Bilateral Pools

The TTBE Report notes that the TTBE treats bilateral pools involving "non-competitors" more severely than cross-licenses between "non-competitors," and covers cross-licensing and pooling arrangements between "competitors" only if the parties are not subject to any territorial restrictions. (¶¶ 136-137). The Report asks whether this differentiation between cross-licenses and bilateral pools between "non-competitors" and this singling out of geographic restrictions is justified.

Initially, the Sections note that parties may hold non-competing, complementary technology, but be competitors. In those circumstances, it may actually be the cross-license or bilateral pool that enabled the parties to become competitors. Therefore, in the context of cross-licenses and pools, the relationships of the technologies involved in the arrangement may be more important in the competition analysis than the relationship of the parties as competitors or non-competitors. An arrangement involving complementary technologies may need to be viewed differently than an arrangement involving blocking patents or rival/competing patents, and agreements regarding blocking patents may need to be considered separately from those regarding rival patents. These issues are discussed in greater detail above.

The Sections agree that whenever two or more intellectual property rights owners license each other or jointly license third parties under their respective intellectual property rights, such agreements may be termed "patent pools" or "cross-licenses" without material analytical distinctions. Therefore, we agree that the more severe treatment of bilateral pools under the TTBE is unjustified.

Moreover, we believe that pools, particularly bilateral pools, and cross-licenses involving non-competing technologies should be covered by a block exemption, even if exclusive territories are granted in the arrangements. For example, in the context of purely two-party cross-licenses or pools that involve only complementary patents, it is unclear in what circumstances the grant of exclusive territories to the parties in the cross license or to third parties by the pool would give rise to anti-competitive effects that would consistently outweigh any efficiencies or pro-competitive effects. In any event, the Sections agree that there is little basis to emphasize this one aspect of territorial restrictions over other provisions in the arrangements that may have comparable competitive effects.

E. Tying

The Sections welcome the significant movement shown in the TTBE Report in considering efficiencies resulting from tying as well as the anticompetitive effects and the proposal to extend the TTBE to tying in licensing agreements between "non-competitors," provided that the licensor's market share does not exceed thirty percent

(30%). (¶¶ 161-164). While there may be debate over the appropriate market share threshold, and subject to the need to apply a flexible approach to market definition as discussed above, this proposed approach is, in the Sections' view, the wiser one.

As noted in the TTBE Report, historically the Commission and the European Court of Justice have taken a negative view of licensing of a patent conditioned upon the licensee's agreement to purchase non-patented products without considering possible efficiencies resulting from tying. The Report refers to the European Court of Justice's 1996 decision in *Windsurfing*, which upheld a Commission decision condemning such a license, and then provides the basis for greater flexibility. The Report notes that European Court of Justice in its *Windsurfing* decision held that "'the obligation arbitrarily placed on the licensee only to sell the patented product in conjunction with a product outside the scope of the patent [was not] indispensable to the exploitation of the patent' and, for that reason, fell under Article 81(1)."[29] The Report then reasons that since the decision did not discuss the applicability of Article 81(3), the decision "does not prejudice" considering possible efficiencies resulting from tying under Article 81(3).

The Sections agree with the observation in the TTBE Report that the "net competitive effects of tying generally depend on the degree of market power that the licensor has in the relevant technology and product markets." The Report notes that "tying may be harmful when a licensor with market power uses this restraint to extend this power from the tying product market to the tied product market, so as to foreclose rivals in the second market or to obtain supra-competitive prices." (¶ 162).

After noting that the block exemption for vertical agreements, Reg. No. 2790/1999, "exempts tying between non-competitors up to a 30% market share threshold," the TTBE Report suggests that "tying" between "non-competitors" be removed from the grey list and included in a block exemption with a market share threshold. (¶ 164). The Sections believe that such a block exemption would be a significant improvement. The Commission should provide additional guidance for determining whether a particular tying restraint where the market share threshold is exceeded would be condemned under EU competition law.

F. Grant-Back Clauses

The Sections welcome the significant movement shown in the TTBE Report's proposal to extend the TTBE to non-reciprocal and certain exclusive grant-back clauses. (¶¶ 165-168). Non-exclusive reciprocal grant-back obligations between licensor and licensee are currently covered by the TTBE, but non-reciprocal grant-back obligations on the licensee and exclusive grant-backs for severable improvements are on the "grey" list. The Report notes such clauses may "promote innovation and subsequent licensing of the results of the innovation" or "harm competition if they reduce significantly the licensee's incentive to invest in improving the licensed technology." The Sections believe that non-exclusive, non-reciprocal grant-back obligations should be covered by an exemption, and

[29] Case 193/83, ECJ Report 1986, p. 611.

that certain types of exclusive non-reciprocal grant-backs should also be considered for coverage under a block exemption.

G. Output Restrictions

The Sections support an approach that exempts output restrictions between "non-competitors," but not those between "competitors." In this regard, the TTBE Report suggests that quantity restrictions agreed between "non-competitors" may restrict competition by reducing the incentive of licensees to compete with each other. (¶ 149). This concern seems misplaced in that, without the license, there would have been no competition between licensees in the first place.

