INTELLECTUAL PROPERTY RIGHTS AND THE EC COMPETITION RULES

Intellectual Property Rights and the EC Competition Rules

by

Valentine Korah LLM, PhD

Professor Emeritus of Competition Law,
University College London;
Barrister

• HART •
PUBLISHING

HART PUBLISHING
OXFORD AND PORTLAND, OREGON
2006

Hart Publishing
Oxford and Portland, Oregon

Published in North America (US and Canada)
by Hart Publishing
c/o International Specialized Book Services
5804 NE Hassalo Street
Portland, Oregon
97213-3644
USA

Distributed in the Netherlands, Belgium, Luxembourg by
Intersentia, Churchillaan 108
B2900 Schoten
Antwerpen
Belgium

Hart Publishing is a specialist legal publisher based in Oxford, England.
To order further copies of this book or to request a list of other
publications please write to:

Hart Publishing, Salter's Boatyard, Folly Bridge,
Abingdon Road, Oxford OX1 4LB
Telephone: +44 (0)1865 245533 or Fax: +44 (0)1865 794882
e-mail: mail@hartpub.co.uk
WEBSITE: http://www.hartpub.co.uk

British Library Cataloguing in Publication Data
Data Available

ISBN 13: 978-1-84113-614-1 (hardback)
ISBN 10: 1-84113-614-x (hardback)

Typeset by Compuscript Ltd, Shannon, Ireland
Printed by TJ International, Padstow, Cornwall

Foreword

THE RT HON SIR ROBIN JACOB

When Val Korah wrote to ask whether I would write a foreword for this book. I straightaway e-mailed a 'yes.' I had not of course even seen so much as a draft paragraph, let alone a chapter. Was I taking a risk? Was there a chance I might be writing a foreword to a dull but worthy book or, even worse, a bad one? No, not a bit. For I knew both how clearly Val thinks and how clearly she writes. And of course her store of knowledge of Competition Law must be unequalled. Following my acceptance she e-mailed me the book in draft. I thought I would dip into it and that would be enough for a foreword. Wrong. It is really a bit of a page-turner.

The conflict between intellectual property (laws for stopping people doing things) and competition laws (laws for allowing people to do things) is obvious—the monopolists v the anti-monopolists. Moreover by its very nature the key areas of competition law are apt to be fuzzy both in law and on the facts. How do you decide whether someone has a dominant position, and what amounts to abuse of such a position when the law has given you a monopoly anyway? These and similar questions are perennial. And it is all too easy to say it is one big muddle with no clear rules.

Well, there is something in that, but it is not true to say that no guidance can be given. This book proves it. Val Korah not only tells you what has been going on, what can be predicted and what not, but also she identifies the key economic and other thinking (in some cases 'thinking' is too kind a word) which lies behind some of what has gone on. And she is not slow in directing astute criticism.

Let me give some examples. Look at her criticism of what happened in *Merck v Stephar*—where the Court said exhaustion of patent rights applied even in a country where there was no patent to exhaust (see Chapter 2) 'That is not a reason, but a conclusion' is about as pithy a way of condemning judicial reasoning as you can get. Or take her discussion of the Commission's attitude to IPR licensing in the 70s and early 80s to be found in Chapter 4. She points out about as clearly as anyone could that the Commission and Court have not really understood the problems from a practical, commercial point of view. It would be, and would have been, so much better, if the approach is that in a licence the parties are basically free to decide what they like—and that competition law should only interfere where one is sure that it is necessary to do so. The onus should lie on he who seeks to upset a commercial agreement. If that had always been the approach, I rather think that EU companies would have found life much easier; and EU economies would have been more competitive rather than less: over-regulation by a wooden, rule of thumb, approach to competition law impedes industry and commerce, rather than stimulates competition.

I could go on, but this a foreword, not a review. What shines out at every point is an intelligent discussion of the issues. If I were teaching competition law, this book would be mandatory. And I think the student/teacher discussions it would provoke would be intelligent and lively. As it is, I do not teach competition law. But as soon as a competition case reaches a court in which I sit, I shall reach for this book. It will surely give the key thinking about the area of law in which the problem has arisen. Often it will provide enough for the answer.

Sir Robin Jacob
London
26 September 2005

Preface

Encouraged by the demand for my monographs on distribution and technology transfer and by the welcome received by those on earlier group exemptions, I have prepared not just a commentary on the latest technology transfer block exemption.[1] I have analysed it in the context of the case law of both the Commission and the Community courts in Luxembourg and of the Commission's guidelines on technology transfer.

The Commission has taken great strides towards adopting a more economic approach. The most important development is its willingness to look *ex ante:* to compare what has happened with an agreement and its restrictions on conduct with what would have happened without it and without the restriction. Formerly, once licensor and licensee were producing substitute products, the Commission treated any restrictions of conduct in the agreement with greater hostility on the ground that the parties were competitors. Yet if the licensee could not legally have produced substitutes without a licence, the licence almost certainly increased competition and should have been cleared as not infringing Article 81.

Nevertheless, the Commission has moved only part of the way towards an economic approach. It accepts that the function of competition law is to increase consumer welfare not that of competitors, and that efficiencies made possible by licensing may lead to cheaper or better products or to products with additional functions. It adds that most vertical agreements are pro-competitive. Yet it refuses to balance the pro- and anti-competitive effects of a licence under Article 81(1), when the burden of proof is on the person alleging illegality, but only under Article 81(3) when a heavy standard of proof is required of the person alleging legality.

The burden of proof under Article 81(3) is particularly serious now that the block exemption is capped by market shares. Agreements that qualified under the former block exemption may not qualify under this. Many markets are difficult to define, but definitions of those affected by licensing are particularly arbitrary, because the analysis is prospective and the future hard to envisage. R & D may be financed by promises of licences when the

[1]Regulation 772/2004, on the application of Article 81(3) of the Treaty to categories of technology transfer agreements, OJ 2004, L123/11.

technology is perfected. True, potential competition is not relevant in technology markets, but it is when analysing product markets. It will often be unclear whether the block exemption applies to a licence being negotiated.

The concern that holders of very valuable patents may be forced to license them to competitors downstream has been reduced by the limitation of the special responsibility of a dominant firm under Article 82, most convincingly by Advocate-General Jacobs in *Oscar Bronner*[2] and *Syfait.*[3]

Nevertheless, the doctrine of essential facilities hardly exists now in the US.[4] Moreover, the US Agencies' guidelines are more favourable to licensing. The heavy burden of proof is on the parties claiming that a licence infringes section 1 of the Sherman Act or section 5 of the Trade Commission Act. Even the agencies may drop objections if a court holds that the matter is governed by the rule of reason.[5]

When the draft regulation was published for consultation there was great fear that licensing and even research and development in Europe would be chilled: such activities could be carried out elsewhere, particularly in the United States, and the products exported to Europe with the loss of many well paid and interesting jobs. Such fears have been greatly reduced by the modifications to both regulation and guidelines before adoption, but some concern remains.

In this book, after a short introduction to the tension between competition law and intellectual property with quotations from Schumpeter, I have analysed critically but shortly the case law on exhaustion because so much of the earlier case law was concerned with export bans and the use of intellectual property rights to induce investment by dealers and licensees by granting exclusive territories. After considering the status of guidelines from the Commission I analyse the early case law on licensing, mostly from the Commission.

Only in chapter 5 do I outline the provisions of the group exemption and consider its provisions *seriatim* and at length in the light of the guidelines. Chapter 6 deals, mainly in the light of the guidelines, with provisions in licences that may fall outside the group exemption.

Chapter 7 is shorter and deals with licenses of other kinds of intellectual property such as trademarks and traditional copyright. It also analyses the

[2] *Oscar Bronner GmbH & Co KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co KG and Others* (C-7/97), 26 November 1998, [1998] ECR I-7817, [1999] 4 CMLR 112, [1999] CEC 53. The ECJ followed its AG in the result, but without the theoretical underpinning of the opinion.

[3] *Syfait—Synetairismos Farmakopoion Aitolias & Akarnanias (Syfait). v Glaxosmithkline AEVE* (C-53/03), 31 May, [2005] 5 CMLR 7.

[4] *Verizon Communications IC. v Trinco LLP,* 540 US 398 (2004), 124, S Ct 872, 157 L Ed 2d 823 and *Covad Communication Company et al v Bell Atlantic Corp et al* 1 March 2005, 398 F 3d 666, 365 US App DC 78.

[5] Eg the objection to tying windows to browsers in the Microsoft case was dropped when it was held that the matter should be governed by the rule of reason.

case law on avoiding honest concurrent user of a mark. In chapter 8, I analyse the case law on refusals by a dominant firm to deal and license, before shortly considering, in chapter 9, the most obvious differences between the competition laws in Europe and the US.

I am indebted to many people for considerable help in preparing this text whom I would like to thank.

As always, in 2004 Fordham law School provided me with the use of a good library, help from skilled and constructive librarians, a fast computer, help with its use and companionship. Professor Hugh Hansen enabled me to meet many IP specialists at his wonderful conferences on international IP law and policy[6] and developed my interest in the interface between it and competition.

UCL also provided research assistance. In 2005 Hao Wu was very clever with computers, but also spotted errors of omission and commission in the text and made unusually helpful suggestions.

Andrea Renda, an economic consultant and research fellow of the University of Luiss in Rome, read through the section on *Microsoft* and made many helpful suggestions.

Finally, but not least, I would like to thank Lord Justice Jacob, who wrote a foreword that is both amusing and flattering.

Richard Hart is my favourite publisher. He is an entrepreneur who makes decisions immediately, often when a project is proposed for the first time on the 'phone. I offered him this book only about a month before he started organising its production. His office is still tiny, given that he publishes considerably more than a book a week, because he sub-contracts much of the work and chooses his sub-contractors well. For this book I am indebted to Julian Roskams for his careful editing and guidance. Hart's is a lovely firm with which to work: it has the friendliness and loyalty of a much smaller organisation.

Valentine Korah
Professor Emeritus of Competition Law
University College London
Bentham House
Endsleigh Gardens
London
WCIH 0EG
tel: (44) 0207 483 208186

[6] www.fordhamipconference.com.

Contents

Table of Cases

References in bold type are to discussions in the text.[1]

I THE EC COMMISSION AND COURTS

[1] I have tried to give multiple citations to each case for the benefit of those who may have access to only one of the main series of law reports.

For mergers, I have added Kluwer's *EC Merger Control Reporter* as 'Merger Reporter'. It has now reached its fifth volume and includes all the merger decisions, some of which have not been published elsewhere. Those not drafted in English are being translated. Its cases have numbers starting with B. I have also given the M-number used by the Commission. Decisions of mergers that went through the second stage are published in the L-series of the OJ, those that were decided at stage one in the C series before the conclusion is reached.

The CCH series has gone through several stages. Some of the older judgments and decisions were reported as the *Common Market Reporter* (CMR). From 1989, they were published separately as CEC, and now the CMR has become the *European Union Reporter*. This contains particularly useful and accurate finding lists. The update volume also contains what used to be called 'New Developments'; these are described but not always reported verbatim.

Erauw-Jacquery (Louis) SPRL v La Hesbignonne SC (27/87), 19 April 1988, [1988] ECR 1919, [1988] 4 CMLR 576, [1989] 2 CEC 637 .... **4.1.1.2**, 4.1.1.3

European Night Services (ENS) and Others v Commission (T-374, 375, 384 & 388/94), 15 September 1998, [1998] ECR II-3141, [1998] 5 CMLR 718, [1998] CEC 955; appeal from Commission decision (94/663/EC, IV/34.600), 21 September 1994, OJ 1994, L259/20, [1995] 5 CMLR 76, [1998] CEC 955 .... **3.4**, 8.1.5

Evelyne Delauche v Commission (111/86), [1987] ECR 5345 .... 3.4

SA Fonderies Roubaix—Wattrelos v Société Nouvelle des Fonderies A Roux and Société des Fonderies JOT (63/75), 3 February 1976, [1976] 1 CMLR 538, CMR 8341 .... **3.3**

Ford-Werke AG and Ford of Europe Inc v Commission (25 & 26/84), 17 September 1985, [1985] ECR 2725, [1985] 3 CMLR 528, CMR 14144 .... 6.3.4

Guérlain—Procureur de la République v Giry and Guérlain (253/78 & 1-3/79), 10 July 1980, [1980] ECR 2327, [1981] 2 CMLR 99, CMR 8712 .... **3.5**

Hag II—CNL Sucal v Hag (C-10/89), 17 October 1990, [1990] ECR I-3711, [1990] 3 CMLR 571, [1991] 2 CEC 457 .... **2.2**, 2.4, **7.1**

Hauptzollamt Mainz v CA Kupferberg & Cie KG (104/81), 26 October 1982, [1982] ECR 3641, [1983] 1 CMLR 1, CMR 8877 .... **2.4**

Hilti—Eurofix Ltd and Bauco (UK) Ltd v Hilti AG (88/138/EEC), 22 December 1987, OJ 1988, L65/19, [1989] 4 CMLR 677, CMR 10976; on appeal *Hilti AG v Commission* (T-30/89), 12 December 1991, [1991] ECR II-1439, [1992] 4 CMLR 16, [1992] 1 CEC 155 (CFI); *Hilti AG v EC Commission* (C-53/92P), 2 March 1994, [1994] ECR I-666, [1994] 1 CMLR 590, [1994] 1 CEC 590 (ECJ) 8.1.9.3.1

Firma Joseph Hoche another v Bundesantstalt fürlandwirtschaftliche Marktordnung (154 and 155/83), 2 May 1985, [1985] ECR 1215, [1986] 2 CMLR 632, CMR 14192 .... 3.3, **3.4**

Hoffmann-La Roche & Co AG v Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse GmbH (102/77), 23 May 1978, [1978] ECR 1139, [1978] 3 CMLR 217, CMR 8466 .... 2.2

Hoffmann-La Roche & Co AG v Commission (85/76), [1979] ECR 461, [1979] 3 CMLR 211 .... **6.3.2.1**, **6.3.2.2**, **6.4.3**, 8, **8.1.9.3.4**

Ideal-Standard—IHT Internazionale Heiztechnik GmbH v Ideal-Standard GmbH (C-9/93), 22 June 1994, [1994] ECR I-2789, [1994] 3 CMLR 857, [1994] 2 CEC 222 .... **2.2**

IMS interim order of Commission (2002/165/EC, COMP D3/38.044), 3 July 2001, OJ 2002, L59/18, [2002] 4 CMLR 58, [2002] CEC 2234 .... 8.1.6

II. AUSTRALIA

III. NEW ZEALAND

IV. UNITED STATES

Table of Legislation[1]

EUROPE AGREEMENTS

SUBORDINATE LEGISLATION

Directives

[1] The numbers **in bold** are the more important references.

[2] Almost all the articles of the EC Treaty were changed when the Treaty of Amsterdam came into operation in May 1999. In this book, I have used the new numbering, but in this table, the former numbering is included. Appendix III consists of a conversion table for all the provisions in the EC Treaty.

A convenient consolidated version omitting the protocols is *European Union, Consolidated Versions of the Treaty on European Union and the Treaty establishing the European Community*, ISBN 92-828-1640-0, obtainable from the Office for Official Publications of the European Communities in Luxembourg for 12 Euros. It includes the changes made by the Treaty of Amsterdam and both new and old numbering.

[3] Since all but Chapter 3 of the book relates to article 81, I have not inserted many references under this head.

[4] I have inserted few references under article 82.

Regulations[5]

[5] I have given the official OJ or Special edition citation, and, where they exist, those for the *Common Market Reporter*. All the regulations and notices are set out as corrected in Jones, Van der Woude and Lewis, *EC Competition Law Handbook*, updated annually. They are also set out in *Butterworths Competition Law Handbook*, (4th ed., 1995), as well as in the *Commission's Handbook*.

Notices

I. Introduction

II. General principles

III. Application of the block exemption regulation

IV. Application of Art 81(1) and (3) outside the scope of the BE reg

NATIONAL LEGISLATION

United States

Guidelines

1

Introduction – Tension Between Intellectual Property Rights (iprs) and Competition Rules and the Principle of Free Movement

A PATENT DOES NOT confer any right to use an invention; it enables the holder to restrain others from using it. The holder of an improvement patent may not be entitled to exploit it at all unless the holder of the basic patent grants it a licence, but the improvement patent may help the holder to negotiate such a licence in return for a cross licence under the improvement patent. A licence does not infringe Article 81(1) of the EC Treaty unless it is coupled with restrictions that have the object or effect of restricting competition in some way. In the absence of an agreement or concerted practice, it is not contrary to Article 81 to refuse to grant a licence. Refusals to supply contrary to Article 82 will be considered in chapter 8 below, but to apply for a patent or other intellectual property right (ipr) does not infringe Article 82.[1]

Patents are based on a competitive philosophy: they may encourage investment in research; into kinds of innovation that are easily copied and which might otherwise not be worthwhile for any individual firm.

Perceived *ex post*, after an investment has been made in innovation or the establishment of a reputation for quality, exclusive iprs are anti-competitive in that they restrain other people from taking advantage of the innovation or reputation without the consent of the holder: iprs may constitute barriers to entry and create market power when there are no close substitutes on the demand or supply side of the market. For this reason, German economists and political scientists after the Second World War—the Ordo Liberals – were distrustful of iprs and of restrictive clauses in licences. They treated any restriction on conduct as a loss of freedom and as a restriction

[1] In *Astra Zeneca*, 15 June 2005, IP/05/737, the European Commission imposed a fine for providing national authorities with misleading information to obtain a supplementary protection certificate that would, in effect, prolong the life of a patent and exclude generic producers. An appeal has been lodged.

of competition.[2] Yet even they did not object to the application for a patent, although they believed that a patentee should act as if it did not hold an exclusive right. The Ordo Liberal tradition influenced the thinking of Commission officials dealing with licensing in the 1970s and may well have influenced the European Court of Justice (ECJ).

On the other hand, when perceived *ex ante*, from the time when the decision to invest or create was made – such rights encourage some kinds of investment that otherwise might not be worthwhile and so lead to a more competitive economy. Some inventions, once available, can be easily copied and, without patent protection for a period of time, it would not be worth investing in making them in the first place. This is particularly true of pharmaceutical products that are costly to develop and take through their clinical trials, but often can be copied cheaply from the published specification required to obtain their marketing authorisation. Without copyright protection, authors and artists might have little chance to earn a living.

Many economists, the most prominent of whom was Schumpeter, consider that competition in innovation is more important than marginal competition in price in existing markets.

> [The] competition that counts [is] competition from the new commodity, the new technology, the new sources of supply, the new type of organisation ... competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the outputs of the existing firms but at their foundations and their very lives.

He argued that to survive in capitalist competition, incumbents must withstand 'a perennial gale of competition' in the form of 'the new consumer goods, the new methods of production or transportation, the new markets, the new forms of industrial organisation.'[3]

Consequently, intellectual property rights (iprs) which enable the innovator to obtain the fruits of its investment for a period of time may create more competition for the benefit of consumers than they cost in the exclusion of free riders. It is better and more competitive to induce one firm to compete in new ways than to have none.

Common lawyers tend to stress that patents operate as incentives to investment. Civil lawyers emphasise that patents are the reward for creative effort. These rationales both lead to similar policy. A third rationale is that to obtain a patent, the inventor has to disclose the invention, which may legally be used by anyone for research purposes even during the life of the patent. The patent may be perceived as the price of disclosure. Without a patent system, more know-how might remain secret indefinitely and less

[2] See D Gerber, (1998) *Law and Competition in Twentieth Century Europe: Protecting Prometheus*, (Clarendon Press, Oxford), ch VII.

[3] Joseph Schumpeter, (1942) *Capitalism, Socialism and Democracy*, pp 83–84.

use be made of it. Fourth, the exclusive right makes it easier for inventors to negotiate licences – once they have applied for a patent, they can disclose the invention to potential licensees with less fear of plagiarism.

Similar economic rationales apply to other kinds of ipr, such as design rights, plant breeders' rights and copyright. Trademarks enable the holder to sue those who confuse buyers into thinking that their products emanate from it. They make possible competition in qualities that are not immediately obvious to shoppers, such as the taste of packaged food. They do not prevent others from selling competing goods unbranded or under a different mark. In the long term, protection of such rights may increase efficiency as well as consumer choice and so make the economy more competitive. Exclusive intellectual property rights are usually national.[4] Patents may be applied for in many countries. A UK patent does not protect the holder from others exploiting an invention in France or any other country. In the 1960s it was widely thought that an agreement to divide the Common Market along national boundaries would infringe Article 81 of the EC Treaty, but that the exercise of intellectual property rights would not. The national limitations of intellectual property rights, however, are difficult to reconcile with the concept of a common market. The ECJ therefore adopted a doctrine of Community exhaustion, under which once the holder had placed protected goods on the market in one Member State or consented to someone else doing so, its iprs were exhausted and ineffective to control sales of the same items in other Member States.

Consten and Grundig v Commission[5] was the beginning of a development preventing this. Grundig placed a second trademark 'GINT' on the apparatus it made in the 1960s and enabled its distributor in each Member State to register the mark. This enabled Consten to sue the parallel importer UNEF under French law for trademark infringement in addition to unfair competition. Advocate-General Roemer considered that this was an abuse of trademark law, since the Grundig mark, which was also placed on the equipment, adequately indicated the origin of the goods, that is, the person who was responsible for their specification.

The judgment went further and distinguished the existence or ownership of such rights under national law, which are protected under Article 295 of the Treaty, from their exercise, which is subject to the treaty provisions. In legal theory, it is impossible to draw the line between existence and exercise, except at the extremes. The existence of a right comprises all the ways in which it may be exercised. In ruling that an important difference rests on a distinction, which cannot be drawn by logical analysis, the ECJ created a

[4] Benelux design and trademark laws cover three Member States of the EC; Belgium, the Netherlands and Luxembourg.

[5] (56 & 58/64), 13 July 1966, [1966] ECR 299, [1966] CMLR 418, CMR 8046, para 50.

very flexible instrument for it to develop the law and reduce the possibilities of dividing the Common Market through the use of national or regional intellectual property rights. Kinds of use that did not divide the Common Market could be held to relate to the existence of the right and outside the Treaty. Kinds of use that divided the market related to the exercise of the rights and were subject to it.

1.1 BIBLIOGRAPHY

GERBER, D (1998) *Law and Competition in Twentieth Century Europe: Protecting Prometheus* (Clarendon Press, Oxford), ch VII.

SCHUMPETER, J (1942) Capitalism, Socialism and Democracy.

VAN BAEL and BELLIS, (2004) *Competition Law of the European Community,* 4th edn (Kluwer Law International), ch 6.

2

Free Movement of Goods

The principle of the free movement of goods mentioned in Article 3(1)(a) and (c) of the EC treaty is crystallised in Articles 28–30 (formerly Articles 3–36). Article 28 provides:

> Quantitative restrictions on imports and all measures having equivalent effect shall be prohibited between Member States.

The ECJ has interpreted this provision, implementing one of the fundamental principles[1] of the Common Market, very widely. 'Quantitative restrictions' is a term referring to customs quotas—only so many widgets shall be imported from state A each year. An extreme quantitative restriction is a nil quota—no widgets shall be imported thence. The right of a patent or trademark holder to restrain imports has been perceived as a measure of equivalent effect to a nil quota—no protected articles shall be imported without its consent. Article 29 makes similar provision for quantitative restrictions on exports.

