

COMMISSION DRAFT REGULATION ON TECHNOLOGY TRANSFER BLOCK EXEMPTION

UK RESPONSE

Introduction

1. The UK welcomes the Commission's consultation on the text of the new Commission regulation setting out the terms of a block exemption for technology transfer agreements. The existing regulation, dating from 1996, has been an important factor in determining the shape of licensing agreements between parties. The UK agrees with the Commission, however, that it is appropriate to look again at the Regulation and the administrative arrangements for its enforcement in the context of modernisation.
2. To inform this response we have, on an ad-hoc basis, sought the views of a number of key UK stakeholders with an interest in the review. A copy of this response has been sent to all those whose views were sought. It has also been posted on the DTI website. **In summary, the UK has serious concerns about the potential adverse consequences on innovation and growth in the European Union were the proposed draft Regulation on Technology Transfer Block Exemption to be implemented in their current form. The Commission's current proposal does not appear adequately to reflect evidence from business practitioners in the EU and regulatory experience on other markets, such as the United States, on how best to secure the benefits of innovation and competition.** We look forward to learning of the wider response to the consultation and to continuing to work with the Commission as it develops its proposals further. In particular, **we call on the Commission to arrange a full consultation with Member States as soon as possible in the New Year.** We would, of course, be happy to respond to any questions the Commission may have on any of the comments that follow.

General

3. The UK believes that effective competition is a key driver of innovation. A strong competition regime encourages companies to innovate in order to maintain or improve their position within the marketplace. The UK also recognises the importance of strong enforcement of competition rules, both to the benefit of consumers and to ensure that there is a level playing field for companies.
4. However, there is also an inevitable tension between competition law and innovation. Intellectual property (IP) rights exist to provide a greater incentive to innovate. Licensing between companies to share the returns from IP rights is a common way of reducing exposure to the costs, time and risks associated with innovation. As evidenced by recent policy reviews in the UK¹, technological

¹ DTI Innovation Review – Economic analysis, November 2003 at http://www.dti.gov.uk/economics/economics_paper7.pdf ; Lambert review of business university collaboration, December 2003 at http://www.hm-treasury.gov.uk/media/EA556/lambert_review_final_450.pdf

innovation by business is increasingly conducted via an ‘open model’ of innovation, in which companies acquire and share intellectual property from other companies, universities and public sector research labs. This contrasts with former narrower approaches to acquiring knowledge by many larger companies, which invested in their own capacity to supply their R&D needs intra-murally. In this new environment, where individual companies need to broaden their sources of R&D, the role of licensing of intellectual property is likely to play a more important role in the process of translating research into innovative products and services. Licensing of intellectual property is also particularly important, as a recent review of business-university collaboration in the UK highlights, as a channel for translating university research effectively into commercial innovation.

5. But licensing of technology is only likely to be considered when it is clear that an agreement is, and will remain, legally enforceable. It is important to bear in mind that in an area as sensitive as technology transfer many technology holders will be reluctant to risk licensing what is probably their most valuable assets if the agreement falls outside the scope of a block exemption. The costs of mitigating these risks, through legal advice and alternative business models for exploiting intellectual property, are likely to fall disproportionately on smaller technology-based enterprises. This in turn would impede the competitive and dynamic evolution of markets based on new technologies, where in many sectors new enterprises play a key role in developing R&D and subsequently challenging incumbents. There are some industries, such as those in which there are “patent thickets”, where there is a recognition by some companies that their licensing agreements will inevitably fall outside the scope of a block exemption. For these companies, what is crucial is that the guidelines do not state or imply that arrangements common in licensing agreements in such industries are in fact anti-competitive by their very nature, thereby giving a steer to Member State enforcement authorities to challenge them as anti-competitive agreements.
6. It is therefore important that the Commission strikes an appropriate balance between the often competing demands of free and open competition and encouraging innovation through IP licensing in developing its new block exemption regulation, with particular reference to ensuring that its new block exemption regulation is not drawn too narrowly. The UK is of the view that the appropriate starting point is that licensing agreements should be viewed as an essential item in the innovation tool-kit, and can, for example, introduce competition into markets where previously there was none. This is not to say that all technology transfer agreements are by definition benign; simply that what evidence there is (such as that in the Commission’s own evaluation of Regulation 240/96) tends to suggest that such agreements are not frequently anti-competitive either by design or effect.
7. We have been struck by the very large number of comments that we have received (from individual companies, trade bodies, agencies, lawyers, economists and analysts), expressing deep and fundamental concerns about the draft regulation and guidelines. Some of these concerns have focussed on what stakeholders consider is an attempt to place licensing agreements within the same format of block exemption regulation used for other types of agreements, ignoring the special characteristics of licensing agreements, reflected in the relevant case-

law; others on specific provisions which raise concerns, or on the likely overall effect of the changes. We set out a few of the areas which seem to us deserve particularly close scrutiny in the “details” section of this response. We believe it is vital that the Commission address these concerns, and others raised by UK stakeholders, in full, either through changes to the draft regulation or through compelling explanations as to why the concerns raised are unfounded, before proceeding further. **The changes proposed are far-reaching and we believe it is imperative that they are given careful and thorough consideration. As part of this process we call on the Commission to arrange a full consultation with Member States as soon as possible in the New Year.**