H. Site Licenses

For the same reasons as relates to output restrictions, the Sections support an approach that exempts site licenses between "non-competitors," but not as between "competitors." (¶¶ 152-153).

I. Non-Compete Clauses

The Sections support the exemption of a non-compete obligation imposed on a licensee in the context of an agreement between "non-competitors" so long as such an obligation would not result in significant foreclosure effects. A non-compete can have a positive effect on competition because a licensor might be unwilling to license its technology if it did not have adequate assurance that its "technology would not benefit the production and commercialisation of competing products." (¶ 157). The effect of a non-compete clause is that the licensee would be committed to exploiting the licensor's technology rather than that of a rival. This assurance would seem to be more important in the case of technology transfers than in the case of some other kinds of vertical agreements because the licensee is often required to make significant investments in machinery and equipment needed to exploit the licensed technology. The non-compete clause offers the licensor some assurance that the licensee will be devoting its scarce capital resources to exploiting the licensor's technology and not that of a competitor. In addition, if a licensee is allowed to use a competing technology, this creates a risk that the licensee could use its knowledge of the licensed technology to become a competitor of the licensor or benefit a competitor of the licensor.

The exemption of non-compete obligations between "non-competitors" would also result in a more coherent treatment of these obligations. Under the current TTBE, non-compete obligations are black-listed, but it is permissible for the licensor to require the licensee to produce a minimum quantity of the licensed product and to use its best endeavors to exploit the licensed technology. If these latter obligations are included in an agreement between "competitors" and have the effect of a non-compete, the Commission is empowered to withdraw the benefit of the block exemption, but, otherwise, they are permissible. As a practical matter, this means that, in agreements between "non-competitors," licensors can use minimum quantity and best endeavors obligations to achieve virtually the same effect that they could achieve with a straightforward non-compete obligation. This creates the anomalous situation whereby the TTBE permits licensors to do indirectly what they cannot do directly.

The Sections believe that non-compete provisions should be exempted for the term of the agreement. Under Regulation 2790/1999, non-compete obligations are exempted for a period of five years. The Vertical Restraints Guidelines, however, recognize that non-compete obligations are justified for the life of the agreement in the case of transfers of know-how on the grounds that, once the know-how is transferred, it cannot be taken back and the licensor may not want it to be used by or for its competitors. The Sections also respectfully submit that non-compete obligations that extend beyond the term of a license should not be included in a hard-core list of restrictive practices.

The TTBE Report suggests that there may be less justification for a non-compete obligation with respect to R&D activities than with respect to the use of a competitor's technology or the distribution of competing products. The Sections believe that a non-compete obligation imposed on a "non-competitor" licensee with respect to R&D activities in the field unconnected with that of the licensed technology would not be justified because this would harm innovation and would not give rise to offsetting efficiencies. In contrast, a non-compete obligation with respect to R&D activities in a connected field would seem to be justified on the grounds that it would oblige the "non-competitor" licensee to concentrate its activities within the field on exploiting the licensed technology and it would minimize the risk of the licensee misappropriating the licensor's technology. Moreover, it is questionable whether a restriction on the licensee's R&D activities in a field connected to that of the licensed technology would harm innovation because, as the licensee would not be a "competitor," it would seem much less likely to be undertaking significant research in the field covered by the license when compared to competitors already active in the field.

The Sections believe that non-compete obligations contained in agreements between "competitors" should not be exempted, subject to our concerns relating to how "competitors" are defined. Such obligations between "competitors" not only limit competition on product markets, but could stifle innovation, and should continue to be regarded as hard-core non-exempt clauses.

J. No-Challenge Clauses

On balance, the Sections believe that the positive effects of no-challenge clauses outweigh any negative effects that they may have, and, accordingly, they should be exempted under a revised TTBE. As recognized in the TTBE Report, no-challenge clauses may have negative effects on competition in that they could allow licensors to charge royalties for IPRs that are invalid, thus leading to higher prices for the licensed products. Licensees are often in the best position to challenge the validity of the licensed technology, and allowing licensees to challenge invalid IPRs could enhance competition in the market.

No-challenge clauses also have pro-competitive effects. In particular, they could encourage licensors to license their technology in the first place because they will no longer need to be concerned about the risk of challenges from the licensee. As noted in the Report, smaller licensors dealing with large licensees may be particularly concerned about this risk. The smaller licensor may not have the resources to engage in protracted litigation to protect its IP rights.

When considered in the overall context of today's economy, the removal of the protection offered to licensors by no-challenge clauses could have a chilling effect on innovation and the dissemination of technology that would seem to outweigh concerns over licensors using no-challenge clauses to protect invalid IPRs. The scenario of the small licensor and the large licensee is becoming much more common, and the inability of licensees to protect themselves in such situations may discourage them from licensing their technology or from investing in research and development activities at all. Moreover, preventing the licensee from challenging the validity of the licensed technology does not mean that such challenges will not be mounted by competitors or other third parties. In fact, licensees often do not have any interest in challenging the licensed technology because the licensed IPRs may serve to protect the licensee from competition in its market.