Exceptions are provided in Article 30 for measures justified on various grounds, including the protection of 'industrial and commercial property', but its provisions derogate from a *fundamental principle* of the Treaty and have been narrowly construed. Moreover, there is a sting in the tail:

> Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States.

[1] 'Principles' are more important than rules—free movement is a fundamental *principle* of the common market. Comment, Michel Waelbroeck 'The Effect of the Rome Treaty on the Exercise of National Industrial Property Rights' (1976) 21 *Antitrust Bull* 99.

Article 30 confirms that the authors of the Treaty thought that industrial and commercial property rights could have an equivalent effect to quantitative restrictions.

2.1 JUDGMENTS ON EXHAUSTION OF PATENTS

The ECJ extended the doctrine of exhaustion of iprs that formed part of some national laws, so that holders were unable to divide the Common Market by relying on national iprs. It held that once the protected products had been sold by or with the consent of the holder, the right was exhausted and could not be used to keep the product out of other Member States. The national limitation of iprs could not be used to discriminate against customers in some Member States.

2.1.1 'Specific Subject Matter'

The ECJ developed the concept of the 'specific subject matter' of the particular kind of industrial or commercial property being considered, in the light of which protection may be justified. In *Centrafarm v Sterling*,[2] it stated:

> 9. In relation to patents, the specific subject matter of the industrial property is the guarantee that the patentee, to reward the creative effort of the inventor, has the exclusive right to use an invention with a view to manufacturing industrial products and putting them into circulation for the first time, either directly or by the grant of licences to third parties, as well as the right to oppose infringements.

This may not be an excellent analysis of either the nature of the right, nor of the reason patents are granted under national law. None of the judges at that time was an expert in intellectual property law. It is clear, however, that 'the specific subject matter' includes both the nature of the right—the right to restrain others from using the invention or selling goods made through its use—and the reason the law grants it—the reward to those investing in innovation.

Sterling held patents in the UK, the Federal Republic of Germany, the Netherlands and elsewhere. Centrafarm had bought the patented drug in England and Germany where Sterling had obtained some recompense; but the UK price for the drug was half the Dutch price, partly because of fluctuating currencies and partly because of the buying power of the UK government. It pays for most medicines used in the UK and had a right to exploit patented inventions for its own use in return for a royalty set arbitrarily under the Crown use provisions of the Patents Act 1949 (since repealed and replaced).

[2] (15/74), 1 Oct 1974, [1974] ECR 1147, [1974] 2 CMLR 480, CMR 8246.

The ECJ does not seem to have been concerned about the size of the reward, and was not prepared to allow the national patent laws to divide the Common Market in order to permit Sterling to obtain further remuneration when its drug entered the Netherlands, where it was more highly valued:

> 11. Whereas an obstacle to the free movement of goods of this kind may be justified on the ground of protection of industrial property where such protection is invoked against a product coming from a Member State where it is not patentable and has been manufactured by third parties without the consent of the patentee
>
> and in cases where there exist patents, the original proprietors of which are legally and economically independent,
>
> a derogation from the principle of the free movement of goods is not, however, justified where the product has been put onto the market in a lawful manner, by the patentee himself or with his consent, in the Member State from which it has been imported, in particular in the case of a proprietor of parallel patents. [The sentence has been divided into three for ease of comprehension].

The ECJ made clear the possibility of restraining parallel traders at the two extremes, but there is some intermediate ground which it left open, part of which has been clarified by later cases. Later judgments applied paragraph 11 literally and treated a patent as exhausted by any sale in another Member State by or with the consent of the holder, whether or not a monopoly profit could be earned in the country of export.[3]

The Court did not address the issue of direct sale by a licensee outside its territory, but in *Tiercé Ladbroke v Commission*,[4] the CFI interpreted the ECJ's judgment in *Centrafarm v Sterling* literally and held that such a sale was not made with the consent of the holder and did not exhaust the copyright in question. It looked to the words of the judgment, rather than to the idea of not permitting two bites of the cherry.

For some years, little attention was given to the need for a monopoly profit—the reward for creative effort mentioned in paragraph 9 of the judgment of *Centrafarm v Sterling*, which provides the incentive to invest in innovation. This is unfortunate and surprising in view of the teleological approach the Court claimed to adopt in the 1970s. The Court may have been influenced by the Ordo Liberal distrust of intellectual property rights, which were perceived as entry barriers depriving others of their freedom. Clearly free movement is the fundamental principle of the Common Market.

Sterling had argued that it should be allowed to protect the Dutch market because the price differences were due to different government policies in the two countries. The Court answered:

[3] See *Merck v Stephar*, 2.1.2 below.

[4] (T-504/93), 12 June 1997, [1997] ECR II-923, [1997] 5 CMLR 309, [1997] CEC 812. Beware! There are several cases called *Ladbroke v Commission*. The appeal has been withdrawn.

> 23. It is part of the Community authorities' task to eliminate factors likely to distort competition between Member States, in particular by the harmonization of national measures for the control of prices and by the prohibition of acts which are incompatible with the Common Market, in addition to the exercise of their powers in the field of competition.

It added (at paragraph 24) that the different national policies did not justify the exercise of the patent rights: it was for the Community institutions to prevent such distortions. Since then, the Commission has not proposed legislation to limit national price control of medicines, where it does not bear particularly heavily on imports, and has used the competition rules to make export limitations illegal. Even if the Commission were to propose a directive to the Council, it is unlikely that the Member States that constitute the Council would be prepared to give up their control over the cost of medicines.

2.1.2 *Merck v Stephar*

In *Merck v Stephar*,[5] Merck had sold or consented to the sale in Italy by its subsidiary of a drug called 'Moduretic'. It held patents for this in other Member States, but at the time of the discovery it was not possible to obtain a patent for pharmaceutical products in Italy. Although the law preventing the grant of patent protection for drugs had since been held unconstitutional by the highest Italian court, no transitional provisions were enacted for drugs discovered during that period, which cannot now be patented because they are no longer novel.

Prices for the drug were very different in different Member States. In the Netherlands, Germany and Belgium, the patent law was strong and the price was high; in the UK, where the main purchaser was entitled to a compulsory licence under the Crown use provisions, the price was less than half the Dutch price. In Italy the price was lower still, but it was lowest of all in France, where there was patent protection. The French government, however, imposed maximum price controls, restricting the returns on the drug even more tightly than did the lack of patent protection in Italy.

Although neither Merck nor its subsidiary had had any possibility of earning a monopoly profit in Italy, the Court ruled that Merck could not rely on its Dutch patent to keep out a drug that had been sold in a Member State by it or with its consent.

The Advocate-General had pointed out that not all patentees make a monopoly profit—they have only a chance of doing so. One might reply

[5] (187/80), 14 July 1981, [1981] ECR 2063, [1981] 3 CMLR 463.

that there are always commercial constraints. Few patents have any value because usually there are cheaper or better substitutes on the market or because a drug is found to produce disastrous side effects. The Italian law, however, ensured that no inventor of pharmaceutical products who sold them in Italy could prevent firms in other Member States taking a free ride on its investment in innovation for medicines.

The Court's only apparent reason for preventing Merck from using its Dutch patent to protect one of the countries where it could make a monopoly profit was that Merck must take the consequences of its conduct in selling the product in Italy (paragraph 11). That is not a reason, but a conclusion.[6] To discourage the patentee from selling in countries where it can obtain no protection may in theory lead to the products being sold only where they are protected by patent and not subject to price control, and this might divide the market even more seriously than does differential pricing. It may be that patents for pharmaceutical products are weak in too many countries for this to be worthwhile.

The Court's judgment must have reduced the returns in Europe from R & D, and may marginally have reduced that activity although pharmaceutical companies also exploit their R & D in the US and other developed countries outside the EEA.

The only reason of policy, which in my view might justify the Court's decision, is that it encouraged private firms to persuade their governments not to control a patentee's profit margin so tightly. I am told that after the judgment in *Merck v Stephar*, French pharmaceutical firms persuaded the French government to raise the maximum prices at which they were permitted to sell in France on the ground that this would enable them to make higher profits on exports to other Member States. This had the incidental advantage of bringing the national laws closer together. It is however tough for a firm in the private sector to be squeezed between the governmental desire in some countries to keep down the cost of medicine and the Community rules for free movement, which extend to the whole Common Market the rules of the Member State giving least protection to innovators. It is also hard on the countries which provide strong patents because of their desire to encourage innovation.

Hugh Hansen of Fordham Law School argued that neither the Treaty nor the principles of free movement require international exhaustion between Member States. The doctrine of exhaustion expands the number of people selling products that are already on the market in Member States. It reduces the prices obtainable in some Member States and leads to artificial distortion of the market, as dealers buy where the maximum is

[6] Valentine Korah, 'The Exhaustion of Patents By Sale In A Member State Where A Monopoly Profit Could Not Be Earned', [1997] 18 ECLR 265, at pp 267–268.

low and sell where it is high. It may decrease the amount sold because the expectation of parallel trading which may prevent the recovery of the costs of introducing a new product onto the market will discourage investment in invention.[7]

The doctrine of exhaustion limits the extent to which holders of intellectual property rights can discriminate geographically. Economists are agreed, however, that where substantial overhead costs are sunk (when their value cannot be recovered except for the purpose for which they were incurred), resources are most efficiently allocated if most of the overhead is recovered from those whose demand is less responsive to price, provided that every buyer pays at least the average variable cost of supply. Those willing to pay least obtain the product at a price they are willing and able to pay and may contribute something to the overhead, which benefits those suffering discrimination. No one is worse off. This theory, developed by Ramsey[8] in the context of identifying the least distorting tax system, however, has not been accepted by the Commission or by Community courts in any judgments, although the opinion of A-G Jacobs in *Syfait* (8.1.7 below) supports it.[9]

In several subsequent cases the ECJ has extended to the doctrine of exhaustion to other kinds of iprs, such as design rights,[10] copyright and neighbouring rights,[11] and trademarks,[12] but not to performing[13] or rental[14] rights. For a time in the 1980s the Court drew back somewhat from the erosion of iprs and stressed the need for remuneration, made possible by requiring the holder's consent, if the doctrine of exhaustion is to apply. Nevertheless, in *Merck v Primecrown*,[15] the ECJ rejected the opinion of A G Fennelly and confirmed its judgment in *Merck v Stephar*.

[7] Hugh Hansen, 'International Exhaustion: An Economic and Non-economic Policy Analysis', *International Intellectual Property Law and Policy*, vol 6, (Juris Publishing, 2001), 114-110.

[8] FP Ramsey, 'A Contribution to the Theory of Taxation', (1929) 37 *Economic Journal* 47-61.

[9] *Syfait-Synetairismos Farmakopoion Aitolias & Akarnanias (Syfait) and Ors v Glxosmithkline AEVE* (C-53/03), [2005] 5 CMLR 7, Opinion Jacobs, 28 October 2004 (8.1.7 below).

[10] *Keurkoop BV v Nancy Kean Gifts BV* (144/81), 14 September 1982, [1982] ECR 2853, [1983] 2 CMLR 47, CMR 8861.

[11] *Deutsche Grammophon v Metro* (78/70), 8 June 1971, [1971] ECR 487, [1971] CMLR 631.

[12] *Sirena Srl v Eda Srl* (40/70), 18 February 1971, [1971] ECR 69, [1971] CMLR 260, CMR 8101.

[13] *Coditel (SA Compagnie Générale pour la Diffusion de la Télévision) v Ciné-Vog Films* (62/79), 18 March 1980, [1980] ECR 881, [1981] 2 CMLR 362, CMR 8662.

[14] *Warner Bros and Metronome v Christiansen* (158/86), 17 May 1988, [1988] ECR 2605, CMR 14497.

[15] (C-267 & 268/95), 5 December 1996, [1996] ECR I-6285, [1997] 1 CMLR 83, [1997] 1 CEC 261.

2.2 EXHAUSTION OF TRADEMARKS

At first, the ECJ was very scathing about trademarks,[16] but in *Hag II*,[17] it withdrew the remarks it had made about trademarks in early cases and, at paragraph 13, following A-G Jacobs, it referred to trademarks as being:

> an essential element in the system of undistorted competition which the Treaty aims to establish and maintain. In such a system enterprises must be able to gain customers by the quality of their products or services, which can be done only by virtue of the existence of distinctive signs permitting identification of those products and services. For a trademark to be able to play this part, it must constitute a guarantee that all the products bearing it have been manufactured under the supervision of a single enterprise to which responsibility for their quality may be attributed.

The Court went on to hold that the holder of the German mark was entitled to enforce it, but it was not clear whether the judgment was based on the lack of consent by the German holder whose mark had been confiscated by the state (paragraph 15) or on the possible confusion of the public (paragraph 16).

In *Ideal Standard*,[18] the ECJ came down firmly in favour of confusion. A single firm owned two businesses, one in France and one in Germany. The insolvent business in France was sold by the liquidator as a going concern together with the French mark, but the ECJ ruled that the products of the French firm had been sold in Germany without the consent of the German holder. The Court stressed that the function of a trademark is to save consumers from confusion (paragraph 45). Where there is no continuing relationship between the vendor and purchaser of a business, there is no guarantee that the specification of the products sold in the two areas will be the same. So, consumers may be confused.

The trademark regulation,[19] creating a Community mark, contains provisions in Articles 5 and 7 introducing the concept of Community exhaustion. In *Bristol-Myers Squibb and Others v Paranova*,[20] the ECJ was asked to interpret these provisions. It followed A-G Jacobs and ruled at paragraph 25 that a national law implementing a directive should be construed in the light of the directive and that the directive should be construed in the light

[16] A-G Dutheillet de Lamoth in *Sirena Srl v Eda Srl*, para 14, judgment para 7.

[17] (C-10/89), 17 October 1990, [1990] ECR I-3711, [1990] 3 CMLR 571, [1991] 2 CEC 457.

[18] (C-9/93), 22 June 1994, [1994] ECR I-2789, [1994] 3 CMLR 857, [1994] 2 CEC 222, paras 46–51.

[19] Council Regulation 40/94-Community Trademark, OJ 1994, L11/1, amended by Regulation (EC) 3288/94, L349/83.

[20] (C-427, 429 & 436/93), 11 July 1996, [1996] ECR 1-3457, [1997] 1 CMLR 1151, [1996] 1 CEC 716. The cases was decided under the trademark directive (89/104/EEC), OJ 1989, L40/1, CMR 5826, but that was construed in the light of the case law under Art 30 (paras 38–41), so must be relevant to that provision.

of the case law under Articles 28–30 of the EC Treaty. It also ruled that a holder might not restrain parallel trade by a dealer who had repackaged goods if the use of the mark would have the effect of artificially dividing the Common Market (paragraph 57).

Various pharmaceutical companies had sold their trademarked pills in the quantities customary in each Member State. There were vast differences in the prices at which they were sold owing to national measures, such as the control of maximum prices or profit. Parallel traders bought these pills in the countries where they were cheap, and cut the blister packs or changed the quantities in ampoules etc so as to contain the appropriate amount of medicine for the country of destination. They then replaced the outer packaging in such a way that the original trademark could be seen.

The Court held (paragraph 55) that repackaging would not prevent the doctrine of exhaustion from applying where it was necessary to enable the parallel trader to conform to rules or to well-established medical prescription practices about the quantities to be marketed, or the reimbursement of medical expenses. The Court went on to confirm (paragraphs 75–79) that exhaustion would take place when the repackaging did not correspond to the conditions it had specified in earlier cases.[21] It added a new condition that the repackaging must not spoil the appearance of the products. It was for the national court to decide whether the original condition of the goods was affected by the repackaging (paragraphs 58–66).

2.3 EXHAUSTION OF COPYRIGHT

Traditional copyright that restricts marketing of books or records is subject to the normal doctrine of exhaustion,[22] but the ECJ has treated far more favourably copyright in the exhibition of films, broadcasts and other performing rights—the right to reproduce the protected work in public.

[21] *Hoffmann-La Roche & Co AG v Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse GmbH* (102/77), 23 May 1978, [1978] ECR 1139, [1978] 3 CMLR 217, CMR 8466:

> However, such prevention of marketing constitutes a disguised restriction on trade between Member States within the meaning of the second sentence of Article 30 where:
> – it is established that the use of the trademark right by the proprietor, having regard to the marketing system which he has adopted, will contribute to the artificial partitioning of the markets between member States;
> – it is shown that the repackaging cannot adversely affect the original condition of the repackaged product;
> – the proprietor of the mark receives prior notice of the marketing of the repackaged product; and
> – it is stated on the new packaging by whom the product has been repacked.

[22] *Deutsche Grammophon v Metro,* (78/70), 8 June 1971, [1971] ECR 487, [1971] CMLR 631 a judgment concerning neighbouring rights in records).

In *Coditel v Ciné Vog Films*,[23] a Belgian cable television company picked up the transmission of a film from Germany and relayed it to clients in parts of Belgium. The exclusive licensee of the film for Belgium objected and sued the cable company for copyright infringement to protect its own market.[24]

The ECJ distinguished broadcast diffusion rights from copyright in a physical disk or cassette (paragraph 12). The former are governed by the rules for the free movement of services—Articles 49 and 50 of the EC Treaty—rather than for goods. It implied something similar Article 30 into the rules relating to services, but went considerably further.

It stated at paragraph 13 that a copyright holder and its assignee have a legitimate interest in calculating royalties on the basis of the number of performances by the licensee and that exploitation of copyright involves various methods, including television. It ruled that the holder was entitled to rely on its copyright to restrain Coditel from relaying the film transmitted with the holder's consent in another Member State (paragraph 18). Consequently, broadcast diffusion rights are not exhausted by a performance in another Member State.[25]

The distinction between the mechanical rights, subject to the rules for the free movement of goods, and performing rights, subject to the rules for the provision of services, was commercially artificial, although they are governed by different parts of the EC treaty. A film producer is induced to invest because of a series of possible exploiting acts. There are royalties to be obtained from selected cinemas charging high prices, then from the general release to cinemas and television—all these derive from services. Now, an increasing proportion of the revenue comes from the sale and, more recently, the hire, of video cassettes and DVDs. This is subject to the free movement of goods, but the Court has not relied on the distinction.

Warner Bros & Metronome v Christiansen[26] was concerned with the hiring out of video cassettes. Christiansen bought some in England with the consent of the copyright holder and imported them into Denmark for the purposes of hiring them out from his shop. Under Danish law, sale and hire are separate infringing acts. Under UK law at that time, copyright holders were able to oppose the sale but not the hire of the cassettes.

[23] (62/79), 18 March 1980, [1980] ECR 881, [1981] 2 CMLR 362, CMR 8662.

[24] Under Belgian law, an exclusive licensee is able to sue infringers without joining the copyright holder.

[25] Subsequently, the Court found for the same reasons that exclusive licences to different broadcasters in different Member States do not infringe Art 81(1), although A-G Reischl observed that such a conclusion would result in absolute territorial protection: see *Coditel II*, *Coditel SA v Ciné-Vog Films SA (No 2)* (262/81), 6 October 1982, [1982] ECR 3381, [1983] 1 CMLR 49, CMR 8865 ; at 4.1.1.3 below.

[26] (158/86), 17 May 1988, [1988] ECR 2605, CMR 14497.

Citing *Keurkoop*,[27] for the proposition that before the national laws have been harmonised by Community directive it is still for national law to define the scope of industrial and commercial property rights, and *Coditel II*,[28] the ECJ stressed the need for the holder to make an adequate return on its investment. The Danish law was not discriminatory. Had the cassettes been bought in Denmark, hiring them would still have infringed the copyright. The Court refused to follow A-G Mancini, and its ruling came as a great surprise to experts.

The Court's emphasis on the need for adequate remuneration was welcome, although it is not possible to say how much remuneration is needed to induce the producer's investment. That should be determined by the market—by the amount that producers can extract from the licensees and buyers of the protected goods.

2.4 NO INTERNATIONAL EXHAUSTION

The rules relating to the free movement of goods apply to imports and exports between EC Member States. So, in *EMI v CBS*,[29] the Court held that where the mark had lawfully been affixed to the goods in the United States by the holder there, the holder in various Common Market states could rely on national law to prevent the import of records bearing the mark, although the marks were of common origin.[30]

Goods bearing a mark may be imported from outside the Common Market to a Member State where no similar trademark is held, but they can be kept out of any other Member States where the mark might be confused with one held independently in that state.[31] There is no doctrine of international exhaustion in relation to goods sold with the holder's consent outside the Common Market.

In *Hauptzollamt Mainz v Kupferberg*,[32] the ECJ ruled that the provisions on free movement contained in the free trade or association agreements it has entered into have direct effect. Nevertheless, it had held earlier, in *Polydor v Harlequin Records*,[33] that they should be construed far more

[27] *Keurkoop BV v Nancy Kean Gifts BV* (144/81), 14 September 1982, [1982] ECR 2853, [1983] 2 CMLR 47, CMR 8861.

[28] *Coditel II—Coditel SA v Ciné-Vog Films SA (No 2)* (262/81), 6 October 1982, [1982] ECR 3381, [1983] 1 CMLR 49, CMR 8865, at 4.1.1.3 below.

[29] (51, 86 & 96/75), 15 June 1976, [1976] ECR 811, [1976] 2 CMLR 235, CMR 8350.

[30] *EMI* was decided before *Hag I* was overruled by *Hag II—CNL Sucal v Hag* (C-10/89), 17 October 1990, [1990] ECR I-3711, [1990] 3 CMLR 571, [1991] 2 CEC 457.

[31] This follows from *Keurkoop* (144/81), 14 September 1982, [1982] ECR 2853, [1983] 2 CMLR 47, CMR 8861, 2.3 above, and from *EMI v CBS and others*, (51, 86 & 96/75),. 15 June 1976, [1976] ECR 811, [1976] 2 CMLR 235, CMR 8350.

[32] (104/81), 26 October 1982, [1982] ECR 3641, [1983] 1 CMLR 1, CMR 8877.

[33] (270/80), 9 February 1982, [1982] ECR 329, [1982] 1 CMLR 677, CMR 8806. *Van Zuylen Frères v Hag AG* (192/73), 3 July 1974, [1974] ECR 731, [1974] 2 CMLR 127, CMR 8230.

narrowly than the EC rules since they are not intended to create a common market but only a free trade area. Consequently, an exclusive licensee of the copyright holder in the UK was entitled to exercise the copyright to restrain the import of records sold with the consent of the holder in Portugal before its accession to the Common Market. The Court's reasoning is based on general considerations that apply equally to marks, patents and other intellectual property rights.

This lack of exhaustion will continue to apply to the association and free trade agreements the EC has made with some third countries, such as Israel. Holders of intellectual property rights will be able to sell cheaply in those countries and prevent the goods from undermining the price in the Common Market. This no longer applies after such a state accedes to the EC Treaty.

Protocol 28 of the EEA Agreement provides for exhaustion throughout the European Economic Area (Iceland, Liechtenstein and Norway plus the Member States of the EC). Exhaustion is to be understood in accordance with the case law of the ECJ. Goods sold by or with the holder's consent in Norway[34] cannot be kept out of the Common Market by exercising intellectual property rights, and vice versa.

The ECJ has held that the doctrine of exhaustion expressly adopted in the trademark directive is not international, even if the Member State of import has adopted a concept of international exhaustion.

Article 5 of the directive prescribes the rights of the holder of a trademark registered under the directive and Article 7 of the directive provides:

> 1. The trademark shall not entitle the proprietor to prohibit its use in relation to goods which have been put on the market in the Community under that trademark by the proprietor or with his consent.
>
> 2. Paragraph 1 shall not apply where there exist legitimate reasons for the proprietor to oppose further commercialisation of the goods, especially where the condition of the goods is changed or impaired after they have been put on the market.