8. In terms of ensuring that the appropriate degree of consideration can be given to these proposals we note that the Commission does have alternatives to bringing this draft regulation and its guidelines into force by 1 May 2004.
9. Before turning to detailed points, the UK has three general concerns worth emphasising at this point:
 - Possible negative practical impact of moving from a form-based to effects-based approach
 - Cost of implementation for business
 - Reduction in efficiency of technology transfer market.
10. First, there has been much comment on moving away from the current approach to the block exemption regulation. The UK believes that the Commission’s move away from a form-based approach, based on the terms contained within an agreement, to bring a more outcomes-focussed approach to the block exemption, is consistent with the approach taken in other areas, and with Article 81 itself. The UK welcomes this development, as long as it does not have a negative effect on innovation within markets. It is clear that nearly all stakeholders we have heard from believe that there will a number of negative effects, for various reasons which you will have seen in other responses to your consultation. We would urge the Commission to give careful consideration to these points and reflect carefully on whether the concerns raised can be remedied within the framework proposed.
11. The second point relates to cost of implementation. A number of companies we have met have suggested that one of the advantages of the current block exemption is that it clearly sets out the sorts of terms which can be included within a licensing agreement so that it is clearly within the scope of the existing block exemption regulation. Some companies can, and do, have standard licensing agreements that they can draw upon to agree licenses with companies within a matter of days, if not hours. In such cases only a licensing expert and an in-house lawyer need be involved in the drafting of the agreement. Concerns have been expressed that under the new regulation the cost of ensuring that an agreement is within the scope of the new block exemption, or outside it but still not anti-competitive, would be significantly higher. In particular, an analysis of the relevant product or technology markets, and of the positions of both players in the market, or their separate markets, would have to be conducted to determine whether the agreement would fall within the block exemption. This would entail the gathering of significant amounts of market information and the employment of

a specialist to analyse it. Licensing is becoming increasingly important for many such organisations. An example is licensing in universities: between academic year 1994/95 and 2000/01 licensing income rose from £8 million to £18 million in nominal terms in the UK, and all the indicators suggest that this growth rate is set to continue in the near future. Significant concerns have been expressed that the additional cost and time associated with analysing the effects of agreements will deter companies from entering into many licensing agreements. Such an outcome must be to the detriment of consumers and to the innovation process itself. We would welcome the Commission's reflections on this issue.

12. The third point is that, by putting the block exemption regulation in its current terms, and in particular setting the market share thresholds at the levels currently specified, it has been suggested that there may be a reduction in the value of IP. In probably the vast majority of cases it would simply be inappropriate to try and licence on a non-exclusive basis within a market (for example if the licensee had to make a significant investment in order to develop or market the technology). But to license on an exclusive basis will often risk the agreement falling outside the scope of the block exemption. This is particularly true in areas such as the development of new drugs, many of which will be considered as being in a new technology or product market at the time of licensing. Ultimately, less-preferred responses may be used as a way of reducing legal uncertainty as to whether a licensing agreement can be signed – such as simply selling a technology, or capital market activity. Moreover, by restricting the working of the market the incentives to innovate may well be reduced – the less-preferred methods of exploitation may not generate as high a return as the best method. **It would be deeply unsatisfactory if the effect of the regulation were to reduce the efficiency of technology transfer within the EU.** Again, the UK would welcome the Commission's reflections on how to deal with this issue.

Details

'Safe harbour' market share thresholds

13. As noted above, the UK can welcome in principle the Commission's move away from a formalistic approach based on the strict categorisation of clauses in technology transfer agreements to a more flexible functional approach, as contained in the draft regulation. We believe that the Commission's proposal to use 'safe harbours' based upon market share within which agreements are likely to be block exempt from Article 81 is a cornerstone of this effects-based analysis, and is appropriate as long as it does not have the side-effect of excluding from the safe harbour many agreements which are clearly not anti-competitive (and indeed may be pro-competitive), or of making illegal clauses that are not by their object anti-competitive..
14. A number of UK Stakeholders have questioned whether the Commission's draft regulation may be too restrictive of technology transfer licensing agreements between non-competitors, and indeed whether a threshold for such arrangements is even needed. Similarly, the market share threshold between competitors has been variously criticised as being far too low and not an appropriate test. UK Stakeholders are concerned that any problems met in calculating and

implementing the market share thresholds may be intractable, especially for new technologies that are a long way from the market but are not necessarily still at the R&D stage, and for technology markets where market shares can and do fluctuate by large amounts rapidly. It is worth noting in its forthcoming publication "Patents and Innovation: Trends and Challenges" the OECD state that "Innovation systems ... [are] becom[ing] less centred on the individual firm and more based on markets and knowledge networks". This seems to suggest that concerns about defining market shares may have validity given the complex way in which markets are developing. Questions have also been raised about the lack of differentiation between product markets and other types of market (technology, innovation); licensing practises may well differ to take account of the very different business models applicable.