We do not believe that the approach to no-challenge clauses adopted in the R&D Block Exemption Regulation of allowing the licensor to terminate the license in the event of a challenge adequately addresses the licensor's concern over possible challenges. While such a clause may discourage frivolous challenges by licensees, it does not protect the licensor who has given the licensee access to its technology only to find that the licensee turns around and uses its knowledge of the licensed technology to mount a challenge to its validity. From this perspective, once the licensor grants the license, the damage is largely done.

K. Customer Restrictions and Field-of-Use Restrictions

As noted in Parts II.C.3 and V.B, above, and subject to the points made therein, the Sections support the extension of the TTBE to cover customer restrictions and field-of-use restrictions.

Part VI—
Territorial Restrictions

In addition to the broader question of whether a revised TTBE should cover field of use and customer restrictions in addition to territorial restrictions, the Report raises the question of whether the treatment of territorial restrictions should be revised. The Sections support the continued inclusion of territorial restrictions within a revised TTBE, and address these restrictions in a separate part of these comments because of the Commission's historically strong aversion to such clauses.

The Sections acknowledge the historical importance of the Commission's concerns regarding such restrictions, in light of the duty to integrate the market. Respectfully, the Sections submit that integration has progressed sufficiently, and the permissibility of territorial restrictions is so often necessary to provide appropriate incentives to the spread of new technologies and products incorporating such technologies, that the general disfavor with which such clauses have been viewed under EC competition law is no longer appropriate.

Under the current TTBE, the licensor may prevent a licensee from actively seeking customers in territories reserved for other licensees, and from making so-called "passive" sales -- i.e. sales in response to unsolicited requests from customers located in territories allocated to other licensees -- for a period no longer than five years from the date the licensed product was first put on the EU market by one of the licensees. The Report notes that this restriction on passive sales is out of line with the approach adopted by the Commission in the field of vertical restraints because Regulation 2790/1999 does not allow any restriction to be placed on passive sales.

The Sections recognize, as do the *IP Guidelines*, that "intellectual property may in some cases be misappropriated more easily than other forms of property." Therefore, while the antitrust principles that apply to a licensor's grant of various forms of exclusivity to and among its licensees should in general be similar to those that apply to comparable vertical restraints outside the licensing context, restrictions that might be anticompetitive in other contexts may indeed be justified in intellectual property licenses.[30] The Sections would not support bringing the treatment of licenses in this respect in line with the approach adopted by the Commission relative to vertical restraints.

More broadly, the Sections urge the Commission to provide to IP licenses consistent treatment across territorial, field of use and customer restrictions and other vertical non-price restraints, both in scope and in duration.

Part VII—
Procedural Rules and Substantive Guidelines

The Sections respectfully submit that the proposed revisions to the TTBE, coupled with the contemplated modernization of the application of Articles 81 and 82, are likely to create significant burdens on firms doing business in the Community, both administratively and in becoming familiar with the changes in the law.[31] The Sections request that the Commission consider the adoption of detailed procedural rules for the application of the new TTBE, and transparent substantive criteria and guidelines for its application.

[30] *See IP Guidelines* § 4.1.2. However, the Sections are not suggesting that territorial restrictions or other vertical restraints, outside the IP context, should be excluded from any block exemption.

[31] As the Report noted (¶ 81), most comments received in response to the Commission's questionnaire indicated that the adoption of guidelines would be welcomed.

The Sections note that the Commission has adopted Guidelines accompanying Commission Regulation No. 2790/1999 for vertical agreements, No. 2658/2000 for specialization agreements and No. 2659/2000 for R&D agreements. The Report suggests (¶178) that the new competition rules for licensing agreements also could take the form of a block exemption coupled with guidelines. We urge the Commission to adopt this approach. The need for procedural clarity and uniformity is particularly acute in light of the proposed modernization, and decentralization of the application of Articles 81 and 82. To avoid renationalization of competition policy,[32] the Commission should promulgate clear procedural rules and transparent substantive guidelines for the application of the TTBE throughout the Community.

Some of the topics that would be particularly helpful to business people and practitioners to have covered in guidelines include: (1) multi-party licenses; (2) situations where market shares involved exceed the thresholds covered by the block exemption, particularly where a dominant position might be involved along with tying or exclusivity provisions; and (3) restraints that will no longer be per se illegal, such as quantity restrictions, customer restrictions, maximum and recommended prices, and territorial restraints. To the extent a block exemption covering a particular topic, such as multi-party agreements, cannot be achieved without amendment of a Council Regulation, then it is even more important that guidelines be issued to provide transparency as to Commission policy and analytic approach.

Conclusion

The Sections again thank the Commission for providing this opportunity to comment on the TTBE Report. We would be pleased to respond to any questions the Commission may have regarding these comments, or to provide any additional comments or information that may be of assistance to the Commission.

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[32] We note and agree entirely with the statement in the Commission's press release of September 27, 2000, IP/00/1064, that "as the European Parliament has stated on many occasions, greater decentralization must under no circumstances lead to any renationalisation of competition policy. . . ."