In *Silhouette Internationale Schmied GmbH & Co KG v Hartlauer Handellsgesellschaft mbH*,[35] elegant sunglasses of an out of date model were sold for sale in Sofia in Bulgaria by the holder of the trademark. The glasses were, however, found on sale in Austria and the holder sought an interim injunction. Under Austrian national law, there was a doctrine of international exhaustion so the mark was exhausted by the sale in Bulgaria which is outside the Common Market and an injunction was not obtainable.

There had been much controversy about international exhaustion when the trademark directive was being debated. So the directive, which represented a compromise, is not clear on the subject. To allow international

[34] A member of the EEA, but not of the EC.
[35] (C-355/96), 16 July 1998, [1998] ECR I-4799, paras 23-31.

exhaustion in Sweden and Austria would divide the Common Market, as goods sold outside it with the consent of the holder would be able to circulate in those two Member States but not in the rest. So the ECJ interpreted the directive as precluding international exhaustion under national law. It did not consider whether it would have been desirable for the Council to have provided for such a doctrine, but held that it had not done so. Nor did it consider Article 81, which might have applied to the agreement between the holder of the mark and its Bulgarian dealer. Once the goods entered into one Member State, they might have been sold on into another.

In *Javico*,[36] there were contractual restrictions forbidding a distributor in Eastern Europe from selling trademarked products into the Common Market. The ECJ held that such a ban did not necessarily have the object or effect of restricting competition within the Common Market. The legal and economic context was important. Such a restraint might have an effect in the Common Market when the market was oligopolistic or where there was a significant difference in price between products inside and outside the Common Market. It was for the national court to decide the facts.

2.5 SALE WITHIN THE COMMON MARKET WITH THE HOLDER'S CONSENT

The concept of a sale within the Common Market with the holder's consent has been considered more recently, in *Davidoff (Zino) SA & A & G Imports Ltd* (C-414/99) and *Levi Strauss & Co and another v Tesco*.[37] On a reference under Article 234, the ECJ ruled that consent to sale within the Common Market by an intermediary outside could not be implied:

> consent [to market the goods within the Community] must be so expressed that an intention to renounce [trademark] rights is unequivocally demonstrated. (paragraph 45)

Consequently an injunction could be obtained even if consent to sale within the Common Market had not been expressly withheld.

The ECJ did not consider Article 81. Its ruling on free movement, however, reduces the need to insert a ban on marketing within the Common Market, although one might prefer to sue the dealer for breach of contract in relation to a large batch of items rather than claim trademark rights once the goods have been distributed in small lots around the Common Market.

[36] (C-306/96), 28 April 1998, [1998] ECR I-1983, [1998] 5 CMLR 172, [1998] CEC 813.

[37] (C-415/99), 20 November 2001, [2001] ECR I-8691, [2002] 1 CMLR 1, [2002] CEC 154, comment: Thomas Heide, 'Trademarks and Competition Law after Davidoff,' [2003] EIPR 163.

Davidoff, however, created problems relating to the burden of proof. In *Van Doren v Lifestyle*,[38] the parallel trader could not prove that the items he had bought in the Common Market had been sold there with the consent of the American brand owner. According to the German law applicable, the burden of proof was on the parallel trader, but it did not know where its supplier had obtained the goods, and even if it had, disclosing their provenance would have probably caused the supply to dry up. In its preliminary ruling, the ECJ accepted that according to the general rule, the burden of proof is a question of procedural law to be determined by national law. At paragraphs 37 and 38, it added, however, that the German rule of evidence would require qualification as a result of the principle of free movement of goods, in particular if it allowed the holder to partition national markets. It ruled that, if the parallel trader could establish a real risk of market partitioning if he bore the burden of proof as to where the goods were first placed on the market with the holder's consent, the burden should shift to the holder.

In *Micro Leader Business*,[39] certain French language software was cheaper in Canada than in France. The Commission dismissed a complaint by Micro Leader Business that charging a higher price in France while relying on its copyright to exclude imports amounted to the abuse of a dominant position. The Court of First Instance (CFI) confirmed (paragraphs 27–39)[40] that the sale into Canada did not exhaust the copyright and that there was no evidence that the holder had discouraged its Canadian distributor from exporting to France.

It added at paragraph 34 that even if the holder had discouraged such trade into the Common Market, any agreement or concerted practice would have done no more than enforce the holder's copyright, and unilateral action is not contrary to Article 81. The language is not clear, but suggests that such an agreement would not have had any appreciable effects within the Common Market. If followed by the ECJ in subsequent cases, this could be very helpful to those seeking to charge higher prices within the Common Market. The contractual restriction may be relied upon at the earlier stage, before a batch of products has been split up.

The complaint to the Commission also alleged that the higher price in France amounted to the abuse of a dominant position. The Commission dismissed this complaint on the grounds that the complainant had not

[38] *Van Doren & Q GmbH v Lifestyle Sportswear Handelsgesellschaft mbH* (C-244/00), April 8, 2003, [2003] ECR I-3051, [2003] 2 CMLR 203.

[39] *Micro Leader Business* (T-198/98), 16 December 1999, [1999] ECR II-3989, [2000] 4 CMLR 886, [2000] CEC 540.

[40] *Micro Leader Business* (T-198/98), 16 December 1999, [1999] ECR II-3989, [2000] 4 CMLR 886, [2000] CEC 540.

brought sufficient evidence, nor had it proposed a remedy. The CFI observed that the higher price seemed to show discrimination contrary to Article 82(c). The holder had issued bulletins to its dealers in France that suggested that the imported products were in direct competition with those sold in France. Enforcement of intellectual property rights may, in exceptional cases, amount to an infringement of Article 82 (8.1.9 below). So the Commission was wrong to dismiss the complaint under Article 82 without further investigation.

Conditions outside the Common Market may be very different from those within. A firm that has spent large sums on R & D may want to sell the results at lower prices in some countries and this makes sense as long as it covers its incremental costs.[41] Some pharmaceutical companies have made available in Africa medicines for treating AIDS at prices that would not enable them to recover much of their investment in R & D.

Would a patent holder infringe Article 82 if it relied on its unexhausted patents to keep the drugs sold cheaply in undeveloped countries out of Europe?[42] The economy is better off if a monopolist engages in Ramsey pricing (2.1.2 above). Unless the cheaper medicines can be kept out of the most developed countries, they are unlikely to be made available at prices that even the richer people in the less developed world can afford. DG Competition shows no signs of being convinced that Ramsey pricing is desirable, or even permissible. On the other hand, it can be argued that conditions in the less developed countries are very different from those in Europe, when such medicines would mostly be paid for by the state. Is that enough to show that there would be no discrimination contrary to Article 82(c): that equals are not being treated differently?[43]

2.6 CONCLUSION

In the early 1970s, the ECJ prevented national intellectual property rights from dividing the Common Market even if the right holder had not been able to earn a monopoly profit because of national state measures. Its judgments during the following decade stressed the importance of not undermining the specific function of the particular kind of intellectual property rights and demonstrated awareness that rewards and incentives are important. By the mid 1990s, however, the Court had become more loath to

[41] *Syfait* [2005] 5 CMLR 7 (8.1.8 below).

[42] See Eleanor Fox, 'Parallel Imports, and the Intra-brand/Inter-brand Competition Paradigm and the Hidden Gap between IP Law and Antitrust', (2002) 25 *Fordham International Law Journal* 982.

[43] I am told that this question is academic. Dishonest traders can sell pills in Europe masquerading as medicines but lacking the active ingredient. There is no need for a fraudster to pay for the genuine pills sent to undeveloped countries.

reverse its earlier judgments and, in *Merck & Co Inc v Primecrown,*[44] it confirmed *Merck v Stephar*.[45]

Since intellectual property rights may impede inter-state trade where the right holder in the country of import had no rights in the country of export and the protected product was put on that market by a third party without its consent, the Council has been adopting directives to ensure that differences in the law should not divide the Common Market. The process has been a gradual one and has usually led to greater protection than under former national law.[46] It is not always possible politically for the legislature to reduce the scope of iprs in the Member State with the strongest protection. I am concerned that the life of copyright has been extended to life plus 70 years, whether or not that extra protection is required to induce the creation of artistic and useful work, solely to limit restraints on inter-state trade. One of the most important functions of the Commissioner responsible for competition should be advocacy against the creation of entry barriers by Council directives or national measures.

Problems remain where protection is greater in the country of import than in that of export, and right holders will have to consider carefully before themselves marketing the goods in Member States where the protection is weak, for instance because of maximum price controls. Where large price differences are caused by governmental measures, this may divide the Common Market far more severely than would the exercise of patents.[47]

It seems that any restrictions on inter-state trade will have to be imposed by contract, and be subject to the application of Articles 81 and 82 of the EC Treaty. Until 2004, when such an agreement was notified, fines could not be imposed for a period before the Commission takes a decision, but now that notification has been abrogated, this safe haven has disappeared. Despite paragraphs 21–25 of the judgment in *Centrafarm v Sterling*,[48] the Commission has been hostile towards restraints on exports or on parallel trade, but some limited protection is permitted by the group exemptions for exclusive distribution and technology transfer. Another possibility is to ration the dealers in the Member States where prices are low, being careful not to ask them not to sell in other Member States.[49]

[44] (C-267 & 268/95), 5 December 1996, [1996] ECR I-6285, [1997] 1 CMLR 83, [1997] 1 CEC 261.

[45] (187/80), 14 July 1981, [1981] ECR 2063, [1981] 3 CMLR 463, CMR 8707 (2.1 above).

[46] Eg, the copyright term directive, Council Directive 93/98/EEC, OJ 1993, L290/9.

[47] See A-G Jacobs in Syfait *and Others v Glaxosmithkline* (C-53/03), [2005] 5 CMLR 7, 28 October 2004, paras 77–104; 8.1.8 below. The ECJ declined jurisdiction under Art 234 because it thought the Greek Competition Commission was not a court or tribunal capable of asking for a preliminary ruling: Ministerial influence reduced its independence. Since the opinion was not rejected by the ECJ, it continues to have some value as a precedent.

[48] (15/74), 31 Oct 1974, [1974] ECR 1147, [1974] 2 CMLR 480, CMR 8246; 902[1][1] above.

[49] *Bundesverband der Arzneimittel-Importeure eV and Commission v Bayer* (C-2 & 3/01 P) 6 January 2004, [2004] 4 CMLR 653, [2004] All ER (EC) 500 (ECJ).

Charging what the market will bear is an efficient way of recovering overhead costs, but requires some barrier to prevent arbitrage. The Community institutions have refused to consider justifications, but assume that restrictions on trade between Member States disintegrate the market. They may do so, but not always. Indeed when conditions are very different in different Member States, parallel trade may disintegrate it further by discouraging sales in the lower priced countries.[50]

It seems to me anomalous that the Council, on a proposal from the Commission, should be increasing intellectual property protection when the ECJ is reducing it through the doctrine of exhaustion even when the market is distorted by state measures, such as price control, or where there were no rights in the country of export. The Commission and ECJ remain hostile to export bans and deterrents that might limit government distortions to the Common Market.

2.7 BIBLIOGRAPHY

WAELBROECK M, 'The Effect of the Rome Treaty on the Exercise of National Industrial Property Rights' (1976) 21 *Antitrust Bull* 99.

RAMSEY FP, 'A Contribution to the Theory of Taxation', (1929) 37 *Economic Journal* 47–61.

HEIDE T, 'Trademarks and Competition Law after Davidoff' [2003] EIPR 163.

KEELING DT, (2003) *Intellectual Property Rights in EU law, Vol 1, Free movement and Competition Law* (Oxford, OUP), second volume on competition in preparation.

RIDYARD D, and LEWIS D, 'Parallel Trade in Patented Medicines – Economics in Defence of Market Segmentation' [1998] Int TLR 14.

[50] See A-G Jacobs in *Syfait and Others v Glaxosmithkline* (C-53/03), 28 October 2004, [2005] 5 CMLR 7, paras 77–104.

3

Status of Various Sources of Law

THERE ARE VARIOUS sources of Community law: not only the Treaties and subordinate legislation in the form of directives and regulations, but also judgments of the Community courts and soft law in notices and guidelines of the Commission. Books and articles by academics have more influence than under common law systems.

3.1 JUDGMENTS

It is clear that the most important source of law, after the EC Treaty, is a judgment of the ECJ supporting a ruling for a national court or CFI on appeal from a decision of the Commission. The ECJ is not bound by its earlier decisions, but has reversed them very rarely, although it occasionally makes a U-turn. Some say that it will reverse an earlier judgment only if there is a large majority for change. A ruling under Article 234 of the EC Treaty is binding on the court that requested it, and relieves other national courts from the duty to refer the same question of Community law.
When the judgment relates to the validity or interpretation of secondary legislation, subsequent legislation may reverse the position.

3.2 DECISIONS OF THE COMMISSION

Decisions of the Commission bind those to whom they are addressed, even if subject to appeal to the CFI. Only to the extent that the CFI or ECJ suspends part of the operative part of the decision, are they not binding. In *Masterfoods Ltd and HB Ice Cream v Commission*,[1] a Commission decision had been appealed to the CFI and the ECJ ruled that:

[1] (C-344/98), 14 Dec 2000, [2000] ECR I-11369, [2001] CMLR 449.

> Where a national court is ruling on an agreement or practice the compatibility of which with Articles 85(1) and 86 of the EC Treaty (now Articles 81(1) and 82)... is already the subject of a Commission decision, it cannot take a decision running counter to that of the Commission, even if the latter's decision conflicts with a decision given by a national court of first instance. If the addressee of the Commission decision has, within the period prescribed ..., brought an action for annulment of that decision, it is for the national court to decide whether to stay proceedings pending a final judgment in that action for annulment or in order to refer a question to the Court for a preliminary ruling.

Third parties can rarely appeal against decisions addressed to someone else or to general legislation.[2] Decisions are administrative acts and do not have the force of law. Nevertheless, the Commission often cites them. A lawyer advising on competition law would be negligent if he ignored them, but they clearly do not bind the CFI or ECJ and, in so far as they indicate the Commission's practice, a national court should take them into account.

3.3 RECITALS TO AN ACT

In interpreting the Articles of a regulation or directive, how much reliance should be placed on its recitals and any guidelines (Gs) adopted by the Commission if these do not conflict with judgments of the ECJ or CFI? One view of recitals is that they form part of the instrument adopted by the Commission or Council and are vital under Community law since the Articles are sometimes construed so as to give effect to them, even when this is contrary to the clear meaning of the operative part.[3] The ECJ, however, has also decided that recitals cannot override clear wording.[4] I have heard, however, that in the directives on intellectual property, the official who loses an argument and finds the Article drafted contrary to his wishes may be

[2] *Plaumann v Commission* (25/62), 15 July 1963, [1963] ECR 95, [1964] CMLR 29, CMR 8013.

[3] For instance, in *Fonderies Roubaix v Fonderies Roux* (63/75), 3 February 1976, [1976] ECR 111, [1976] 1 CMLR 538, CMR 8341, in the light of unclear recitals, the ECJ virtually read Art 1(2) out of Reg 67/67 because it led to anomalous results that would, otherwise, have required amendment. This was confirmed in *de Norre v Concordia* (47/76) [1977] ECR 65, paras 16–20.

For the effect of recitals, see generally, Paul Lasok in David Vaughan QC (ed), *51 Halsbury's Laws of England*, 2.268 and *Halsbury's Laws of England 2005 Cumulative Supplement*, Part 2, 2.268.

A court may use recitals to confirm the interpretation in the regulation: *Stauder v Ulm* (29/69), 12 November 1969, [1969] ECR 419, 425; *Adorno v EC Commission* (107/80), 3 June 1981, [1981] ECR 1469 at 1484 & 5; *Effer v Kantner* (38/81), 4 March 1982, [1982] ECR 825 at 834. For the significance of the preamble of a Regulation, see *Firma Josef Hoche and Firma Roomboterfabriek 'De beste Boter' v Bundesanstalt fur landwirtschaftliche Marktordnung* (154-155/83), 2 May 1985, 1985] ECR 1215, [1986] 2 CMLR 632. I analysed the position more fully in *Distribution Agreement under the EC Competition Rules* (Hart Publishing, Oxford, 2002), 3.2.

compensated by a recital that contradicts the Article, making interpretation difficult for those not involved in the drafting process.

3.4 GUIDELINES

Guidelines are not listed amongst the sources of Community law in Article 249. They are sometimes referred to as 'soft law', but are strongly persuasive. They are usually stated not to bind the ECJ or CFI and national courts and competition authorities may not apply a test conflicting with that of the ECJ.

If a guideline giving the Commission's view is mistaken, but acted upon by an undertaking, the consequences in a national court might be different from those before the Commission. The court would not be bound by the guideline and might find that, on a proper construction of Article 81, the contractual term sought to be enforced was void *ab initio*. The firm might argue, however, that it should not be fined by the Commission for past conduct based on legitimate expectations, although the Commission might order it to terminate the infringement in future.

The question arises whether expectations are legitimate. Guidelines used to be of two sorts. Those that give the Commission's view of the law have no binding legal effect but may bind the institution issuing them to the extent that it should not punish an undertaking that has acted on them before they were withdrawn.[5]

[4] In *Joseph Hoche and Roomboterfabriek 'De Bester Boter' v Bundesanstalt für landwirtschaftliche Marktordnung* (154 and 155/83), 2 May 1985, [1985] ECR 1232, [1986] 2 CMLR 632, CMR 14192, para 13. The recitals mentioned a smaller class than the Articles of the regulation. The ECJ concluded that

> 13 . . . as [the defendant] and the Commission rightly argued, the decisive factor in the interpretation of Article 6(a) on that point is not the preamble of the regulation which introduced it, which merely sets out the general aims of the regulation, but the wording of the Article itself, which makes it clear that Article 6(a) is not restricted to products falling under the heading 19.08 of the Common Customs Tariff but applies to all products referred to in Article 6(i)(c).

In *Criminal proceedings against Gunnery Nilsson and others* (C-162/97), 19 November 1998, [1998] ECR I-7477, an argument was based on a recital to a directive. A-G Mischo said:

> 92. As the Commission rightly points out, the preamble is not a rule of law. It cannot therefore be invoked to derogate from the rules laid down in the directive. The recitals in the preamble state the reasons for the contents of the rule and can sometimes help with its interpretation, but they cannot form the basis of a derogation from one of the directive's express provisions.

The ECJ agreed at paras 54 and 55.

[5] In *Suiker Unie*, (40-48/73, 50/73, 54-56/73, 111/73, 113-114/73), 16 December 1975, [1975] ECR 1663, [1976] 1 CMLR 295, CMR 8334, para 555, the Court reduced a fine on the ground that undertakings might have relied on the Commission's notice on agency. One infringement was not taken into account by the Court when fixing the amount of the fine because the parties might have been misled by the notice (since replaced by guidelines 12-20 on vertical restraints, OJ 2000, C291/1, [2000] 5 CMLR 1074).

The Commission's notices on the construction of the competition rules in the treaty have frequently been mentioned by Advocates-General, who have advised the ECJ to ignore them.[6] This it has consistently done, except in *Suiker Unie*, where it reduced a fine on the ground that undertakings might have relied on the Commission's notice on agency. In *European Night Services*,[7] the CFI refused to follow blindly the Commission's notice on minor agreements and in *Langnese-Iglo GmbH & Co KG v Commission*,[8] the CFI refused to follow the same notice, which it thought was inconsistent with the judgment of the ECJ in *Delimitis (Stergios) v Henninger Bräu*.[9] In *Métropole Télévision (M6) and Others v Commission,*[10] the CFI, however, placed considerable weight on the guidelines concerning the construction of the merger regulation and those on horizontal joint ventures in deciding whether covenants not to compete with the joint venture were ancillary to the joint venture and not to be assessed separately from the joint venture.

By virtue of Article 1 of Regulation 1/2003, however, the power to apply Article 81(3) is now shared with national courts and national authorities. The guidelines are likely to influence the network of competition authorities and national courts because of the desire for consistency throughout Europe. There is little doubt that differences will develop, but the Commission is trying to prevent this by loading national judgments, in the original language, on its web site. Guidelines interpreting the law are important in practice, even if not formally binding. There are various points at which the guidelines on technology transfer take a position that is not made clear in the regulation itself or that even conflicts with the words of the regulation (eg G 51) and then it will be argued that it is the Regulation that governs, and that the guidelines should be invoked only when the Regulation is unclear. Guidelines have become fairly hard 'soft law'. Not all statements, however, give rise to legitimate expectations.[11]

Guidelines relating to how the Commission intends to exercise its discretionary powers (for instance its policy on fines or the approval of state aids) bind the Commission to the extent that they create legitimate expectations.

[6] Eg, A-G Warner in *Miller v Commission* (19/77), 1 February 1978, [1978] ECR 154, 157 *et seq*; A-G Dutheillet de Lamothe in *Cadillon v Höss*, (1/71), 11 May 1971, [1971] ECR 358, 361 and in *Beguelin* (22/71), 25 November 1971, [1971] ECR 964, 968.

[7] (T-374, 375, 384 & 388/94), [1998] ECR II-3141, para 102. See also *Greene King – Roberts and Roberts v Commission* (T-25/911), [2001] CMLR 828, paras 90 and 120.

[8] (T-7/93), [1995] ECR II-1533, para 98.

[9] (C-234/89), [1991] ECR I-935.

[10] (T-112/99), 18 September 2001, [2002] ECR II-2459, [2001] 5 CMLR 1236. Note that there are several judgments with this name.

[11] *Evelyne Delauche v Commission* (111/86), 16 December 1987, [1987] ECR 5345, [1989] 2 CMLR 565, paras 23 and 24.

Where legitimate expectations have been aroused, the Commission would have to withdraw the guideline generally, or give a specific undertakings notice, before the undertaking acts on the basis of it.[12] In *Dijkstra*,[13] the ECJ stated that in order to avoid decisions inconsistent with those envisaged by the Commission (paragraph 28) in interpreting a Council Regulation 'it is necessary to take into account its genesis and the reasons on which the relevant regulation was based' (paragraph 17).

Moreover, a notice must be interpreted carefully. Some of the undertakings fined for participating in the *cartel for pre-insulated pipes*[14] argued that the fines should have been reduced to the level customary at the time of the infringement, not according to a notice issued later. A-G Tizzano said:

> 138. It is true that ... the Commission states that it is "aware that this notice will create legitimate expectations on which enterprises may rely when disclosing the existence of a cartel to the Commission". However it seems clear to me that any legitimate expectations which the appellants might have by virtue of the [leniency] notice can relate only to the modalities for the reduction to be made in respect of their cooperation and not the amount of the fine "which would otherwise have been imposed on them" or the method of calculation adopted in setting it.

The absolute amount of the fine was limited only by the 10 per cent ceiling imposed by Regulation 17 (now Regulation 1/2003, Article 23(2)).

The Commission remains the institution responsible for the implementation and orientation of Community competition policy, and only it has been empowered to grant group exemptions. Nevertheless, now that officials no longer monitor agreements notified to it but concentrate on detecting international cartels, appraising the activities of undertakings given special or exclusive rights and monitoring state aids, it is less likely that the Commission will make subsequent conflicting decisions in other fields. The strength of guidelines may, therefore, decline over time.