15. Some UK Stakeholders have also questioned why the Commission does not generally consider appropriate the so-called 'technology poles' approach in the US technology transfer licensing guidelines, in instances where product markets and technology markets based on royalties may be impossible to define in practical terms. (We believe that the Commission reserves this method only for a limited number of cases in paragraph 22 of its Guidelines.) The UK believes that these issues merit the detailed further consideration on the part of the Commission.

Black list of hard-core restrictions

16. As a feature of its move to a more functional analysis of licensing restrictions, the UK welcomes the idea of a 'black list' of hard-core licensing restrictions that are unlikely to be exempted from Article 81 because they have as their object the restriction of competition.
17. Nonetheless, the UK believes that some elements of the Commission's black list may have a deleterious impact on competition not as their object but *in extremis* as their effect, a belief that is echoed by UK Stakeholders. The UK believes that the Commission should consider carefully whether any possible inclusion of effects-based restrictions in the object-based black list might be counter-productive, resulting in commonly used provisions, which in most circumstances do not have anti-competitive effects, having to be removed from existing and future agreements in order to try and achieve certainty of the legality of agreements. Moreover, the guidelines do not appear to be definitive on how these provisions should be used: in paragraph 10 it says that "the Commission considers that the restrictions covered by the list of hardcore restrictions of competition contained in Article 4 of the TTBER are restrictive by their very object". But paragraph 72 of the guidance provides that "An examination of the facts underlying the agreement and the specific circumstances in which it operates may therefore be required before it can be concluded whether a particular restriction constitutes a hardcore restriction of competition", which suggests the need for at least some degree of effects-based analysis.
18. Furthermore, a number of UK Stakeholders have expressed the concern that the practical effect of the Commission having simplified the technology transfer block exemption regulation is to have moved much of the actual law from the regulation

to the guidelines. In light of the Commission's modernisation agenda – which removes the opposition procedure for notification – the UK is concerned that this possible conflation of law and guidance might also create legal uncertainty. The UK would welcome the Commission's detailed reflections on these issues.

Scope of regulation

19. The UK welcomes the increase in the scope for exemption afforded by the Commission's draft technology transfer block exemption regulation (for example, extending the ten-year exemption limit for know-how licensing).
20. However, UK Stakeholders are concerned that the draft regulation nonetheless impinges upon areas where the threat of anti-competitive outcomes as a result of licensing restrictions in technology transfer agreements is slight. In this regard, UK Stakeholders have suggested a number of specific concerns.
21. First, since the draft regulation covers only bilateral licensing agreements and not multilateral agreements, UK Stakeholders are concerned that many of the defensive licensing restrictions commonly used to negotiate a way through the so-called 'patent thicket' in multilateral agreements (for example, those concerning the setting of technological standards) will not be exempted by the draft regulation, because of revisions to the black list of hard-core restrictions and associated guidelines. Examples of these restrictions in multilateral agreements, we are informed, include field-of-use exclusivity and some types of running royalty.
22. Secondly, UK Stakeholders have expressed reservations about the retrospective and retroactive nature of the Commission's draft technology transfer block exemption regulation. UK Stakeholders are concerned that renegotiating existing licensing agreements is problematic from a commercial point of view because of the possibility for strategic intent on the part of parties to the negotiation. Additionally, the concerns of UK Stakeholders with respect to the Commission's proposed 'safe harbour' market share thresholds (outlined in paragraph 14 above) also mean UK Stakeholders are worried that licensed technologies falling within a 'safe harbour' early in their life cycles may fall outside the scope of the block exemption regulation if they subsequently become successful in the product market, whereupon any restrictions in their licensing agreements would be subject to Article 81 scrutiny. UK Stakeholders believe that the possibility for such *ex post* action on the part of the Commission creates undesirable commercial uncertainty for licensors and licensees, unlike other spheres of commerce where UK Stakeholders might qualify for block exemption. Whilst it is clear that falling outside the scope of the block exemption is not in itself an indication that an agreement is anti-competitive, in an area such as technology transfer there are valid concerns raised that the threat of falling outside the safe harbour will deter parties from licensing their technology.
23. Thirdly, the draft regulation does not cover settlement agreements, which we are informed are a common out-of-court solution in IP litigation cases. Some UK Stakeholders are of the opinion that settlement agreements are often indistinguishable from licensing agreements in practice. They are concerned that

the Commission's omission of the possibility of exemption for settlement agreements from its draft regulation may foster exactly the kind of costly litigation that might be thought to inhibit technology transfer. An article by Lanjouw and Schankerman² gives an empirical indication of how one aspect of the market for IPR - enforcement - works in practice, and suggests that large US firms avoid litigation by trading their IP and repeated interaction. We might well see a rise in litigation in the EU if a means of avoiding it is removed by the terms of the block exemption guidelines.

24. These concerns are, in the view of the UK, fundamental in nature and worthy of serious further consideration by the Commission.

Department of Trade and Industry
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² Lanjouw and Schankerman (2001) Enforcing IPR, NBER Working Paper 8656