[12] In *CIRFS – Comité International de la Rayonne et des Fibres Synthétiques and Others v Commission* (C-313/90), [1993] ECR 1125, the Commission had changed its policy in relation to state aids for synthetic fibres of which there was already excess production capacity (para 39). The ECJ stated:

> 44. A measure of general application cannot be impliedly amended by an individual decision.
> 45. Furthermore, neither the principle of equal treatment nor that of the protection of legitimate expectations may be relied upon in order to justify the repetition of an incorrect interpretation of a measure.

[13] *Hendrik Evert Dijkstra and Others v Friesland (Frico Domo) Coöperatie BA and Others*, (C-319/93, 40 & 224/94), 12 December 1995, [1995] ECR I-4471, [1996] 5 CMLR 178.

[14] (IV/35.601/E-4), 21 October 1998, OJ 1999, L24/1, [1998] CMLR 402, [1999] 1 CEC 2020; appeal to CFI, *Logstor Ror (Deutschland) GmbH v Commission* (T-16/99), 20 March 2002; on appeal to ECJ, (C-208/02 P). Opinion of A-G Tizzano, 8 July 2004, judgment 28 June 2005, paras 169 *et seq* confirmed this.

3.5 COMFORT LETTERS

In the first set of *Perfumes* judgments,[15] the ECJ had stated that national courts were not bound to follow the views expressed by the Commission in comfort letters addressed to individual firms, but they were entitled to take them into account, and this was not expressly overruled in *Delimitis*.[16] Nevertheless, if a national court were to take an independent line, its judgment might well contradict a subsequent formal decision of the Commission, which the ECJ said it should not do.

It is thought that comfort letters are more reliable now that Article 81(3) has direct effect and can be applied by national competition authorities (NCAs) and courts. They are likely to be disposed to follow the Commission's views now that the network of Community competition authorities is in place. Now they can apply Article 81(3) they are free to do so. Nevertheless, it is thought that fewer guidance letters will be written.

[15] Eg, in *Guérlain – Procureur de la République v Giry and Guérlain* (253/78 & 1-3/79) [1980] ECR 2327 and *Lancôme-SA Lancôme and Cosparfrance Nederland BV v Etos BV and Albert Heijn Supermart BV* (99/79) [1980] ECR 2511, the ECJ ruled that an individual comfort letter may be taken into account by a national court, but does not bind it.

[16] *Delimitis (Stergios) v Henninger Bräu* (C-234/89), 28 February 1991, [1991] ECR I-935, [1992] 5 CMLR 210, [1992] 2 CEC 530.

4

Article 81

A PATENTEE MAY DECIDE not to exploit the protected investment itself in every country, but license its invention to a third party. In *Velcro/Aplix*,[1] the inventor's company did not itself start to manufacture until the basic patents had expired, presumably because the holder needed to accumulate licence fees to pay off its debts and finance a factory. Now that the Common Market has been expanded again, more patentees will be unable to finance production sufficient to supply every Member State and many will exploit their asset in at least some Member States through licensing.

In the early days, when there was considerable distrust of iprs, perceived *ex post* as barriers to entry, rather than *ex ante* as inducements to various kinds of investment (chapter 1 above), a distribution agreement that protected dealers by enabling the dealer for each Member State to register the manufacturer's second trademark was condemned in *Consten & Grundig*.[2] It sheltered the French dealer from all intra-brand competition.

Most systems of antitrust law have had difficulty in distinguishing permissible clauses from those that confer undue protection. In 1995, the Department of Justice and Federal Trade Commission in the United States took the view that a patentee is entitled to a property right granted by

[1] (85/410/EEC), 12 July 1985, OJ 1985, L233/22, [1989] 4 CMLR 157, CMR 10719.

[2] *Re the Agreement of Grundig Verkaufs-GmbH* (64/566/EEC), 23 September 1964, JO 2545/64, [1964] CMLR 489; appeal *Etablissements Consten SA and Grundig-Verkaufs-GmbH v EEC Commission* (56 & 58/64), 13 July 1966, [1966] ECR 299, [1966] CMLR 418, CMR 8046 para 37.

Congress and that any monopoly power conferred by the exclusive right provides the incentive for the innovative effort required to create the property.[3] Antitrust authorities should intervene only when agreements increased that market power. For instance, agreements between competitors to pool their patents are suspect but even they may be justified on other grounds, for instance by the need for design freedom.[4] In Europe, it is clear that the competition rules may override property rights, and it is only recently that the Commission has recognised the need to protect the parties to a licence from free riders.

In principle a licensee may need more protection from dealers and other licensees than does a dealer. Not only does it have to establish a market, usually it also has to set up a production line and may still have to develop the technology. A licensee often has to invest more capital than a dealer and accept greater risk. Much of the Community case law relates to attempts by a licensor to protect itself or its licensees from parallel trade. Both the Commission and ECJ have been very hostile to territorial protection, especially if absolute, on the ground that it divides the Common Market. Historically, both have perceived restrictions on trade between Member States *ex post*, and treated them as restrictions by object, which are assumed to infringe Article 81(1) and are not likely to qualify under Article 81(3).

It was argued by Chicago economists that no public control is needed when the parties could not have competed without the agreement, since the patentee has an interest in its licensees being subject to competition and earning the minimum margin. The licensor has no incentive to share any market power it may enjoy with its licensee. It is likely to protect each licensee from others only in so far as it thinks necessary to induce it to accept the risks of investing in plant, development and establishing a market. It is more likely to get the balance right than is an official enforcing the law since it is in the business and the decision will affect its profits. Later, economists have argued, however, that the licensor may want to induce sufficient improvements or service to encourage marginal buyers of the final product: some buyers may be almost indifferent as to whether or not to buy and may be induced to do so by costly services provided by the licensee, when most buyers would prefer a lower price.

The Chicago argument has been rejected by the Community institutions since the fear of isolating national markets is strong and protection has often taken the form of an exclusive territory defined by national boundaries. Moreover, it is not always easy to tell whether the licensee would have

[3] Antitrust Guidelines for the Licensing of Intellectual Property, 6 April 1995, (1995) 68 ATRR 462, CCH TRR 13,132, [1995] 7 EIPR 3, section 2.3.

[4] See 6.4.3 below at n 57 and the Gs cited therein for references to design freedom.

been likely to enter the market independently or with less protection. Licensing agreements may restrict competition between actual or potential competitors and require control.

The ECJ has said in several cases, starting with *Sirena Srl v Eda Srl,*[5] that:

> A trademark right, as a legal entity does not in itself possess those elements of contract or concerted practice referred to in Article 85(1) (now Article 81(1)). Nevertheless, the exercise of that right might fall within the ambit of the prohibitions contained in the Treaty each time it manifests itself as the subject, the means or the consequence of a restrictive practice.

The statement has been extended to other kinds of iprs and licences or assignments have been treated as agreements subject to the competition rules, whether or not the parties could have competed without the agreement. Contrast the Commission's more recent views considered at 5.3.1 below, where it requires a comparison of the current effects with what would have happened without the agreement or the restriction.

From 1972, the Commission adopted several individual decisions, mostly exempting exclusive patent and know-how licences. The law was based on form. One could go through an agreement and tick or cross particular provisions. There was little market analysis beyond applying the *de minimis* rule. The ECJ has also been somewhat formalistic.

In 1984, the Commission adopted a group exemption for patent licensing agreements,[6] which might include know-how. It was drawn so narrowly that few agreements qualified. So, in 1989, the Commission adopted a group exemption for patent and or know-how licences.[7] This was followed in 1996 by the group exemption for technology transfer.[8] In their turn, each of these regulations provided exemption for a class of agreements, narrowly defined. Each contained a blacklist of provisions that prevented the application of the exemption, even to other clauses. There were non-exhaustive lists of provisions that rarely infringe Article 81(1), but were exempted just in case.

[5] (40/70), 18 February 1971, [1971] ECR 69, [1971] CMLR 260, CMR 8101. See also *Etablissements Consten SA and Grundig-Verkaufs-GmbH v EEC Commission* (56 & 58/64), 13 July 1966, [1966] ECR 299, [1966] CMLR 418, CMR 8046, for the distinction between the grant or existence of a right and its exercise.

[6] Commission Regulation 2349/84 – Group exemption for patent licensing agreements, OJ 1984, L219/15, corrections OJ 1985, C113/34, [1984] 2 C.L.E. 389, commentary, Valentine Korah, (1985) *Patent Licensing and EEC Competition Rules: Regulation 2349/84* (Oxford, ESC/Sweet and Maxwell).

[7] Commission Regulation 556/89 – Group exemption for know-how licensing agreements, OJ 1989, L61/1, [1989] 4 CMLR 774, commentary, Valentine Korah, (1989) *Know-how Licensing Agreements and the EEC Competition Rules, Regulation 556/89* (Oxford, ESC/Sweet and Maxwell).

[8] Commission Regulation 240/1996 – Technology transfer, OJ 1996, L31/2, [1996] 4 CMLR 405, [1996] 4 EIPR Supp iv, commentary, Valentine Korah, (1996) *Technology Transfer and the EC Competition Rules* (Oxford, OUP).

In 2004, the Commission granted the current group exemption for technology licences, which applies when specified ceilings of market share are not reached provided that there are no blacklisted provisions. The blacklists are more limited than under the earlier group exemptions, and there is no white list. The Regulation applies to any provisions when there are no black listed provisions. At the same time the Commission issued guidelines not only giving its interpretation of the group exemption, but also its views on the application of the competition rules to licences that are outside the group exemption. Its earlier case law must be read in the light of these, although the guidelines bind no one since they do not relate to the exercise of the Commission's discretion. Nevertheless, as argued at 3.4 above, even guidelines interpreting legislation are likely to be influential. They do not override rulings by the ECJ, but owing to the narrow jurisdiction of the court this is not a substantial limitation to the guidelines.

4.1 HISTORICAL ATTITUDE OF COMMISSION AND COURTS TOWARDS LICENSING

The Commission adopted no decision on licences until 1972, by which time it had ceased to accept the position as it had stated in 1962.[9]

4.1.1 Exclusive Licences With and Without Export Bans

From its first decision in *Davidson*, the Commission was hostile to export bans imposed on licensees, but less hostile to exclusive manufacturing licences.

4.1.1.1 Exclusive Patent and Know-How Licences

In *Davidson Rubber*,[10] the Commission took the view that, subject to a *de minimis* threshold, licences granting an exclusive territory infringed Article 81(1) and required exemption, even if it were necessary to persuade the licensee to take a licence and commit itself to building a production line and developing a market for the product. In several later decisions it confirmed this, but, as in *Davidson Rubber*, it exempted many agreements with clauses conferring manufacturing exclusivity, provided that export bans on licensees were deleted.

[9] Notice on patent licences ('Christmas Message'), since withdrawn, JO 1962, 139/2922, [1969] CMLR D41.

[10] (72/237/EEC), 9 June 1972, JO 1972, L143/31, [1972] CMLR D52, paras 39 and 40.

Its hostile attitude to export bans was caused by its view, lasting over 30 years, that once licensee and licensor were producing and selling substitute products, they were competitors: the relationship was horizontal. This perception *ex post* was widely criticised, but continued at least until after the Commission published draft guidelines on technology transfer in 2003.[11]

Meanwhile the Commission condemned and refused to exempt an exclusive manufacturing licence in *Bronbemaling v Heidemaatschappij*.[12] It adopted a decision under Regulation 17, Article 15(6), terminating the freedom from fines obtained by notification (a procedure no longer possible now that notification has been abrogated by Regulation 1/2003) when proceedings in the patent office to oppose the grant of a patent were compromised by the grant of licences with an element of exclusivity. These licences, however, had been granted to firms competing at the date of the licence. So the relationship was horizontal even under the current test.

In its later decisions on know-how licences granted when the Commission was establishing its powers to grant a group exemption in 1988,[13] the Commission accepted that exclusive licences, even if 'open',[14] always infringed Article 81(1), unless they were *de minimis*. The Commission exempted all the agreements it investigated although every market considered was competitive. Even then only manufacturing exclusivity was permitted, restrictions on sales were not exempted, and purchasers from the licensee were free to sell throughout the Common Market because of the doctrine of exhaustion (Chapter 2 above).

4.1.1.2 Exclusive Licences of Plant Breeders' Rights

In contrast to the Commission's practice, the ECJ held in the *Maize Seed* case, *Nungesser v Commission*,[15] that an 'open exclusive licence' of plant breeders' rights is not in itself contrary to Article 81(1). INRA had enabled the proprietor of the firm Nungesser to apply in Germany for plant breeder's rights over a variety of hybrid seed INRA had developed in France. The ECJ, realistically, treated this as an exclusive licence for Germany.

An open exclusive licence is one:

> where the exclusivity of the licence relates to the contractual relationship between the owner of the right and the licensee, whereby the owner merely undertakes not to grant other licences in respect of the same territory and not to compete himself with the licensee on that territory. On the other hand, ... an exclusive licence

[11] Draft guidelines on technology transfer agreements, OJ 2003, C235/17, [2004] 4 CMLR 188. The contrary view was taken in the actual regulation and guidelines (5.2.1 below).

[12] [1975] 2 CMLR D67.

[13] Commission regulation 556/89 – Group exemption for know-how licensing agreements, OJ 1989, L61/1, [1989] 4 CMLR 774.

[14] Contrast *Nungesser* and 4.1.1.2 below.

[15] (258/78) [1982] ECR 2015.

> or assignment with absolute territorial protection, under which the parties to the contract propose, as regards the products and the territory in question, to eliminate all competition from third parties, such as parallel importers or licensees for other territories ...(paragraph 53)

infringes Article 81(1).

It was not clear whether a licence remained open if the licensee in one territory was restrained from selling in another—paragraph 53 of the judgment was inconsistent on that point. Exclusive licences to different undertakings limited to different Member States seem to come within the definition of 'open licences' within the first sentence, but they would confer absolute territorial protection. The Commission held in *Boussois/Interpane*[16] that such a licence is not open. It is clear that intellectual property rights are exhausted only when the licensee sells the protected goods within the terms of the licence, and not by the grant of the licence itself

To a significant extent the ECJ expressly accepted the free rider argument in relation to both parties when considering Article 81(1) (paragraphs 56 and 57). It referred to the investment by INRA in research and experimentation and added:

> 57. In fact, in the case of a licence of breeders rights over hybrid maize seeds newly developed in one Member State, an undertaking established in another Member State which was not certain that it would not encounter competition from other licensees for the territory granted to it, or from the owner of the right himself, might be deterred from accepting the risk of cultivating and marketing that product; such a result would be damaging to the dissemination of a new technology and would prejudice competition in the Community between the new product and similar existing products.
>
> 58. Having regard to the specific nature of the products in question, the Court concludes that, in a case such as the present, the grant of an open exclusive licence, that is to say, a licence which does not affect the position of third parties such as parallel importers and licensees for other territories, is not in itself incompatible with Article 81(1) of the Treaty.

Despite the Court's concern in relation to Article 81(1) that the Commission should investigate the effects of exclusivity and consider whether INRA's varieties could have been sold in Germany without protection from the French licensees, it was much more rigid when discussing the possibility of exemption. INRA had not granted open exclusivity; it had tried to prevent the French licensees from exporting, and Nungesser's manager had succeeded in restraining parallel imports by two dealers which had bought in France. Without giving reasons, the Court concluded that:

> 77. As it is a question of seeds intended to be used by a large number of farmers for the production of maize, which is an important product for human and animal

[16] (87/123/EEC), 15 December 1986, OJ 1987, L50/30, [1988] 4 CMLR 124, para 16(a).

> foodstuffs, absolute territorial protection manifestly goes beyond what is indispensable for the improvement of production or distribution or the promotion of technical progress... .

It is anomalous that the Community Court adopted a *per se* rule for an important licence under Article 81(3), while not doing so in relation to Article 81(1). In *Consten and Grundig v Commission*,[17] the ECJ had stressed the complex economic appraisal needed in deciding whether to grant an exemption, which necessitates a wide discretionary power then being exercised only by the Commission.

In both *Consten and Grundig* and *Nungesser*, however, the Court adopted a *per se* rule against absolute territorial protection.[18] It did not articulate its reasons. The rule is arbitrary in its application: open exclusivity gives considerable protection from parallel imports of goods of low value in relation to the cost of freight, but virtually no protection for relatively more valuable products.

The Court went much further in relation to a licence of performing rights in *Coditel II*.[19] It ruled that even absolute territorial protection may not infringe Article 81(1) in the light of the commercial practice in the particular industry and the need for a film producer to obtain an adequate return (4.1.1.3 below).

The Court went further still in relation to plant breeders' rights in basic seed in *Erauw-Jacquéry*.[20] It referred to *Nungesser* and the investment needed to develop basic seed. It ruled that the holder of the plant breeders' rights that result:

> must be allowed to protect himself against improper handling of those varieties of seeds. To that end the breeder must have the right to reserve propagation for the propagating establishments chosen by him as licensees. To that extent the clause prohibiting the licensee from selling and exporting basic seeds does not come within the prohibition laid down by Article 81(1) of the Treaty.

In *Erauw-Jacquéry*, the Court distinguished the basic seed supplied to propagators from the certified seed sold to farmers. Even absolute territorial protection for the basic seed sent to propagating establishments for multiplication before sale to farmers was cleared, whereas in *Nungesser* such a clause was held to go too far even for an exemption.

The Court's remarks in *Erauw-Jacquéry* were confined to basic seed, but the reference to investment is of wide application. So the judgment might be extended to other protected products that need careful handling, such as

[17] (56 & 58/64), 13 July 1966, [1966] ECR 299, 347.

[18] Compare the ECJ in *Miller International Schallplatten GmbH v Commission* (19/77), 1 February 1978, [1978] ECR 131, [1978] 2 CMLR 334, CMR 8439.

[19] (262/81), 6 October 1982, [1982] ECR 3381, paras 15–20.

[20] *Erauw-Jacquéry (Louis) v La Hesbignonne* (27/87), 19 April 1988, [1988] ECR 1919, [1988] 4 CMLR 576.

software. The Commission is treating it as being confined to basic seed.[21] Whether it can be extended is less important now that software licences may qualify under the technology transfer block exemption. The Commission, however, is construing the precedent more narrowly, to relate only to basic and certified seed. Moreover, once a plant variety ceases to be distinct, uniform and stable, the intellectual property right is lost. This is not true of most other kinds of intellectual property right. Consequently control of licensees is less important.

In *Tetra Pak Rausing SA v Commission*,[22] the ECJ confirmed the Commission's decision that the acquisition of an exclusive licence for the only technology (patent and know-how) that competed with that of a dominant firm infringed Article 82.

In its individual decisions the Commission has never upheld open exclusive licences as not infringing Article 81(1). In the decisions made before adopting a block exemption for know-how, the Commission distinguished *Nungesser* on the ground that the product was not new, even though it accepted that it was better than anything else on the market.[23] Nevertheless, a national court or authority should follow the Court's precedents rather than those of the Commission.

The ECJ has remained hostile to absolute territorial protection and the discrimination it makes possible. In *Syfait and Others v Glaxosmithkline*[24] (8.1.7 below), however, Advocate-General Jacobs went far—in the very special circumstances of the pharmaceutical market, where the distribution and maximum price of medicines are controlled at different levels in different Member States—in saying that for a dominant firm to ration wholesalers in the Member States where maximum prices were lowest in order to restrain parallel trade, might be justifiable. The opinion, however, is clearly related to the very unusual circumstances of that industry.

4.1.1.3 Exclusive Licences of Performing Rights

A year after *Nungesser*, the ECJ went much further in clearing, as not contrary to Article 81(1), a licence of performing rights. In *Coditel II*[25] it ruled that even absolute territorial protection may not infringe Article 81(1) in

[21] *SICASOV* (99/6/EC), 14 December 1998, OJ 1999, L4/27, [1999] 4 CMLR 192.

[22] (T-51/89), 10 July 1990, [1990] ECR II-309, [1991] 4 CMLR 334, [1990] 2 CEC 409.

[23] *Rich Products/Jus-Rol* (88/143/EEC), 22 December 1987, OJ 1988 L69/21, [1981] 4 CMLR 527, CCH 10,925. In Nungesser, the ECJ rejected the Commission's view that INRA maize seed was not new, because the variety was better than what preceded it. See my monograph on technology transfer cited in the bibliography at 10 below at pp 47–48.

[24] (C-53/03), OJ 2003, C101/18, [2003] 4 CMLR 925, opinion by A-G Jacobs, 28 October 2004. The Court declined jurisdiction on the ground that the Greek Competition Commission was not a court or tribunal entitled to a preliminary ruling. The opinion has not been reversed and retains some authority.

[25] (262/81), 6 October 1982, [1982] ECR 3381, [1983] 1 CMLR 49, paras 15–20.

the light of the commercial practice in the particular industry and the need for a film producer to obtain an adequate return.

In *Coditel*[26] (2.3 above) the ECJ had held that there is no exhaustion of performing rights. In *Coditel II*,[27] although Advocate-General Reischel had observed that in the light of *Coditel* exclusive licences to different distributors in different Member States led to absolute territorial protection, the ECJ held that the grant of exclusive, territorially limited licences did not necessarily infringe Article 81(1) (paragraph 15). It distinguished traditional copyright on the ground that artistic works are made available to the public by repeated performances (paragraph 11) and that fees for each performance were part of the essential function of performing rights (paragraph 12).

The ECJ told the national court that had sought a preliminary ruling to look to the characteristics of the film industry and the need for the producer to earn enough to support the sunk costs. The referring court had supplied few facts, and the ECJ said that:

> 19… . it is for national courts, where appropriate, to make such enquiries and in particular to establish whether or not the exercise of the exclusive right to exhibit a cinematographic film creates barriers that are artificial and unjustifiable in terms of the needs of the cinematographic industry, or the possibility of charging fees which exceed a fair return on investment, or an exclusivity the duration of which is disproportionate to those requirements, and whether or not, from a general point of view, such exercise within a geographic area is such as to prevent, restrict or distort competition within the Common Market.

This would be no easy task. The ECJ is asking the national court to decide whether the cinematographic industry as a whole is too profitable. A full market analysis is required. One case where the Commission condemned an exclusive licence of performing rights for a large range of films lasting over a considerable period of time was *ARD*,[28] but the judgment has been the subject of devastating criticism[29] and it is hoped that in the light of the more economic approach now being adopted by the Commission and often by the CFI, it would be differently decided today.

In *Coditel II*, the ECJ implied that the licence could be confined to a single kind of copyright—just to performing rights, the holder retaining his right to control the marketing of the prints. This was sensible. The various

[26] *SA Compagnie Générale pour la Diffusion de la Télévision v Ciné-Vog Films* (62/79), 18 March 1980, [1980] ECR 881, [1981] 2 CMLR 362, CMR 8662.

[27] *Coditel SA v Ciné-Vog Films SA (No 2)* (262/81), 6 October 1982, [1982] ECR 3381, [1983] 1 CMLR 49, CMR 8865. This judgment was in relation to the same facts as in *Coditel*. The ECJ neglected to answer some of the questions and the referring court referred them again.

[28] *Re Film Purchases by German TV Stations* (89/536/EEC), 15 September 1989, OJ 1989, L284/36, [1990] 4 CMLR 841, [1989] 2 CEC 2109.

[29] Warwick A Rothnie, 'Commission Re-Runs Same Old Bill (Film Purchases by German TV Stations),' [1990] 12 EIPR 72.

rights protected by copyright are usually exploited by different kinds of undertaking. Enabling them to be licensed separately leads to no field of use not being supplied.

Nor was exhaustion applied to the hiring out of records in *Warner Bros and Metronome v Christiansen*[30] (2.3 above). The copyright holder could exercise its Danish rights to control hiring out, even after the product had been sold with its consent in the UK. We thought that *Merck v Stephar* was no longer good law, but were proved wrong in *Merck v Primecrown* (2.1.2 above). This judgment also implied that the various rights protected by copyright could be licensed separately.

In *PMI/DSV*,[31] however, the Commission, rejecting its earlier views about literary copyright, held that a licence of performing rights limited to Germany did not amount to a licence for the whole Common Market.

> Such a clause [limiting the licence to Germany] could not be caught by Article 85 (now Article 81), since the licensor remains free, under such Community rules, to choose his licensee and the size of the territory which he grants him. If such a clause were not included, the licence would become a European licence under which the licensor would no longer be free, in particular, to choose his sub-licensee for the other Member States for business or financial reasons, or on the grounds of honesty. The omission of such a clause might also deprive the licensor of the right to check the subcontractor's technical capacities, such as his capacity to relay properly the sound and pictures sent to him, bearing in mind in particular the fact that the authorization conferred on FCR for the relay of such sound and pictures stops at the boundaries of the territory granted under the agreement ... if such a clause were not included, therefore, the licensor would be unable to co-ordinate the management of all the relays of sound and pictures to other Member States... .

This was confirmed by the CFI in *Tiercé Ladbroke v Commission,* an appeal from the rejection of another complaint against PMI relating to Belgium:[32] The Commission and CFI are becoming less hostile to exclusive licences. It is hoped that this relates not only to performing rights, but also to licences of other iprs. Performing rights are not as fragile as plant breeders' rights, which last only as long as the variety is useful, distinct, uniform and stable. So, this judgment may extend *Erauw-Jacquery (Louis) SPRL v La Hesbignonne SC*[33] to other kinds of ipr.

4.1.1.4 Copyright Collecting Societies

The ECJ has ruled that the grant of an exclusive licence to a copyright collecting society does not, in itself, violate the competition rules. If, however,

[30] (158/86), 17 May 1988, [1988] ECR 2605, [1990] 3 CMLR 684, CMR 14497.
[31] (95/373/EC), 31 January 1995, OJ 1995 L221/34, [1996] 5 CMLR 320, [1995] 2 CEC 2169.
[32] T-504/93, June 12 1997, [1997] ECR II-923, [1997] 5 CMLR 309, [1997] CEC 812. Commission, paras 146 and 151.
[33] (27/87), 19 April 1988, [1988] ECR 1919, [1988] 4 CMLR 576, [1989] 2 CEC 637.

it is too broad—for instance when exclusive rights for all present and future works are surrendered to a dominant collecting society—it may infringe Article 82. This is especially true if the exclusive rights apply for an extended period after a member withdraws from the society.[34]

Most collecting societies are national in scope and some enforcing performance rights enter into 'reciprocal representation contracts' giving each other the right to grant licences within their respective territories. Consequently, ultimate licensees have to go to only one society for a global licence to perform, or whatever, within the Member State where it operates. This does not infringe the competition rules, but if the societies undertake not to permit direct access to the repertoires by foreign users it may infringe Article 81.[35] It may also do so if they systematically refuse to allow direct access to foreign users without an objective justification. Usually, the high cost of monitoring in other countries will amount to such a justification.

Now television and radio stations are transmitting programmes via the Internet as they simultaneously transmit along traditional terrestrial or cable networks: 'simulcasting'. This enables audiences to view or listen to broadcasts from any Internet hookup on the globe, regardless of the jurisdiction from which the broadcasts originate. To obviate the need to obtain numerous licences, the International Federation of the Phonographic Industry (IFPI) notified an agreement whereby a single licence covers most EEA countries and some others.[36] This one stop shop saves considerable transaction costs. The Commission approved the arrangements as efficient and advancing the objectives of the single market. The parties undertook to separate the relevant copyright royalty from the fee for administration. The Commission believed that this would facilitate identification of the most efficient collecting societies.

4.1.1.5 The Software Directive

Directive 91/250[37] requires Member States to protect software through the law of copyright 'as literary works'. The directive is not part of the competition rules, but Article 6 provides that if sufficient information is not given to enable firms to connect other software, they may decompile a programme to do so. Consequently, most holders provide any necessary information to enable interconnection.

[34] *Musik-Vertrieb Membran v Gema* (55 & 57/80), 20 January 1981, [1981] ECR 147, para 18.

[35] *Ministère Public v Tournier* (395/87), 13 July 1989, [1989] ECR 2565, [1991] 4 CMLR 248, [1990] 2 CEC 815, para 18 et seq.

[36] *Simulcasting* (2003/300/EC, COMP/C2/38.014), 8 October 2002, OJ 2003, L107/58, [2003] 5 CMLR 386.

[37] EEC Council Directive 91/250/EEC-Legal protection of computer programs, OJ 1991, L122/42, CMR 5991.

4.1.1.6 Software Licensing

Software licensing used not to be subject to any group exemptions, unless it was not the primary object of a vertical distribution agreement exempted by Regulation 2790/99. Software licences continuing after 1 May 2004 may now fall within the new block exemption for technology transfer. Software licences that infringed Article 81 before that date may have become valid from 1 May 2004.

4.1.2 No Challenge Provisions

The Commission has been hostile to no-challenge clauses since its decision in *Davidson Rubber*,[38] where such a clause had to be abrogated before the Commission would exempt even manufacturing exclusivity. The Commission stated that the licensee had a greater incentive than other undertakings to challenge doubtful patents and so avoid the obligations and restrictions accepted under the licence. In *AOIP v Beyrard*,[39] the Commission added that the licensee might be the person best placed to challenge the patents on the basis of information given to it by the licensor. In several individual decisions, the Commission condemned restrictions on challenging not only patents, but also trademarks.[40]

The approach adopted by the Commission in its older decisions was static. Once the licence was granted, the market would be more competitive if invalid patents could be challenged. What the analysis overlooks, however, is the effect of such a rule on the holder's willingness to invest in R & D or to grant licences. Patent litigation is notoriously lengthy and expensive. Licensors, especially small firms, may not be able to survive it. A patentee may well not be able to obtain firm advice as to the validity of its patent. It may not know of a prior publication of the innovation, and the test of obviousness or its converse, an inventive step, is inherently subjective.

If a licensee is likely to challenge a patent,[41] whether or not the licensor believes it to be valid, the holder may well hesitate to grant a licence. Indeed, since the decision in *Davidson Rubber* (4.1.1.1 above) many firms

[38] (72/237/EEC), 9 June 1972, JO 1972, L143/31, [1972] CMLR D52 (4.1.1.1 above).

[39] (76/29/EEC), 2 December 1975, [1976] OJ L6/8, [1976] 1 CMLR D14, CMR 9801.

[40] I discussed the older decisions rather more fully in Valentine Korah, (1985) *Patent Licensing and EEC Competition Rules? Regulation 2349/84* (Oxford, ESC Publishing), pp 61-65. The book is out of print, but available in some libraries.

[41] A patent or the secrecy of the know-how is not likely to be challenged before the licensee has invested in production facilities. So, often, a licensee has an incentive not to challenge in order to exclude third parties. Nevertheless, with the passage of time, it may want to use rival technology, or just refuse to pay royalties. This final option may be avoided by providing that in the event of challenge the licence may be determined, which is not black listed in the current group exemption.

have granted few licences for the Common Market countries to firms that they did not control, whether through a shareholding or commercial relationship. The inability to restrain challenge must have reduced the incentive both to licence existing technology, and to invest in innovation. A holder may prefer to protect the territory for which it can produce rather than license a third party for a marginal area for which it lacks production capacity. Usually more is to be made from making and selling than from licensing.

The Court upheld the Commission's *per se* condemnation of a no challenge clause relating to a trademark that had not been licensed with a patent in *Windsurfing*,[42] although Advocate-General Lenz had pointed out that the clause had no significant effect on the competitive position of licensees which had developed their own marks and so had no significant effects on competition. The judgment may be distinguished on the ground that usually the mark not to be challenged is one being licensed. Moreover, it is quite possible that the mark in *Windsurfing* had become descriptive of the sport, so was particularly likely to be invalid. The strong-minded may also argue that the judgment was given by a chamber of only three judges and could well be reversed by a larger chamber. Indeed, it may already have been reversed in *Bayer & Hennecke*,[43] considered below, and is difficult to reconcile with the Commission's subsequent decision in *Moosehead/Whitbread,*[44] where the acknowledgement that the mark being licensed was valid and owned by the licensor was held not to infringe Article 81(1). By 1990, more Commission officials were beginning to think *ex ante*.

In *Windsurfing*, the Court followed the Advocate-General in relation to the restriction on challenging the validity of the patent. A-G Lenz pointed out that some other licensees had not been restrained, but had not used their liberty to challenge the validity of the patent. Moreover, after the abrogation of the clause, the two licensees who had been restrained had not challenged it either. Lenz observed that a licensee may well not want to challenge a clause that would open its market up to competitors, so the restriction on its freedom to challenge might not be significant. Nevertheless, he thought the Commission's condemnation could not be attacked.

More recently, the Commission and courts have been more flexible in their approach to no challenge clauses in patent licences. In *Bayer & Hennecke*, both litigation and opposition proceedings in the German patent

[42] *Windsurfing International Inc v Commission* (193/83), 25 February 1986, [1986] ECR 611, [1986] 3 CMLR 489, CMR 14271, paras 92–93.

[43] *Bayer and Hennecke v Söllhöfer* (65/86), [1988] ECR 5249, [1990] 4 CMLR 182, [1990] 1 CEC 220, a decision of a full Court of nine. See comment Valentine Korah, 'No Duty to Licence Independent Repairers to Make Spare Parts: The Renault, Volvo and Bayer & Hennecke Cases', [1988] 12 EIPR 381, at 384.

[44] (90/186/EEC), 23 March 1990, OJ 1990, L100/32, [1991] 4 CMLR 391, [1990] 1 CEC 2127 (see at end of this section below).

office were settled on the grant of reciprocal non-exclusive licences under the German patent and model containing a no-challenge clause relating to the validity of the corresponding industrial property rights of Bayer & Hennecke in other Member States. The ECJ was asked to give a preliminary ruling as to the validity of the no-challenge clause. The Commission argued that although it was still hostile to restrictions on challenging intellectual property rights, there was a public interest in compromising litigation and the no-challenge clause was ancillary to the compromise, not *vice versa*. In such circumstances the clause should fall outside Article 81(1).

This the ECJ rejected. It ignored the precedents on ancillary restraints and said that Article 81 draws no distinction between agreements made to compromise litigation and those made for other purposes. Nevertheless, both Advocate-General and Court pointed out that before finding that a no challenge clause infringes Article 81(1), the national judge should look to its legal and economic context. The ECJ is not required to apply its ruling under Article 234 (then Article 177): that task is for the national court that requested the preliminary ruling.

The judgment is important for deciding that such clauses are not necessarily illegal, although the examples the Court gave of situations where a restraint on challenge would not infringe Article 81(1) were not helpful. At paragraph 17 the Court suggested that such a clause would not restrict competition if the licence were royalty free, since the licensee would not be under a competitive disadvantage. This misses the point that the patent may exclude others, who have more incentive to challenge, but may be less able to do so. Moreover there was consideration for the licence in the grant of a reciprocal licence.

The Court seems to have been concerned more with fair than free competition. The particular licence seems to have been granted to a competitor, in which case reciprocal licences of an invalid patent together with a no-challenge clause relating to patents elsewhere might be a way of excluding competitors. Most disputes that lead to licences are between competitors, so a difficult decision was needed as to whether the possibility of restricting competition by allocating markets between competitors outweighed the cost savings and certainty from resolving the dispute, enabling the parties to carry on producing, or preparing to produce, without concern about infringing each other's intellectual property rights. Given that it is at the time the agreement is being negotiated that certainty is required, it is thought that the Commission was right to argue that obligations not to challenge are ancillary to the compromise and should automatically be cleared, subject to a sham exception.

The *Bayer & Hennecke* judgment made it extremely difficult to resolve disputes over the validity of intellectual property rights. A compromise, under which the holder of the possibly valid right provides consideration to the person opposing validity, often includes a restriction on the latter challenging the right. It has become more difficult to argue that such a restraint is justified by the saving in the costs of litigation and the reduction of uncertainty.

Where such a compromise is made between firms who could have competed without any licence, such an agreement could be a sham, concealing a horizontal arrangement that permits a limited amount of territorial protection. Where, however, it is not a sham, such an agreement may save a great waste of resources. It is, however, not always easy to tell when an agreement is a sham.

The ECJ stated that the agreement must be examined in its economic and legal context before it is found to infringe Article 81(1). So, if it can be shown that the dispute had merit on both sides, it would be arguable that a no-challenge clause does not infringe Article 81(1). It is thought that a recital in a licence agreement acknowledging that the know-how is valuable and secret at the time of the licence and that the patent licensed is valid does not amount to a 'prohibition' on contesting its secrecy, and may be helpful in altering the onus of proof in a national court.[45]

In *Moosehead /Whitbread*,[46] Whitbread acknowledged Moosehead's title to the marks and the validity of the registration (point 8.3) but this was treated in the legal assessment as amounting to a no-challenge clause (point 15.4) (see 7.1.1 below).

The treatment of no-challenge and non-assert agreements is considered in the new guidelines on technology transfer (5.5.2 and 6.4.2 below). These are probably more important than the older decisions of the Commission, but it is doubtful how far they can override judgments of the Court.

4.1.3 Feed and Grantback Provisions

The Commission has followed its view in *Davidson* (4.1.1.1 above) that feed and grantback provisions do not infringe Article 81(1), provided that they are reciprocal and enable the licensee to use its own improvements, or license others to use them. Most licences, other than those granted to resolve disputes, are for the latest technology, so most feed and grantback clauses are reciprocal. Many, however, were condemned for being too strong, such as those under which the licensee was required to transfer any iprs to the licensor. In *Velcro SA v Aplix SA*[47] the Commission refused to

[45] In *Computerland* (87/407/EEC, IV/32.034), 13 July 1987, OJ 1987, L222/12, [1988] 4 CMLR 592, CMR 12,165, at para 5, the Commission noted that there was an acknowledgement in a franchise agreement that a mark was valid, but there was no restriction on challenging its validity. See Gs 204 et seq; 6.4.2 below.

[46] (90/186/EEC), 23 March 1990, OJ 1990, L100/32, [1991] 4 CMLR 391, [1990] 1 CEC 2127.

[47] (85/410/EEC), 12 July 1985, OJ 1985, L233/22, [1989] 4 CMLR 157, CMR 10719.

clear a stronger grant back clause, even though there was provision for reasonable payment supported by an arbitration clause (but see G 110 and 5.5.1 below).

4.1.4 Royalties to Continue After the Last Intellectual Property Right Expires

For the first time in *AOIP v Beyrard*[48] the Commission refused to exempt an exclusive licence because royalties were to continue after the patents were due to expire.[49] It perceived the transaction as a tie of the period for which the product was protected by iprs (the tying product) with the later period after expiry of the patent.

When it came to design the group exemption for know-how licences,[50] the Commission had changed its mind and recital 21 stated that the parties should be free to spread the payments as they wished:

> As a rule, parties do not need to be protected against the foreseeable financial consequences of an agreement freely entered into.

Whether the payments are spread out beyond the period of legal protection should depend on which party is in a better position to finance the investments. A licensor may know more than a lender does about its licensee's business, so the risk of financing it is less than it would be for a bank.

In *Ottung v Klee*,[51] the ECJ did not go quite so far. It ruled:

> 2. A contractual obligation under which the grantee of a licence for a patented invention is required to pay royalty for an indeterminate period, and thus after the expiry of the patent, does not in itself constitute a restriction of competition within the meaning of Article 85(1) of the Treaty (now Article 81), where the agreement was entered into after the patent application was submitted and immediately before the grant of the patent.
>
> 3. A clause contained in a licensing agreement prohibiting the manufacture and marketing of the products in question after the expiry of the patent and the termination of the agreement comes within the prohibition laid down in Article 85(1) (now 81(1)) only if it emerges from the economic and legal context in which the agreement was concluded that it is liable to appreciably affect trade between Member States.

[48] *Association des Ouvriers en Instruments de Précision v Beyrard* (76/29/EEC), 2 December 1975, OJ 1976, L6/8, [1976] 1 CMLR D14, CMR 9801.

[49] [1976] 1 CMLR D14. The parties were in dispute, so there was no question of altering the provisions of which the Commission disapproved.

[50] Regulation 556/89-Group exemption for know-how licensing agreements, OJ 1989, L61/1, [1989] 4 CMLR 774.

[51] (320/87), 12 May 1989, [1989] ECR 1177, [1990] 4 CMLR915, [1990] 2 CEC 674. For comment, see Valentine Korah, (1996) *Technology Transfer Agreements and the EC Competition Rules* (Oxford, OUP), para 7.3.7.

In setting out its reasons, the ECJ added (at paragraph 12) that whether such a clause restricts competition would also depend on the legal and economic context of the agreement. It made the qualifications suggested by the Advocate-General, that the obligations relating to the period after expiry of the patents must be in return for the licence given before, but it is unlikely that the licensee would agree to them were that not the case. It is hoped that the licensee is not required to establish this.

4.1.5 Single Branding Obligations

In *Velcro SA v Aplix SA*,[52] the Commission condemned a clause whereby the licensee agreed not to make or sell any product that might compete with the licensed invention during the term of the agreement and the licensor agreed not to compete with the licensee in the field or to license competitors of the licensee. In *Delta Chemie,*[53] however, the Commission found that a restriction on the licensee manufacturing or distributing similar products without the consent of the licensor did not infringe Article 81, if it were qualified by a phrase that the consent would not be unreasonably withheld.

There are provisions in Articles 4(1) and 5 of the new block exemption regulation ensuring that the licensee be free to use its own R & D (5.4.1.8 and 5.5.3 below*)*. Non-compete obligations in agreements outside the technology transfer block exemption regulation (TTBER) are considered at 6.4.1.12 below.

There were a few other decisions about various provisions in licences, but as the points are covered in the TTBER or guidelines, it seems unnecessary to go through them here.

4.2 COMMISSION'S MORE RECENT VIEWS

Recently, the Commission has been convinced that licensing has many pro-competitive functions and various recitals and guidelines demonstrating this are considered in chapter 6 below.

4.3 BIBLIOGRAPHY

Korah V, (2004) *An Introductory Guide to EC Competition Law and Practice* (Oxford, Hart Publishing, 8th edn), ch 11.

Venit J, 'In the Wake of *Windsurfing*: Patent Licensing in the Common Market' in Barry Hawk (ed) (1986) *Fordham Corporate Law Institute*, ch 222.

[52] (85/410/EEC), 12 July 1985, OJ 1985, L233/22, [1989] 4 CMLR 157, CMR 10719.

[53] *Re the Agreement between DDD Ltd and Delta Chemie* (88/563/EEC), 13 October 1988, OJ 1988, L309/34, [1989] 4 CMLR 535, CMR 95014.

5

The New Group Exemption for Technology Transfer – Regulation 772/04 (TTBER)

In April 2004, the Commission adopted the fourth group exemption for technology transfer (hereinafter referred to as 'TTBER').[1] It is broader than its predecessors in that it covers licences of design rights and software copyright, but is narrower in that if the parties have market shares

[1] Regulation 772/2004, on the application of Art 81(3) of the Treaty to categories of technology transfer agreements OJ 2004, L127, [2004] 5 CMLR 199, Appendix 3 with headings and cross references by Valentine Korah. The three earlier group exemptions are cited at ch 4 above.

exceeding the levels prescribed in Article 3, the exemption will not apply, although there is no presumption that the agreement will infringe Article 81(1). The ceilings are low and, in concentrated markets, it may not be possible for the holder of a right to find licensees competent to exploit a patented invention with a market share sufficiently low. Indeed its own market share may exceed the ceiling, especially where the parties are competitors. Moreover, the ceilings are based on market shares, and it is not always clear what the relevant market may be. The current regulation provides havens that are less safe than under its predecessors.

Recital 4 (R4) to the regulation stresses the importance of a more economic approach and recital 5 the benefits of technology licensing, increasing both efficiency and competition. Recital 6 adds that whether these benefits will outweigh any anti-competitive effects depends on the degree of market power enjoyed by the parties to a licence. The recitals are particularly helpful when arguing that licences that fall outside the block exemption do not infringe Article 81 (6.2 *et seq*, below).

The Commission has also published guidelines (Gs) and these may be more important than the regulation, since it is not always clear whether the market shares are excessive and whether the regulation applies. Some Gs relate to the construction of the regulation, and others to the way the Commission will apply Article 81 to technology licences. The status of the Gs was considered at 3.4 above and their substance at 5.1 *et seq*, below.

The guidelines are less permissive than those in the US[2] and fear remains that the new regulation will chill R & D in Europe. Innovation and production can be carried on outside the Common Market and the products made by using it can be exported to Europe. Then the scope of the contractual provisions in the licence will be subject to the more permissive antitrust rules in the US or elsewhere. This objection is less strong than it was when made against the draft regulation published for comment.[3]

5.1 OUTLINE OF THE REGULATION

The structure of the new regulation is similar to that for vertical distribution agreements. Article 2 exempts:

> technology transfer agreements entered into between two undertakings permitting the production of contract products.

They remain exempt until the last qualifying intellectual property right expires or the know-how ceases to be confidential. The simplicity is only apparent. There are complex definitions in Article 1 to which we will return at 5.2.1.

[2] Antitrust Guidelines for the Licensing of Intellectual Property, 6 April 1995, (1995) 68 ATRR 462, CCH TRR 13,132, [1995] 7 EIPR 3. See ch 9 below.

[3] Valentine Korah, 'Draft Block Exemption for Technology Transfer', [2004] ECLR 247.

Article 3 provides the ceilings of market share above which the exemption does not apply: 20 per cent of the combined market share of the parties if they were competing undertakings before the licence was granted and 30 per cent each if they were not. The market for both the products and the technology are relevant, but potential competition is not. This makes the application of the regulation more predictable, as almost anyone in an industry might be looked upon as a potential entrant to the technology market. The Commission states at G 131 that, in the absence of hardcore restraints, it will rarely consider that Article 81 is infringed if there are at least four other undertakings, independent of the parties, whose product can be substituted for the licensed technology. The Commission wanted to impose a ceiling of market share in the technology transfer regulation of 1996, but desisted when the suggestion caused a furore. Ceilings on market share were imposed on the group exemptions for specialisation[4] and R & D[5] as they had been by the earlier regulations of 1985 that they replaced.

Article 4(1) contains the blacklist of hardcore restrictions that prevent the application of the exemption if the parties are competing undertakings, and Article 4(2) a list (adapted from Regulation 2790/99 exempting vertical distribution agreements) of restrictions that prevent the application of the regulation if the parties are not competing.

Article 5 lists provisions to which the exemption does not apply, although they are severable and do not prevent the regulation applying to other provisions.

Articles 6 and 7 provide for withdrawal of the exemption.

Article 10 provides minimal transitional relief (see 5.8 below).

5.2 COVERAGE OF THE TECHNOLOGY TRANSFER GROUP EXEMPTION (ARTICLE 2)

Article 2 grants the group exemption. It provides in its first paragraph:

> Pursuant to Article 81(3) of the Treaty and subject to the provisions of this Regulation, it is hereby declared that Article 81(1) of the Treaty shall not apply to technology transfer agreements between two undertakings, permitting the production of contract products.

The simplicity of Article 2 is misleading. There are complex definitions in Article 1. We must first consider what amounts to a technology transfer agreement, second, the limitation to two parties and third, the requirement that the licensee be licensed to produce the protected products and not merely to distribute them.

[4] OJ 2000, L304/3, [2001] 4 CMLR 800.
[5] OJ 2000, L304/7, [2001] 4 CMLR 808.

First, 'agreement' is defined in Article 1(1)(a) to include a decision of an association of undertakings or a concerted practice. This simplifies the subsequent drafting.

'Technology transfer agreement' is defined to include licences not only of patents and/or know-how, but also of designs and software copyright, which were not included by the regulation of 1996. The Commission was advised that it lacked power to exempt the more traditional forms of copyright and it did not want to wait two years for the Council to extend its powers. Consequently, it stated in G 51 that it will apply the principles set out in the regulation and guidelines to traditional forms of copyright by analogy. The guidelines do not relate to the way the Commission may exercise its discretion, but to the interpretation of the regulation. Consequently, the validity of this device is questionable, although NCAs and courts may follow the guidelines for the sake of consistency throughout the Common Market. Since they now have power to apply the whole of Article 81, they are able to take the same positions as the Commission under Article 81(3) (see 3.4 above).

Performing rights are to be treated differently (G 52), but the judgments of the ECJ in the *Coditel* cases[6] were more liberal towards multiple parallel licences limited territorially than expected at the time, so exclusive licences of such rights will often not infringe Article 81(1) or need exemption, even if they confer absolute territorial protection.

The Commission will not, however, extend the principles of group exemption and guidelines to trademarks, which are licensed usually in the context of distribution (G 53), although licences of marks may qualify as ancillary to the technology licence when necessary and directly linked to it, Gs 49 and 50). When ancillary to distribution agreements, trademark licences may be exempt under the regulation for vertical distribution agreements[7] (G 53).

'Contract products' include both goods and services produced with the licensed technology (Article 1(1)(f) and G 43). The TTBER covers subcontracting when the sub-contractor is licensed to make products for the licensor, provided that the primary object of the agreement is the licensed technology rather than the supply of the equipment. I wish the Commission would not distinguish ancillary restraints from the primary ones, particularly when they are complementary. I fear that it may be for the person alleging legality to establish that the supply of equipment was not the primary object of the agreement.[8] The actual guidelines differ from the published draft in that the useful sub-contracting notice has not been superseded (G 44). This is welcome: the notice was well drafted and flexible.

[6] *Coditel (SA Compagnie Générale pour la Diffusion de la Télévision) v Ciné-Vog Films* (62/79), 18 March 1980, [1980] ECR 881, [1981] 2 CMLR 362, CMR 8662; *Coditel II-Coditel SA v Ciné-Vog Films SA (No 2)* (262/81), 6 October 1982, [1982] ECR 3381, [1983] 1 CMLR 49, CMR 8865.

[7] Regulation 2790/1999 on the application of Art 81(3) of the Treaty to vertical agreements and concerted practices, OJ 1999, L336/21, [2000] 4 CMLR 398, [2000] ECLR supplement to May issue.

[8] Regulation 1/2003, Art 2, OJ 2003, L1/1, [2003] 4 CMLR 551.

The new exemption does not cover agreements sub-contracting the R & D to be granted back to the licensor. Nevertheless, according to G 45, it covers licences where the licensee will have to carry on development work before the product or process is ready for commercial exploitation, provided that a contract product has been identified. The regulation does not cover a research tool to be used in further research. I do not know why the Commission insists on an identified link between the licence and the final product.

In addition, the empowering Council Regulation 19/65,[9] does not provide for multipartite agreements to be block exempted (G 38). The Commission had had to wait two years to provide for multipartite distribution agreements to be block exempted, and was not prepared to wait again. The guidelines analyse some kinds of multilateral agreements, such as patent pools (Gs 210–235).

The final words of the first paragraph of Article 2 make it clear that the licensee must be permitted to produce the protected product (Recital (R) 7 and Gs 42 and 45). As might be expected, a licence for sale only may come within the block exemption for vertical distribution agreements, but not within the TTBER. Recital 7 states that the final words are intended to exclude patent pools (considered in Gs 210–235) and the sub-contracting of R & D (G 44).

The regulation applies if the licensee is permitted to sub-license third parties, provided that the production of contract products constitutes 'the primary object' of the agreement. G 42 states that where sub-licensing is the primary object, the Commission will 'apply by analogy the principles set out in the TTBER and guidelines'. If so, why does it exclude bilateral 'master licences' in the first place? More licences will be dealt with by national competition authorities (NCAs) and courts than by the Commission, but they may follow the guidelines to avoid inconsistency (see 3.4 above). The lack of clarity may chill licensing in Europe, since assurance that a contract will be performed by the other party may be required before committing assets to performing under a licence.

'Transfer' implies that the technology must flow from one undertaking to another and includes sub-licensing (G 48) and assignments when the risks of exploitation remain with the assignor (Article 1(1)(b)).

The second paragraph of Article 2 defines the duration of the exemption—as long as at least one intellectual property right (ipr) (patent, design, know-how or software copyright, etc) remains valid, subject to the ten year period of the group exemption (Gs 54 and 55).

[9] Council Regulation 19/65 -Vires for group exemptions for exclusive dealing and patent licences, OJ Spec Ed, 1965, 35, amended by Council Regulation 1215/99, OJ 1999, L148/1, app 2.

5.2.1 Definitions

Under Article 1(1)(b), **'technology transfer agreement'** is defined to mean

> a patent licensing agreement, a know-how licensing agreement, a software copyright licensing agreement or a mixed patent, know-how or software copyright licensing agreement ...

'Patents' are widely defined in paragraph (h) of Article 1(1), as in the former block exemption in Regulation 240/1996,[10] to cover many kinds of iprs, but now also include designs (G 46). 'Know-how' is defined more shortly in paragraph (i) than in the former regulation and the amplification in G 47 is a little different, but basically the same.

Article 1(1)(b) continues:

> including any such agreement containing provisions which relate to the sale and purchase of products or which relate to the licensing of other intellectual property rights or the assignment of intellectual property rights, provided that those provisions do not constitute the primary object of the agreements and are directly related to the production of the contract products.

Consequently, unlike the block exemption for distribution, the TTBER may exempt limitations on the licensee's sales or purchases. It exempts all restrictions on active sales. It relates, however, only to the bilateral agreement with the licensor. Both blacklists in Article 4 limit the technology transfer regulation so as not to allow all restrictions on passive sales to protect other licensees.

5.2.2 Relationship with Other Group Exemptions (Gs 56–64)

5.2.2.1 Specialisation and R & D (Gs 57–60)

Technology licensing may be exempt under the block exemption for specialisation[11] where the licence is ancillary to joint production (G 57 and 6.05 below). A licence between the parties or between one of them and their production joint venture may come within the group exemption for R & D; Regulation 2659/2000.[12] Where, however the joint venture licenses the technology to third parties, that licence or a licence from one party to the joint venture may come within the technology transfer regulation.

[10] Commission Regulation 240/96- Technology transfer, OJ 1996, L31/2, [1996] 4 CMLR 405, [1996] 4 EIPR Supp iv.

[11] Regulation 2658/2000 on the application of Article 81(3) of the Treaty to specialisation agreements, OJ 2000, L304/3, [2001] 4 CMLR 800.

[12] Regulation 2659/2000 on the application of Article 81(3) of the Treaty to research and development agreements, OJ 2000, L304/7, [2001] 4 CMLR 808.

5.2.2.2 Vertical Agreements (Gs 61–64)

A contract between a licensor and licensee of technology relating to the conditions under which the parties may buy or sell goods or services may come within the TTBER, which allows protection from active sales and sometimes against even passive sales, while the agreement between licensee and third parties may be subject to Regulation 2790/99,[13] which is less permissive.

5.3 CEILING OF MARKET SHARES (ARTICLE 3)

The group exemption does not apply if the market shares of the parties exceed the ceilings imposed by Article 3. Nevertheless, there is no presumption that their licences infringe Article 81(1) (R 12 and Gs 37 and 130). They are outside the safe harbour of the regulation, that is all.

Article 3 distinguishes licences between competitors and others (defined at 5.3.1 below). The former are horizontal and the ceiling is lower. Not only is the ceiling at 20 per cent rather than 30 per cent, it is the aggregated share that is relevant. Article 3 makes it clear that the market share of a party is ascertained by reference to products produced with the help of the licensed technology. This includes products made by the licensee. Until the technology is used to produce and the market is supplied the market share is nil.

Article 3 provides:

> 1. Where the undertakings party to the agreement are competing undertakings, the exemption provided for in Article 2 shall apply on condition that the *combined market share of the parties* does not exceed 20 per cent on the affected relevant technology and product market.
>
> 2. Where the undertakings party to the agreement are not competing undertakings, the exemption provided for in Article 2 shall apply on condition that the *market share of each* of the parties does not exceed 30 per cent on the affected relevant technology and product market.
>
> 3. For the purposes of paragraphs 1 and 2 the market share of a party on the relevant technology market(s) is defined in terms of the presence of the licensed technology on the relevant product market(s). A licensor's market share on the relevant technology market shall be the combined market share on the relevant product market of the contract products produced by the licensor and its licensees. (my italics)

It may be impossible to find out the royalty income of third parties, so the shares of the technology market are not ascertained by reference to the royalty income (G 23). Guideline 66 states that for the purposes of the block

[13] Regulation 2790/1999 on the application of Article 81(3) of the Treaty to vertical agreements and concerted practices, OJ 1999, L336/21, [2000] 4 CMLR 398, [2000] 5 ECLR Supp.

exemption, but not of Article 81, the parties are competitors on the technology market only if they licence competing technologies, not if the licensee produces using the licensed technology itself, but does not license competing technology. The licensee's production may swell the technology market share of the licensor, as that is measured by the sale of products incorporating the licensed technology on the product market downstream, but it will not make the parties 'competing undertakings' unless the licensor and licensee are actual or potential competitors on the same market and both could have competed without the licence (Gs 67 and 68).

The parties are actual competitors on the product market if they are both active on the same product and geographic market, and potential competitors if within a reasonable period of time they are likely to make the investments and incur the switching costs required to start production in response to a small and permanent increase in relative prices (G 67). So, according to G 68, they are not competitors if the licensor does not produce and the licensee does not license substitutes. They may become competitors if the licensee later starts to license competing technology or the licensor becomes an actual or potential competitor on the produce market.

There are some further provisions concerning the calculation of market shares in Article 8. They should be calculated on the basis of market sales value data, if available. This increases the percentage of those selling at a higher price. If such data are not available, estimates based on other reliable information, including market sales volume, may be used to establish market shares.

Market shares are to be calculated on the basis of data relating to the preceding calendar year. This may be unnecessarily difficult when the undertaking uses a non-calendar accounting period. This may be important even when the call is not close if the technology is successful in a wider market, as sales may increase rapidly once marketing starts. Now that the Commission is treating as competitors only those who could have competed without a licence, it is thought that the application of the TTBER often may not matter. Licences that nearly qualify may not infringe Article 81(1), particularly in light of the newly adopted notice on the application of Article 81(3).[14] Nevertheless, it seems to me to be an unnecessary and burdensome complication.

Where an undertaking is held jointly, the market shares of the joint venture are divided equally between the parents that control it, including those not party to a licence, for the purpose of calculating market share (Articles 1(2) and 8(1)). Selling small shares in a joint venture, provided that they sufficed to give control within the meaning of 'connected undertakings', could be used as a means of reducing market shares. The benefit of the TTBER might be withdrawn, but only for the future, not the present.

[14] Guidelines on the Application of Article 81(3), OJ 2004, C 101/97, [2004] 4 CMLR 1739.

Article 8(2) provides for marginal relief. If the ceilings were not exceeded initially, the TTBER continues to apply for two consecutive calendar years following the year in which the ceiling was first exceeded. This may be very helpful, as exploiting the technology may rapidly lead to significant market shares.

The ceilings of market share have been very controversial for two reasons. First, when drafting or implementing a technology transfer agreement, it is sometimes impossible to predict what market will be identified as relevant by a court or competition authority in the future. Most of the precedents are to be found in the case law under the merger regulation,[15] but it must be remembered that market definitions change over time as more substitutes are discovered or produced.[16]

In the case of medicines the market will probably be all the drugs used for treating a particular ailment, although those that require injection may be in a separate market from those that do not. In other industries the selection may be more difficult. For medicines, the alternative criterion of four independent poles of research (G 131)[17] is likely to work well, as the long period needed for clinical trials enables us to know what new drugs are in the pipeline. The guideline does not distinguish cases where licences from the other four are unlikely to be granted. Technology used captively will constrain the conduct of parties to the fifth licence. Poles of R & D may work less well for other products, but it is the pharmaceutical companies which most need their patents and licences, because it is often easy to copy a medicine once the exact formulation is disclosed in accordance with safety rules.

The second objection to the ceilings is that the permissible market shares are low. Where R & D are expensive, the investment may be worthwhile commercially only if a large part of the market can be supplied. Consequently many technology markets are concentrated. The only possible licensors and licensees may have large market shares. Many fear that in the pharmaceutical industry these limitations to the safe harbour of the regulation will cause firms to carry on their R & D and production outside Europe, supplying Europe by export. This may endanger many good quality jobs in the Common Market. The US case law and guidelines on technology licensing are more liberal (9.1 below). Nevertheless, there is no presumption that licences where the market shares are exceeded infringe Article 81.

When the licence relates to drastic innovations, the market will be taken as separate from traditional substitutes (G 33). The extent of the

[15] Council Regulation 139/2004 on the control of concentrations between undertakings, OJ 2004, L24/1.

[16] *Coca Cola/Amalgamated Beverages* (97/540/EC, M.794), 22 January 1997, OJ 1997, L218/15, [1997] CEC 2,226; confirmed in *The Coca-Cola Company and Coca-Cola Enterprises Inc v Commission* (T-125 & 127/97), 22 March 2000, [2000] ECR II 1733, [2000] 5 CMLR 467.

[17] An idea taken from the Antitrust Guidelines for the Licensing of Intellectual Property, 6 April 1995, (1995) 68 ATRR 462, CCH TRR 13,132, [1995] 7 EIPR 3, section 4.3.

improvement may not be perceived immediately and a licensee may not immediately give up its traditional production and may supply for a few years. During that period it may not be clear that they are not competitors. This corresponds to example 5 at the end of section 3.3 of the US guidelines.

5.3.1 Competing Undertakings (Article 1(1)(j))

Licences between competitors are treated with more hostility than those between non-competitors in two main respects. Not only is the ceiling of market share lower, the black list for agreements between competitors is harsher than that for agreements between non-competitors.

Until 2004, the Commission treated undertakings as competing once both parties were producing. Consequently, the lower market share was appropriate according to the version of the regulation published for comment in October 2003.[18] The Commission treated the agreement as horizontal. This, however, was to perceive the situation *ex post*, after the technology has been successfully developed. It is at the time the commitment is made to invest in it, however, that the American agencies decide whether parties are competing.[19]

> For analytical purposes, the Agencies ordinarily will treat a relationship between a licensor and its licensees or between licensees, as horizontal when they would have been actual or likely potential competitors in a relevant market in the absence of the license.

By the time the intellectual property right is being licensed, the investment in R & D is usually a sunk cost—water under the bridge. So the main justification for restrictive terms has ceased to be relevant.

The European Commission's G 26 accepts that agreements between competitors are more likely to restrain competition than those between non-competitors. It does not recite the Chicago reasoning that each has an interest in the other working on the minimal margin necessary to induce it to enter into the agreement and invest. It adds that competition from the same technology is also important in reducing prices.

There is an important new definition of 'competing undertakings' in Article 1(1)(j) of the Regulation (G 27). It defines undertakings as competing only if they could have done so in the absence of the licence without infringing the other's intellectual property rights. The result is that most licences will now be treated as vertical, subject to the higher ceiling of market share and to the less stringent list of hardcore restraints in Article 4(2) (5.4.2 below).

[18] Draft Commission Regulation on the application of Article 81(3) of the EC Treaty to categories of technology transfer agreements, 1 Oct 2003, OJ 2003, C235/10, [2004] 4 CMLR 188.

[19] Antitrust Guidelines for the Licensing of Intellectual Property, 6 April 1995, (1995) 68 ATRR 462, CCH TRR 13,132, [1995] 7 EIPR 3, section 3.3.

The perception *ex ante* applies also when the Regulation cannot apply because the parties' market shares are excessive. The definition can be transposed to decisions under Article 81 or the group exemption for R & D, which defines whether undertakings are competing *ex post*. Guideline 18 of the Commission's notice on the application of Article 81(3) of the Treaty[20] states that there are two questions to be answered when deciding whether an agreement infringes Article 81(1)—does it restrict actual or potential competition that would have existed without the agreement and without the restrictive provision? It seems that the radical change in perception is general and not confined to licensing. This perception *ex ante* is a major change in policy: parties will only be treated as competing if, without a licence, they could not realistically have competed without infringing iprs.

Pursuant to this new view, at G 33 the Commission states that when the innovation is drastic, suppliers of a traditional product it replaces will not be treated as operating on the same market. The licensor's technology either creates a new market or excludes the traditional product from the market. If this does not happen at once, the Commission considers that there will have been a material change of facts when it does. At that time, they will cease to be competitors.

This is likely to create significant difficulties if the licence has already been negotiated and signed. Originally, the parties may have drafted their agreement on the basis that the agreement was horizontal. By the time it is clearly vertical, the relationship may have changed, but one of the parties may not be prepared to renegotiate the agreement to take advantage of the more favourable legal climate.

There are two markets to be considered when applying Articles 3 or 4. Potential competition is relevant to defining the product market: not only firms making close substitutes, but also firms that might be induced to do so if the price of the product were to rise by 5 per cent or 10 per cent in relation to other products and be expected to stay higher. It is often difficult enough to know who are potential competitors on the product market. It is impossible on the technology market without including a whole industry. So, only actual competitors on the technology market need be taken into account. Potential competition is relevant only in relation to product and geographic markets. Indicating who might realistically compete on technology markets is often speculative. This uncertainty has been avoided.

5.3.2 Conclusion on Market Shares

If the technology licensed is so important that there are no substitutes, the parties are unlikely to have been competitors when the licence was granted and the market share of the licensee at that time is likely to be nil. Only if

[20] Guidelines on the Application of Article 81(3), OJ 2004, C 101/97, [2004] 4 CMLR 1739.

the licensor's share exceeds 30 per cent at that time will the Regulation not apply. The provisions for marginal relief in Article 8(2) and use of the preceding year's turnover for calculating market shares result in the sales of the licensed products not contributing to exceeding the ceilings for more than two calendar years. The Regulation does not state how the part of the year before 31 December is to be treated. When the technology is revolutionary, the licence may well not infringe Article 81(1) and not need the application of Article 81(3).

More often it is when the technology is less revolutionary that the 20 per cent aggregate market share may make it impossible for licences to qualify under the block exemption. Often there are few competitors, each already with large relevant turnover, which would be competent to produce and market the contract products.

5.4 HARDCORE RESTRAINTS (ARTICLE 4, R 13 AND GS 74–76)

Article 4 lists the hardcore restrictions that prevent the application of the regulation to the agreement as a whole. If a technology transfer agreement infringes Article 81(1)—and almost all restrictions of competition by object[21] do so—a hardcore restraint is not only illegal and void in itself, it prevents the application of the block exemption to other provisions in the licence (Article 4(1) and (2), R13, G 75).

Unlike the earlier regulations, Article 4 distinguishes licences between competitors, which are dealt with by Article 4(1), from those between non-competitors dealt with in Article 4(2). The big change since October 2003 is that in the actual regulation we look *ex ante* to the position in the absence of a licence (5.1 above), whereas in the draft of the TTBER we were looking to whether the parties came to operate in the same market as a result of the licence. This is a very important change, as most licences become horizontal looked at *ex post.* Technology holders seldom grant exclusive licences to existing competitors.

The introductory words to both Article 4(1) and (2) are very broad and blacklist agreements which:

[21] See 6.2.3 below. The notice on Art 81(3) says:

21. Restrictions of competition by object are those that by their very nature have the potential of restricting competition. These are restrictions which in light of the objectives pursued by the Community competition rules have such a high potential of negative effects on competition that it is unnecessary for the purposes of applying Article 81(1) to demonstrate any actual effects on the market. This presumption is based on the serious nature of the restriction and on experience showing that restrictions of competition by object are likely to produce negative effects on the market and to jeopardise the objectives pursued by the Community competition rules. Restrictions by object such as price fixing and market sharing reduce output and raise prices, leading to a misallocation of resources, because goods and services demanded by customers are not produced. They also lead to a reduction in consumer welfare, because consumers have to pay higher prices for the goods and services in question.

> directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object

specified restrictions.

5.4.1 As Between Competitors (Article 4(1) and Gs 77–95)

The first three blacklisted clauses in licences between competitors that prevent the application of the Regulation even to other provisions in Article 4(1) are the classic cartel provisions, which most antitrust systems condemn between competitors: price fixing, limitation of output and the allocation of markets. The Commission treats them as restrictions by object.

Indirect inducements to charge minimum, fixed or maximum prices for products made by use of the protected technology may be caught.

There are several exceptions to limitations on output or the allocation of markets even where a licence is between competing undertakings, especially when the licences are not reciprocal. 'Reciprocal agreement' is defined in Article 1(1)(c) as the situation where A licenses B and B licenses A, in the same or separate contracts, to exploit a patent, know-how or software copyright etc, where the technologies are competing or can be used for competing products (G 78). A grantback clause does not make the licences reciprocal, but a licence may become reciprocal if at a later date a cross licence is granted (G 78).

5.4.1.1 Price Fixing (Article 4(1)(a), Gs 79–81)

The first blacklisted provisions are terms that have as their object:

> (a) the restriction of a party's ability to determine its prices when selling products to third parties *[Gs 79–81, 156–160].*

This item does not prevent the parties from agreeing the royalty to be paid for the licence (G 156), unless this varies according to whether suggested prices to third parties are complied with. Guideline 79 exemplifies the width of the introductory words.

> 22. The assessment of whether or not an agreement has as its object the restriction of competition is based on a number of factors. These factors include, in particular, the content of the agreement and the objective aims pursued by it. It may also be necessary to consider the context in which it is (to be) applied and the actual conduct and behaviour of the parties on the market. In other words, an examination of the facts underlying the agreement and the specific circumstances in which it operates may be required before it can be concluded whether a particular restriction constitutes a restriction of competition by object. The way in which an agreement is actually implemented may reveal a restriction by object even where the formal agreement does not contain an express provision to that effect. Evidence of subjective intent on the part of the parties to restrict competition is a relevant factor but not a necessary condition.
>
> 23. Non-exhaustive guidance on what constitutes restrictions by object can be found in Commission block exemption regulations, guidelines and notices. Restrictions that are black listed in block exemptions or identified as hardcore restrictions in guidelines and notices are generally considered by the Commission to constitute restrictions by object. In the case of

G 80 explains the Commission's concern over cross licensing between competitors when the cross royalties affect the marginal cost of the product and might then lead to coordinating prices downstream.

This concern was criticised when the draft guidelines were published for comment. The Commission has softened them, and now says it will treat cross licences with reciprocal running royalties as price fixing only where the agreement has no pro-competitive purpose. Most cases will, however, come before NCAs and courts, and will they follow the guideline or the Regulation (3.4 above)?

Where royalties are calculated on the basis of all product sales whether or not the licensed technology is used, the agreement is caught by both Article 4(1)(a) and (d). It raises the variable cost of using competing technology, and so discourages the licensee from exploiting its own technology or that of someone else contrary to Article 4(1)(d). Nevertheless, such an agreement might merit the individual application of Article 81(3), for instance when there is no other available method of monitoring the use of the technology to make a component that is not sold separately (G 81).

Article 4(1)(a) is similar to Article 3(1)(1) of Regulation 240/1996. Consequently, this blacklisted item is unlikely to require the renegotiation of many licences that were drafted so as to comply with the former group exemption.

5.4.1.2 Limitation of Output (Gs 82–83)

Article 4(1)(b) blacklists agreements that have as their object:

> (b) the limitation of output, except limitations on the output of contract products imposed on the licensee in a non-reciprocal agreement or imposed on only one of the licensees in a reciprocal agreement *[Gs 82, 83, 175-177]*.

The Commission says that one-way restrictions are less likely to result in lower output and there is less risk of the licence being a sham: a cartel taking the form of licences to each other's technology. Limitation of output was blacklisted by Article 3(5) of Regulation 240/1996, in only slightly different terms. So, there may not be much need to renegotiate on this ground.

5.4.1.3 Allocation of Markets or Customers

Article 4(1)(c) excludes from the Regulation agreements that have as their object:

> (c) the allocation of markets or customers except … *[Gs 84–93, 162–164, 168–171, 179–183]*

horizontal agreements restrictions of competition by object include price fixing, output limitation and sharing of markets and customers. As regards vertical agreements the category of restrictions by object includes, in particular, fixed and minimum resale price maintenance and restrictions providing absolute territorial protection, including restrictions on passive sales.

The Commission is concerned by the cost of setting up separate production facilities for different areas or customers. It has, however, become far less hostile to exclusive territorial licences since reading comments on the drafts of the regulation and guidelines that it published for comment in 2003.[22] Guideline 85 makes it clear that paragraph (c) applies even if the licensee is free to use its own technology.

Article 1(1) of Regulation 240/1996 exempted sole and exclusive licences and associated export bans for various limited periods. Article 3(7) of that regulation ensured that export bans that lasted longer than exempted by Article 1 prevented the Regulation from applying. Article 3(3) also prevented its application if one or both parties were required without objectively justified reasons to refuse supplies. Article 3(4) black listed customer restraints between undertakings competing in manufacture before the licence was granted. The old regulation permitted exclusive agreements and their associated export bans only for the periods allowed by Article 1.

To Article 4(1)(c) of the TTBER, however, there are seven exceptions, many where the licence is not reciprocal. There are considerable changes, and exclusive licences drafted on the basis of the earlier block exemption may need renegotiation The Commission has come to accept that sole and exclusive licences may be pro-competitive in that they may overcome hold up and free rider problems, giving the licensee an incentive to invest in and develop the licensed technology (Gs 86 and 87).

5.4.1.4 Sole Licences (Article 4(1)(c)(iii), G 88)

Sub-paragraph (iii) excepts sole licences from paragraph (c):

> (iii) the obligation on the licensor not to license the technology to another licensee in a particular territory.

The Commission's perception of the concepts of 'sole' and 'exclusive licences' is confusing. At Gs 161 and 162, when dealing with provisions outside the group exemption, it defines both terms to refer to restrictions on 'production' rather than on 'exploitation' and considers sales restrictions later at Gs 168–174. Article 1(1)(l) of the Regulation defines 'exclusive territory' to refer to a territory where only one firm is allowed to *produce*. A restriction on the licensor or other licensees selling or, vice versa, a limitation on the licensee selling elsewhere, is not included in the third exception to the hardcore list (Article 4(1)(c)(iii); for restraints on sale see 5.4.1.6 below).

At 4.1.1.3 above, I described *PMI/DSV*, a decision of the Commission holding that a sole and exclusive licence of performing rights limited to

[22] Draft Commission Regulation on the application of Art 81(3) of the EC Treaty to categories of technology transfer agreements and Draft Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements, 1 October 2003, OJ 2003, C235/10, [2004] 4 CMLR 174.

Germany did not infringe Article 81(1). Does it follow that it does not matter whether a limitation to a particular territory or customer group may not be covered by the exception to Article 4(1)(c)? I fear that it may, as the hardcore lists in Article 4 prevent the group exemption applying to other clauses.

If the licence is exclusive as well as sole, in that one of the parties promises not to produce in the other's territory and the licence is not reciprocal, the limitation to protect the other's exclusive territory or customer group from active or passive sales is excepted from paragraph (c) (Article 4(1)(c)(iv)).

> (iv) the restriction, in a non-reciprocal agreement, of active and/or passive sales by the licensee and/or the licensor into the exclusive territory of the exclusive customer group reserved to the other party;

Sole licences, including the associated limitations in licences to other firms, were exempted in the former regulation for technology transfer for ten years from the time when the product was first placed on the market by any licensee in the case of know-how and the duration of the patent in both the territory protected and the licensee's territory where patents were licensed. If both patent and know-how were licensed, the longer period applied. The new regulation grants the exemption until the regulation expires at the end of April 2014. As time goes by, the period remaining will become shorter, but licences drafted in the light of Regulation 240/1996 will not need renegotiation on this ground unless the unexpired duration of the qualifying iprs in 2004 exceeded ten years in both the territory protected and that of the party subject to the restriction This is narrower than under Regulation 240/1996, which allowed restrictions on active or passive sales into the territory of other licensees for short periods. Regulation 240/1996 was repealed two years before it was due to expire although the transitional period for existing agreements that qualified under Regulation 240/1996 went up to the date it was due to expire. Many experts expected it to be renewed, not necessarily with the limit to market shares. Undertakings whose turnover exceed the ceilings may have had many licences to negotiate possibly after bargaining power had altered.

5.4.1.5 Field of Use Restrictions and Exclusive Licences (Article 4(1)(c)(i) and (ii), G 86)

The first sub-paragraph of Article 4(1)(c) permits field of use restrictions on the licensee, whether or not the licence is reciprocal. If it is not, sub-paragraph (ii) exempts also a restriction on either party producing within a field of use, a product market or an exclusive territory reserved for the other party. This applies however large the territory may be: even if it is worldwide (G 86). Field of use restrictions were not limited in time under Regulation 240/1996, Article 2(1)(8). Nor were they subject to a ceiling of market share.

> (i) the obligation on the licensee(s) to produce with the licensed technology only within one or more technical fields of use or one or more product markets; *[Gs 90, 179–185]*
>
> (ii) the obligation on the licensor and/or the licensee, in a non-reciprocal agreement, not to produce with the licensed technology within one or more technical fields of use or one or more product markets or one or more exclusive territories reserved for the other party; *[Gs 86, 179-185]*

5.4.1.6 No Poaching Provisions in Non-Reciprocal Licences (Article 4(1)(c) (iv) & (v), Gs 87 and 89)

In a non-reciprocal licence between competitors, sub-paragraph (iv) of Article 4(1)(c) exempts a restraint on licensor and/or licensee from making active and/or passive sales into the exclusive territory or exclusive customer group reserved for the other:

> (iv) the restriction, in a non-reciprocal agreement, of active and/or passive sales by the licensee and/or the licensor into the exclusive territory or to the exclusive customer group reserved for the other party; *[Gs 87, 170]*

This differs from the former regulation, which allowed restrictions on active sales for the periods explained in relation to sub-paragraph (iii) at 5.4.1.4 above. For a restriction on passive sales, the period used to be only five years from the date when the product was first put on the market in the Common Market by any licensee, whether or not a patent as well as know-how was licensed. From 1 May 2004 the period has been longer than previously, unless any patent licensed had more than ten years to run.

In a non-reciprocal licence between competitors, sub-paragraph (v) permits similar restrictions on the licensee selling actively to protect another licensee of the licensor, provided that the other licensee was not a competing undertaking of the licensor at the time its licence was granted.

> (v) the restriction, in a non-reciprocal agreement, of active sales by the licensee into the exclusive territory or to the exclusive customer group allocated by the licensor to another licensee provided the latter was not a competing undertaking of the licensor at the time of the conclusion of its own licence; *[G 89]*

This provision is less important now that the definition of competing undertakings includes only those who could have competed without a licence and without infringing an ipr.

5.4.1.7 Captive Use and Second Source (Article 4(1)(c)(vi) and (vii), Gs 92–93)

Sub-paragraphs (vi) and (vii) were introduced in earlier block exemptions to enable a component maker to sell large quantities to a manufacturer of vehicles:

(vi) the obligation on the licensee to produce the contract products only for its own use provided that the licensee is not restricted in selling the contract products actively and passively as spare parts for its own products; *[Gs 92, 186–187]*

(vii) the obligation on the licensee, in a non-reciprocal agreement, to produce the contract products only for a particular customer, where the licence was granted in order to create an alternative source of supply for that customer; *[Gs 93 and 189]*

The sale of cars and vans is very sensitive to price. So, the price that can be charged by a component maker for initial equipment is normally very low. A component manufacturer, C, may sell at little more than, or even below, average variable cost to a vehicle manufacturer, V. C will be very concerned that this low price should not undermine its sales of spare parts from which it has to recoup its cost and the risk of designing the component and setting up a production line. Historically, C has sold at a low price to V and required V not to sell the component separately without a vehicle.

Such Ramsey pricing (2.1.2 above) is sensible—no one is worse off; output is increased and prices are likely to be lower. Nevertheless, the Commission has consistently been hostile to discrimination even when it does not infringe Article 82(c). V may, itself, make diesel engines for some of its models but, for others, buy in from C. In that event C and V might be potentially competing undertakings, and their agreements subject to the hardcore list of Article 4(1).

V, however, may not be prepared to buy from C unless he is ensured of alternative supplies should C cease to supply, perhaps as a result of a strike. V may require a licence to make engines using C's technology before signing the agreement to buy the components.

So, sub-paragraph (vi) exempts an obligation on V to use the products it makes under licence from C only for its own production of vehicles. V can be restrained from selling to Ci, a competitor of C's. C can prevent its competitors from taking a free ride on its investment in design and organising production. This applies whether or not the licences are reciprocal.

The Commission, however, has not gone all the way in permitting differentiation between the initial equipment and replacement markets. Sub-paragraph (vi) applies only if V is free to sell the engine as a spare part to dealers. The Commission has compromised.

Sub-paragraph (vii) is based on the same theory, but applies only if the licence is not reciprocal. V may want the engines made by another component manufacturer and sub-paragraph (vii) allows C to licence X to produce the engines and sell them only to V when the licence was granted to create an alternative source of supply for V. As there is no proviso about either V or X being free to sell the engines to dealers, non-reciprocal licences to third parties to create a second source may increase.

5.4.1.8 Restriction on Licensee Using its Own Technology (Article 4(1)(d), Gs 81, 94, 95 and157)

Both parties must be free to carry on their own R & D independently of the other, whether or not in the field covered by the licence. Article 4(1)(d) of the new regulation blacklists agreements which have as their object:

> (d) the restriction of the licensee's ability to exploit its own technology or the restriction of the ability of any of the parties to the agreement to carry out research and development, unless such latter restriction is indispensable to prevent the disclosure of the licensed know-how to third parties *[Gs 81, 94, 95, 157].*

Guideline 94 states that an obligation to pass on improvements of each other's respective technologies is not blacklisted, although it must reduce the incentive to invest in R & D and might have been thought to amount to an indirect way of limiting production or allocating markets. The Regulation does not mention this exception, but does expressly permit a provision restraining R & D when it might undermine the secrecy of know-how. Neither Regulation nor guidelines except from the blacklist a restraint on using third parties' technology to ensure that the licensed technology is used. Where the licence is exclusive, royalties might be undermined if the licensee were to use competing technology. Minimum royalty, or minimum production requirements do not infringe Article 81(1) (G 202; 6.4.1.12 below).

The licensee may not be restricted in the use of its own competing technology or making it available to third parties. It must not be charged royalties on using its own technology, unless it also uses the licensor's technology (G 95).

The Regulation is more restrictive than was Regulation 240/1996.[23] Article 2 of that Regulation contained a white list of provisions that were unlikely to infringe Article 81(1) but are exempted just in case. There is no white list in the recent group exemptions. Article 3(2) prevented the former regulation from applying where:

> one party is restricted from competing within the Common Market with the other party, with undertakings connected with the other party or with other undertakings in respect of R & D, production, use or distribution of competing products without prejudice to ...

various items in the white list of Article 2. These included a best endeavours clause (Article 2(1)(17)), a possibility of reversing the burden of showing that the licensed technology was not being used (Article 2(1)(18)), and minimum quantities and royalties (Article 2(1)(9)). It may be argued from the recitals to earlier block exemptions for the transfer of technology (now

[23] Commission Regulation 240/96 – Technology transfer, OJ 1996, L31/2, [1996] 4 CMLR 405, [1996] 4 EIPR Supp iv.

expired) that such provisions do not infringe Article 81(1). The counter argument is that now the focus is changing away from form-based legal rules to a more economic approach requiring a fuller analysis of the facts.

5.4.2 Hardcore List As Between Non Competitors (Article 4(2), Gs 96–106)

The blacklist of Article 4(1) does not apply when the parties are not competing undertakings. Article 1(1)(b) defines a technology transfer agreement to include provisions relating to the sale or purchase of products made by use of the invention (5.2.1 above). The contracts of sale or purchase by one party with third parties may come within the group exemption for vertical distribution agreements[24] but the limitations by one party to a technology licence on the other's sales or purchases are exempted, if they exist, under the TTBER. In Article 4(2), therefore, the Commission has adapted the list of hardcore restrictions from the vertical restraints regulation.

As in the regulation for vertical restraints and as in Article 4(1), the introductory words are very broad—

> agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object:...

5.4.2.1 Price Restrictions (Article 4(2)(a) and G 97)

The first forbidden item, Article 4(2)(a), is similar to that for vertical agreements:

> (a) the restriction of a party's ability to determine its prices when selling products to third parties, without prejudice to the possibility to impose a maximum sale price or recommend a sale price, provided that it does not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties.

As under Regulation 2790/99, maximum and recommended prices are permitted, provided that they do not amount to fixed or minimum prices as a result of pressure or incentives by the parties.[25] Otherwise, this provision is similar to Article 3(1) of Regulation 240/1996. Consequently, little renegotiation is likely to be required to avoid this item in the blacklist. The Commission has long been hostile to resale price maintenance even in vertical agreements, so distribution and licensing agreements seldom include them.

[24] Regulation 2790/1999 on the application of Article 81(3) of the Treaty to vertical agreements and concerted practices, OJ 1999, L336/21, [2000] 4 CMLR 398, [2000] 5 ECLR Supp.

[25] See Valentine Korah and Denis O'Sullivan, (2002) *Distribution Agreements under the EC Competition Rules* (Oxford, Hart Publishing), paras 4.2–4.2.6.

The introductory words to Article 4(2) are very broad, and the question arises whether marking prices in an advertisement amounts to a fixed or minimum price. It is thought that even if they do, the prices are not the result of pressure or incentives by the parties unless there is discrimination of some kind, or threat of it, against those undercutting them or selling on very low margins. The Commission was convinced by comments on the draft of the regulation published for comment at the time the vertical distribution block exemption was being settled that maximum prices might be pro-competitive. If the licensor enjoys market power it might avoid double marginalisation by imposing maximum prices.

The Commission is also concerned about licences, reciprocal or not, when royalties are calculated on total product sales, even when for some of them the licensed technology is not used. This raises the royalty and marginal costs of the licensee. It may, however, be justified when the protected product is not sold independently, and the royalty is based on the complete product.

5.4.2.2 Territorial Restrictions on Licensee (Article 4(2)(b), Gs 98, 99, 174 and 180)

Article 4(2)(b) blacklists:

> (b) the restriction of the territory into which, or of the customers to whom, the licensee may passively sell the contract products, except: *[Gs 98, 99, 174,180]*

This item forbids restrictions only on the licensee—the licensor may agree not to sell the protected products in any territory or to any customer group.

The licensee, however, may not be restrained from responding to unsolicited orders. Whereas in the distribution regulation all territorial restrictions binding the licensee are hardcore and only a few restrictions on active sales allowed, the technology transfer regulation lists as hardcore restrictions only those on passive sales by the licensee, up to individual market shares of 30 per cent, exempting all restraints on active sales, and some restrictions on passive sales by the licensee.

The exemption of all restrictions on active sales in licences is justified by the greater sunk costs normally incurred by a licensee (G 99) which, unlike a distributor, usually has to establish a production line as well as a market. The avoidance of hold up problems is also mentioned in G 99, but it seems to me that these are a particular example of free rider problems. 'Passive sales' are not defined in the technology transfer block exemption regulation (TTBER) or guidelines, but are widely described by the guidelines on vertical agreements[26] to include an advertisement on the internet with various

[26] OJ 2000, C291/1, Gs 50 and 51. See Valentine Korah and Denis O'Sullivan, (2002) *Distribution Agreements under the EC Competition Rules* (Oxford, Hart Publishing), para 4.3.1.

languages on which to click. The licensor may accept any restrictions on active or passive sales until one of the parties reaches the market share ceiling of 30 per cent with marginal relief under Article 8 if the market share exceeded 30 per cent within the last two calendar years.

5.4.2.2.1 Protection of exclusive territory or customer group of licensor or another licensee (Article 4(2)(b)(i) and (ii) and Gs 100 and 101) The first two exceptions to the blacklisted territorial restraints accepted by the licensee permit protection of the licensor's and other licensees' exclusive territory or customer group. Sub-paragraph (i) permits restrictions on free riders selling in an exclusive territory or customer group reserved to the licensor in order to encourage licensing and the integration of the technology into the licensee's assets (G 100). The following sub-paragraph permits similar protection for other licensees, which are likely to have substantial and risky costs (G 101):

> (i) the restriction of passive sales into an exclusive territory or to an exclusive customer group reserved for the licensor;
>
> (ii) the restriction of passive sales into an exclusive territory or to an exclusive customer group allocated by the licensor to another licensee during the first two years that this other licensee is selling the contract products in that territory.

The licensor may protect, even from passive sales, its own exclusive territory or customer group and that of another licensee for two years from the time when the licensee first put the product on the market. It can probably protect the territory of an exclusive distributor: if no licence has been granted for the territory protected, it may be reserved for the licensor. It is anomalous that a licensee can be kept out of the territory of a distributor indefinitely, but that a licensee can be protected from passive sales for only two years after it starts to market the protected products. Moreover, under the vertical restraints regulation, a dealer cannot be kept from selling even actively into the exclusive territory allocated to a licensee. In principle, the free rider argument is stronger when protecting licensees, since usually they have to set up a production line as well as develop a market. The Commission seems to assume that the holder will either license for the whole Common Market, or will produce enough itself to supply the whole. This is frequently not the case and since enlargement must have become even less common. It is arguable that such protection does not infringe Article 81(1), but it may prevent the group exemption applying to other provisions.

5.4.2.2.2 Captive sales and second source (Article 4(2)(iii) and (iv), Gs 102 and 103) The next two permitted restrictions may protect component makers who license their technology to makers of products that incorporate them:

> (iii) the obligation to produce the contract products only for its own use provided that licensee is not restricted in selling the contract products actively and passively as spare parts for its own products;

(iv) the obligation to produce the contract products only for a particular customer, where the licence was granted in order to create an alternative source of supply for that customer.

Guidelines 102 and 103 explain: a component maker, C, may want to persuade a vehicle maker, V, to buy diesel engines from C. V may fear interruptions in supply and be prepared to buy from C only if V is allowed to use C's technology to make fuel injection pumps, an important component in diesel engines. C may have to agree to this, but may want to restrain V from selling to competitors of C (compare 5.4.1.7 above).

Component makers may spend a great deal on R & D, but not be able to charge on initial equipment enough to cover those costs. Manufacturers find the demand for a vehicle or diesel engine very sensitive to price, but the demand for spare parts far less sensitive. So, component makers often charge little for initial equipment and recover their overheads mainly from replacement parts. This cannot fully be done under sub-paragraph (iii), as C may not restrict V from selling to dealers and repairers of the original equipment. The Commission has provided a compromise. If C licenses V cheaply, it can restrain it from selling to other manufacturers of fuel injection pipes but not from selling to repairers. The Commission is hostile to discrimination even when it is justifiable and customers may all be better off (2.1.2 above).

The fourth item is similar except that C may license X, a third party, to make the pumps for V to provide a second source for V. Under this provision, the licensee, but not V, can be restrained from selling even to repairers. As suggested in relation to Article 4(1)(c) above, this may encourage the reassurance of V through non-reciprocal licenses to third parties rather than licensing V.

Similar arguments for when the regulation does not apply is provided in Gs 188–190.

5.4.2.3 Separation of Wholesale and Retail Functions (Article 4(2)(b)(v), G 104)

The fifth permitted item is similar to Article 4(b), second indent, of the vertical group exemption.[27] It excepts from the block exemption a restriction on wholesalers supplying end users. This probably reflects the German view that it is unfair for a dealer to earn both a wholesale and a retail margin even if it performs both functions. There is, however, no need to take advantage of the freedom to impose the restraint unless constrained under national law.

(v) the restriction of sales to end users by a licensee operating at the wholesale level of trade; *[G 104]*

[27] Valentine Korah and Denis O'Sullivan, (2002) *Distribution Agreements under the EC Competition Rules* (Oxford, Hart Publishing), para 4.3.2.

5.4.2.4 Selective Distribution (Article 4(2)(b)(vi), G 104)

The sixth item treats the ECJ's case law on selective distribution as applying to licensing; but note that the criteria for approval do not have to be qualitative and proportionate as required by the ECJ,[28] merely 'specified'. This change was made in the group exemption for vertical distribution and is sensible. Usually there are sunk costs in meeting the criteria for approval and without quantitative criteria it might not be worthwhile for a dealer to incur them. The licensor may restrict its licensee from selling to dealers who have not been authorised. Article 4(2)(c), however, prevents a restriction on active or passive sales to end users by a licensee who also sells by retail.

> (vi) the restriction of sales to unauthorised distributors by the members of a selective distribution system; *[G 105]*

5.4.3 Where the Parties Become Competitors (Article 4(3))

Where parties were not competing at the time of the licence, the list in Article 4(2), not Article 4(1) is relevant. Article 4(3) provides that if the parties to the licence were not competing when the licence was granted but later come to be 'competing undertakings' the licence is subject to the list in Article 4(2) rather than that in Article 4(1). This provision applies only to Article 4 and not to Article 3.

> (c) the restriction of active or passive sales to end users by a licensee which is a member of a selective distribution system and which operates at the retail level, without prejudice to the possibility of prohibiting a member of the system from operating out of an unauthorised place of establishment.

The provision seems unnecessary: Article 1(1)(j) makes it clear that if the parties were not actual competitors on the technology market or actual or potential competitors on the geographic and product market without the licence, they are not 'competing undertakings' (5.3.1 above). This applies to Article 3 as well as to Article 4. Article 4(3) would have been important had the Commission not changed its mind about the definition of 'competing undertakings'. There was great haste to get the regulation and guidelines published in the OJ before May 2004, when nine further translations would have been necessary.

5.5 EXCLUDED RESTRICTIONS (ARTICLE 5, R14, GS 107–116)

Article 5 lists the restrictions that are not exempted by this Regulation, but which do not prevent the regulation applying to other provisions. These

[28] *Metro v Commission* (26/76), 25 October 1977, [1977] ECR 1875, [1978] 2 CMLR 1, CMR 8435 and many other cases on distribution.

restrictions may or may not infringe Article 81(1). If they do not, they create no problem. Article 5 is more important than the similar list of conditions in the vertical distribution regulation, because more of the provisions they exclude are likely to be caught by Article 81(1).

> 1. The exemption provided for in Article 2 shall not apply to any of the following obligations contained in technology transfer agreements: *[G 108]*

The introductory words to each item are as broad as the introductory words of Article 4(1) and (2).

5.5.1 Grantback (Article 5(1)(a) and (b), and Gs 109 and 110)

The first two items excluded from the block exemption are grantback provisions:

> (a) any direct or indirect obligation on the licensee to grant an exclusive licence to the licensor or to a third party designated by the licensor in respect of its own severable improvements to or its own new applications of the licensed technology; *[G 108–111]*

> (b) any direct or indirect obligation on the licensee to assign, in whole or in part, to the licensor or to a third party designated by the licensor, rights to its own severable improvements to or its own new applications of the licensed technology *[G 109–111]*.

Since 1972, the Commission has been concerned about strong grantback clauses. It has permitted as not contrary to Article 81(1) an obligation to feed or grantback non-exclusively when the requirement is reciprocal, but not to grantback an exclusive licence or to assign the rights (4.1.3 above). Article 5(1)(a) and (b) is concerned with exclusive grantback or assignment to the licensor of severable improvements of the licensed technology or new applications. An improvement is severable if it can be exploited without using the licensed technology (G 109). Strong grant back clauses reduce the incentive for the licensee to innovate, since they restrain it from exploiting the results through licensing. Non-exclusive grantback is, however, permitted. If the licensor grants a package licence it has no chance of obtaining a technical lead over its licensees, so cannot afford to let them gain a lead on it. There would be less licensing if grant-back obligations were not permitted.

The payment of compensation for grantback is not relevant under the Regulation, but G 110 states that its existence and level may be relevant under Article 81, as it may increase the incentive to innovate. In *Velcro SA v Aplix SA,* [29] the Commission ignored a provision for paying reasonable compensation for the grantback of improvements supported by an arbitration clause, but its views have clearly changed.

[29] (85/410/EEC), 12 July 1985, OJ 1985, L233/22, [1989] 4 CMLR 157, CMR 10719.

5.5.2 No Challenge (Article 5(1)(c), Gs 112 and 113)

The third item excluded from the regulation is:

> (c) any direct or indirect obligation on the licensee not to challenge the validity of intellectual property rights which the licensor holds in the Common Market, without prejudice to the possibility to provide for termination of the technology transfer agreement in the event that the licensee challenges the validity of one or more of the licensed intellectual property rights. *[G 112, 113]*

The Commission has long objected to no challenge clauses on the ground that they stifle innovation by the licensee (4.1.2 above). It has been hard to persuade it that without limitations on challenge, a smaller inventor cannot afford to licence a large, aggressive firm, often the only possibility of exploitation for smaller innovators. The Commission has given way to the extent of permitting the possibility of withdrawing the licence once the ipr is challenged. It may well be arguable that a no-challenge clause qualifies under Article 81(3) on the ground that it would have been risky to grant a licence without such a provision. The Commission favours a clause protecting know-how because of its fragility (G 112).

5.5.3 Restriction on licensee using its own technology (Article 5(2), Gs 114–116)

The final excluding provision is in Article 5(2). Under Article 4(1)(d) restrictions on the licensee using its own technology are blacklisted when the undertakings are competing (G 114). The Commission feels less strongly about such limitations when the parties are not competing but does not exempt them.

5.6 WITHDRAWAL OF BLOCK EXEMPTION (ARTICLE 6, RS 16 AND 17 AND GS 117–122)

The provisions for withdrawal are the same as those for the vertical distribution block exemption.[30] As envisaged in recital 16, Article 6(1) of the Technology Transfer Regulation provides that the Commission may withdraw the exemption when a technology transfer agreement has effects that do not merit exemption:

> The Commission may withdraw the benefit of this Regulation, pursuant to Article 29(1) of Regulation (EC) No 1/2003, where it finds in any particular case that a technology transfer agreement to which the exemption provided for in Article 2 applies nevertheless has effects which are incompatible with Article 81(3) of the Treaty.

[30] OJ 1999, L336/21, [2000] 4 CMLR 398, [2000] ECLR Supp to May issue.

Recital 17 notes that Regulation 1/2003 also empowers national competition authorities to withdraw the benefit of the block exemption from technology transfer agreements which have effects contrary to Article 81(3) where they are felt within their respective territory, or part of it, provided that the territory has the characteristics of a distinct geographic market. Member States must ensure that the exercise of this power does not prejudice the uniform application throughout the Common Market of the competition rules, or the full effect of measures adopted in implementing them.

Article 6(2) implements recital 17:

> 2. Where, in any particular case, a technology transfer agreement to which the exemption provided for in Article 2 applies has effects which are incompatible with Article 81(3) of the Treaty in the territory of a Member States, or in a part thereof, which has all the characteristics of a distinct geographic market, the competition authority of that Member state may withdraw the benefit of this Regulation, pursuant to Article 29(2) of Regulation (EC) No1/2003, in respect of that territory, under the same circumstances as those set out in paragraph 1 of this Article.

The four conditions of Article 81(3) are cumulative, so the authority needs to show that only one of them is not satisfied (G 118). The burden of proof is on the authority (G 119). Guideline 119 states that withdrawal implies that the agreement infringes Article 81(1) and does not merit exemption, so must be accompanied by a negative decision based on Articles 5, 7 or 9 of Regulation 1/2003.[31]

Articles 6(1)(a)–(c) and Gs 120 and 121 provide examples of circumstances where the block exemption may be withdrawn. Most are concerned about foreclosure due to cumulative effects. This is also a ground for disapplying the TTBER by Regulation (5.7 below). In judging foreclosure, it is important that the Commission will now look *ex ante*. It will consider whether the agreement or restriction would have restricted competition that would have arisen in the absence of a licence (5.3.1 above).[32] Article 6(1) and the Gs exemplify circumstances in which the authority might choose to withdraw the exemption. It is not bound to do so. Guideline 120 and parts of 121 are drafted neutrally to apply to both the Commission and an NCA. The last sentence of G 121 refers to ‘the Commission, but it is thought that NCAs are likely to follow it with the aim of consistency throughout the Common Market.

Article 6 does not imply a duty to avoid these situations, but if one of them should arise the authority may withdraw the group exemption. The parties have the choice. They may create the situation and risk losing the benefit of the regulation. The burden of proof is on the authority (G 119). The situations are where:

[31] OJ 2003, 1/1, [2003] 4 CMLR 551.

[32] The Commission is more likely to look *ex ante* when conducting competitive assessment under Art 81(1), and this is confirmed in the Commission’s notice on the application of Art 81(3), OJ 2004, C 101/97, [2004] 4 CMLR 1739.

(a) access of third parties' technologies to the market is restricted, for instance by the cumulative effect of parallel networks of similar restrictive agreements prohibiting licensees from using third parties technologies;

(b) access of potential licensees to the market is restricted, for instance by the cumulative effect of parallel networks of similar restrictive agreements preventing licensors from licensing to other licensees;

(c) without any objectively valid reason the parties refrain from exploiting the licensed technology.

Guideline 121 explains that

> 'Articles 4 and 5 of the TTBER, containing the list of hardcore restrictions of competition and excluded restrictions, aim at ensuring that block exempted agreements do not reduce the incentive to innovate, do not delay the dissemination of technology, and do not unduly restrict competition between the licensor and licensee or between licensees. However, the list of hardcore restrictions and the list of excluded restrictions do not take into account all the possible impacts of licence agreements.
>
> In particular, the block exemption does not take account of any cumulative effect of similar restrictions contained in networks of licence agreements. Licence agreements may lead to foreclosure of third parties both at the level of the licensor and at the level of the licensee. Foreclosure of other licensors may stem from the cumulative effect of networks of licence agreements prohibiting the licensees from exploiting competing technologies, leading to the exclusion of other (potential) licensors. Foreclosure of licensors is likely to arise in cases where most of the undertakings on the market that could (efficiently) take a competing licence are prevented from doing so as a consequence of restrictive agreements and where potential licensees face relatively high barriers to entry.
>
> Foreclosure of other licensees may stem from the cumulative effect of licence agreements prohibiting licensors from licensing other licensees and thereby preventing potential licensees from gaining access to the necessary technology. The issue of foreclosure is examined in more detail in Gs 196–203.
>
> In addition, the Commission is likely to withdraw the benefit of the block exemption where a significant number of licensors of competing technologies in individual agreements impose on their licensees to extend to them more favourable conditions agreed with other licensors.' [I have divided this paragraph into 3 for ease of comprehension.]

The Commission accepts (G 94) that it may be necessary to restrain a licensee carrying out R & D with a third party in order to preserve the confidentiality of know-how but does not mention that a holder of technology may be concerned that its licensees should exploit its technology, especially if it has granted each an exclusive territory, customer group or field of use. Since these situations are only examples of where the Commission or an NCA may withdraw the benefit of the exemption, there will be a chance to argue that the restraint was necessary if licensing was to take place.

The third example of a cause for withdrawal is a failure to exploit the technology without an objective justification. Guideline 122 states:

> G 122. The Commission is also likely to withdraw the benefit of the block exemption when the parties refrain from exploiting the licensed technology, unless they have an objective justification for doing so. Indeed, when the parties do not exploit the licensed technology, no efficiency enhancing activity takes place, in which case the very rationale of the block exemption disappears. However, exploitation does not need to take the form of an integration of assets. Exploitation also occurs where the licence creates design freedom for the licensee by allowing him to exploit his own technology without facing the risk of infringement claims by the licensor.[33] In the case of licensing between competitors, the fact that the parties do not exploit the licensed technology may be an indication that the arrangement is a disguised cartel. For these reasons the Commission will examine very closely cases of non-exploitation.

I am happy about the first half of this paragraph but, in my view, there may be good reasons for not exploiting. Suppose the licensor tackles a particular technological problem by both routes A and B. After a licence under both technologies is granted, the parties decide that route A is or may be marginally the better. Neither exploits route B, which is the subject of a licence granted before the choice between technologies was made. The possible loss of the safe harbour of the group exemption unless the B technology be exploited might be a disincentive to developing both solutions at the same time. So, it is hoped that the authority would not withdraw the exemption in such a situation. The Guidelines do not address the question of how much exploitation is required to induce an authority to withdraw the regulation. Is the production of a prototype sufficient? This is another example of the Commission still thinking *ex post*.

5.7 WITHDRAWAL OF BLOCK EXEMPTION BY REGULATION (ARTICLE 7, R 18 AND GS 34, 123–129)

By virtue of Article 7, where parallel networks of similar technology transfer agreements cover more than half of the relevant market, the Commission may, by regulation, declare that the regulation is not to apply to technology transfer agreements containing specified restraints relating to that market. Such a regulation cannot become applicable earlier than six months after its adoption.

This provision reverses the anomaly created by the judgment of the court of first instance (CFI) in *Langnese-Iglo GmbH & Co KG v Commission*.[34] The Commission had withdrawn the benefit of a block exemption from a standard contract used by Langnese when selling to small retailers, but the

[33] As for the design freedom created by licensing, see also note 57 at 6.4.2.3 below.
[34] (T-7/93), 8 June 1995, [1995] ECR II-1533, [1995] 5 CMLR 602, [1995] 2 CEC 217.

CFI held that there was nothing to prevent Langnese from continuing to take advantage of the block exemption for new contracts. Such a situation can now be avoided by the Commission (but not by an NCA) withdrawing the benefit of the exemption from similar provisions. Guideline 123 observes that a regulation adopted by virtue of Article 7 is addressed not to individuals but to all undertakings whose agreements come within the definition.

G 124 states that such a regulation merely reinstates the full rigour of Article 81. The block exemption no longer applies. To see whether Article 81 applies, look to the relevant case law and to the Commission's Guidelines on the effect of trade concept contained in Articles 81 and 82 of the Treaty,[35] and its Guidelines on the Application of Article 81(3).[36] The latter are particularly helpful. The Commission is not bound to adopt such a regulation when half the market is foreclosed – it enjoys discretion (G 126). Such a regulation must be clear.

G 127 states that:

> 127. Any regulation adopted under Article 7 must clearly set out its scope. This means, first, that the Commission must define the relevant product and geographic market(s) and, secondly, that it must identify the type of licensing restraint in respect of which the TTBER will no longer apply. As regards the latter aspect, the Commission may modulate the scope of its regulation according to the competition concern, which it intends to address. For instance, while all parallel networks of non-compete arrangements will be taken into account for the purpose of establishing the 50 per cent market coverage ratio, the Commission may nevertheless restrict the scope of the disapplication regulation only to non-compete obligations exceeding a certain duration. Thus, agreements of a shorter duration or of a less restrictive nature might be left unaffected, due to the lesser degree of foreclosure attributable to such restraints. Where appropriate, the Commission may also provide guidance by specifying the market share level, which, in the specific market context, may be regarded as insufficient to bring about a significant contribution by an individual undertaking to the cumulative effect. In general, when the market share of the products incorporating a technology licensed by an individual licensor does not exceed 5 per cent, the agreement or network of agreements covering that technology is not considered to contribute significantly to a cumulative foreclosure effect. [I have divided a single paragraph for ease of comprehension.]

The block exemption will continue to apply until a regulation adopted under Article 7 comes into force (G 129).

5.8 TRANSITIONAL PROVISIONS

The transitional period is very short—under two years for those agreements made before 1 May 2004 and which qualified under Regulation 240/1996, nothing for agreements made after April. Some undertakings negotiate

[35] OJ 2004, C101/81, [2004] 4 CMLR 1710.
[36] OJ 2004, C101/ 97, [2004] 4 CMLR 1739.

thousands of licences every year and the period is not very long for agreements expected to be exempt for another two years and probably to be extended by any new TTBER. The old licences may require significant renegotiation as important terms will need to be changed. Sometimes the bargaining position of the parties may have changed, making renegotiation complex and unfair. If the market shares are exceeded there may be nothing to be done. The Regulation became public only on 7 April 2004. Three weeks for lawyers to become familiar with it and for businessmen to negotiate within its terms is disgracefully short. Although it was clear that ceilings of market share would be introduced for months before, many changes were made to the draft published for consultation. Many licences granted by companies with important market shares will cease to be exempt. Lawyers and businessmen in the accession countries may be even more taxed. Their licences may not have been designed to qualify under Regulation 240/1996. The only help they get under the Accession Agreement is six months to renegotiate agreements to come within a group exemption. The Commission was determined to adopt the Regulation and Guidelines before the accession of ten more Member States in order to avoid nine extra translations for the OJ. (There is a great shortage of translators.)

5.9 CONCLUSION

The version of the TTBER published for comment was so much narrower than the US guidelines on technology licensing (9.1 below) that there was substantial fear that R & D in Europe would be chilled.[37] Even if Article 81 is not infringed, important iprs may lead to a dominant position and the duty to supply or license its competitors under Article 82 (chapter 8 below). The final version has the same structure as the block exemption for vertical distribution agreements, but the new definition of 'competing undertakings' in *ex ante* terms results in the higher ceiling of market share applying to most licences, and the heavy blacklist of Article 4(1) not applying. This is an important improvement and has been extended generally in the notice on Article 81(3).[38] Under the earlier draft, once both parties were producing the protected product, they would have been treated as competitors. It is hoped that the Commission's conversion to reasoning *ex ante* will apply also to Article 82, but it is too early to say. The Commission is preparing draft guidelines on Article 82 to go out for consultation at the end of 2005.

The ceilings of market share are very low. Where R & D is expensive in relation to the variable cost of production and distribution, markets tend to be concentrated. There may be no one to whom a licence can be granted to come below the ceilings. Indeed the holder of the ipr may exceed the ceiling on its own.

[37] Valentine Korah, 'Draft Block Exemption for Technology Transfer' [2004] 25 ECLR 247.
[38] OJ 2004, C101/97, [2004] 4 CMLR 1739; G 17.

The Commission uses the Guidelines to amplify the Regulation. Will NCAs and courts follow the Guidelines when they go further than the Regulation, such as applying the principles of the Regulation and Guidelines to traditional copyright (3.4 above)?

No challenge clauses are very important if a small licensor faces a larger licensee who is financially more capable of managing patent litigation. Merely to terminate the licence and put the licensee at risk for litigation, which the licensor could not afford, may not be sufficient protection.

There have been many notable improvements since the draft published for comment, but I still fear the migration of some R & D from Europe with the loss of high quality jobs. Holders of iprs should consider the possibility of operating outside the EC.

6

Recitals and Guidelines Not Limited to Agreements Exempted by the TTBER

6.1 STATUS OF RECITALS, GUIDELINES AND OTHER KINDS OF 'SOFT LAW'

THE EXTENT TO which the recitals and guidelines are likely to be followed by competition authorities and courts was considered at 3.3 and 3.4 above.

6.2 COMMISSION'S CURRENT GENERAL APPROACH TO TECHNOLOGY TRANSFER

The original draft of the guidelines was very much stricter than the US guidelines adopted in 1995.[1] Many observed that this might chill R & D in Europe.[2] Innovators might be advised to perform the research and development in the US or round the Pacific rim, grant a licence to manufacture outside Europe and market the products there and in Europe. Such a strategy would also avoid many of the difficulties under Article 82 (chapter 8 below*),* which has been applied far more strictly than section 2 of the Sherman Act. Under EC law there is considerable concern that a holder of an important intellectual property right (ipr) may be required to license it in circumstances where it would not be covered by American antitrust law (chapter 8 below). The stricter and less flexible EC competition rules would then apply only to the marketing end of the operation.

The drafts actually adopted have been substantially softened, but considerable concern still exists. As each guideline is described, therefore, differences from the US position will be noted and the most important differences summarised in chapter 9 below.

6.2.1 More Economic Approach

Recital 4 states that the limitations imposed by Articles 3–5 of the technology transfer block exemption regulation (TTBER) are:

> consistent with an economics based approach which assesses the impact of agreements on the relevant market. It is also consistent with such an approach to make a distinction between agreements between competitors and agreements between non-competitors.

6.2.2 Possible Pro-Competitive Effects of Technology Transfer–Consumer Welfare

Recital 5 mentions some pro-competitive effects of technology licensing:

> Such agreements will usually improve economic efficiency and be pro-competitive as they can reduce duplication of research and development, strengthen the incentive for the initial research and development, spur incremental innovation, facilitate diffusion and generate product market competition.

[1] Antitrust Guidelines for the Licensing of Intellectual Property, 6 April 1995, (1995) 68 ATRR 462, CCH TRR 13,132, [1995] 7 EIPR 3.

[2] Eg, Valentine Korah, 'Draft Block Exemption For Technology Transfer,' [2004] 25 ECLR 247 and the submissions of the ABA to the Commission.

These words are general and not limited to the technology transfer agreements exempted by the regulation. It refers not only to the incentive to license, but also to the incentive to invest in the initial R & D (contrast the discussion of the guidelines on sales restrictions supporting exclusive territories at 6.4.1.5 below). That they focus on consumer welfare rather than on protecting competitors is very welcome. It follows a statement relating to Article 82 by A-G Jacobs in *Oscar Bronner GmbH & Co KG v Mediaprint Seitungs- und Zeitschriftenverlag GmbH & Co KG and others*:[3]

> In assessing this issue it is important not to lose sight of the fact that the primary purpose of Article 82 is to prevent distortion of competition—and in particular to safeguard the interests of consumers—rather than to protect the position of particular competitors.

It is in marked contrast to the earlier and more formalistic views of the Commission (4.1.1 above), but confirmed as of general application by the Commission's Guidelines on the Application of Article 81(3):[4]

> 13. The objective of Article 81 is to protect competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources. Competition and market integration serve these ends since the creation and preservation of an open single market promotes an effective allocation of resources throughout the Community for the benefit of consumers.

Guideline 17 on technology transfer lists the ways in which licensing can increase competition: it may enable innovators to earn returns to cover at least part of the costs for R & D; it may lead to the dissemination of technologies and reduce the production costs of the licensee.[5] Guideline 8 explains the importance of incentives to innovation if the Common Market is to be dynamic. I shall divide the paragraph into six for ease of reference:

> 8. In the assessment of licence agreements under Article 81 it must be kept in mind that the creation of intellectual property rights often entails substantial investment and that it is often a risky endeavour.
>
> In order not to reduce dynamic competition and to maintain the incentive to innovate, the innovator must not be unduly restricted in the exploitation of intellectual property rights that turn out to be valuable.
>
> For these reasons the innovator should normally be free to seek compensation for successful projects that is sufficient to maintain investment incentives, taking failed projects into account.

[3] (C-7/97), 26 November 1998, [1998] ECR I-7817, [1999] 4 CMLR 112, [1999] CEC 53, para 58; 8.1.4 below. See also A-G Fennelly in *Compagnie Maritime Belge Transports SA v Commission* (C-395/96 P), 16 March 2000, [2000] ECR I-1365, [2000] 4 CMLR 1076, paras 132 and 136.

[4] OJ 2004, C 101/97, [2004] 4 CMLR 1739; G 13, Appendix 5 below.

[5] Licensing may also provide for firms to develop their technologies respectively, see note 57 at 6.4.3 below.

> Technology licensing may also require the licensee to make significant sunk investments in the licensed technology and production assets necessary to exploit it. Article 81 cannot be applied without considering such *ex ante* investments made by the parties and the risks relating thereto.
>
> The risk facing the parties and the sunk investment that must be committed may thus lead to the agreement falling outside Article 81(1) or fulfilling the conditions of Article 81(3), as the case may be, for the period of time required to recoup the investment.

Most economists reject the principle of consumer welfare in favour of that of total welfare. Benefits to the parties should be included in any balancing exercise, but it seems that both in Europe and the US, the Agencies prefer the objective of consumer welfare, although this makes the assessment of buying power difficult. Almost all economists agree in preferring total or consumer welfare over the benefit of competitors. Judge Easterbrook goes so far as to suggest that if competitors complain about conduct it is almost certainly efficient![6]

> When a business rival brings suit, it is often safe to infer that the arrangement is beneficial to consumers.

6.2.3 Possible Anti-Competitive Effects of Licensing – Restrictions by Object or Effect

Guidelines 13–15 invoke the distinction between restrictions by object and by effect above. See the first footnote to 5.4 above. Whether there is a restriction by object may depend on how the agreement is implemented as much as on its terms. It does not depend on the subjective intention of the parties. A convenient rule of thumb, encouraged by G 14, is that provisions blacklisted in a block exemption are likely to amount to restrictions by object, be treated as contrary to Article 81(1) and unlikely to qualify under Article 81(3), although the ECJ has so far treated only export bans or deterrents, direct or indirect price fixing or limitations of supply.

For an agreement to restrict by effect, G 15 states that it:

> must affect actual or potential competition to such an extent that on the relevant market negative effects on prices, output, innovation or the variety or quality of goods and services can be expected with a reasonable degree of probability.

Guideline 15 continues:

> market power is the ability to maintain prices above competitive levels or to maintain output in terms of product quantities, product quality and variety or innovation below competitive levels for a non-insignificant period of time.

[6] Frank H Easterbrook 'The Limits of Antitrust' (1984) 63 *Texas Law Review* 1, at pp 18 and 33–39.

Unfortunately it is seldom possible to tell how much would have been produced or at what price if the market had been more competitive. So, this is not very helpful. Nevertheless, it indicates that the question is an empirical one and that the answer requires economic appraisal of the relevant market.

6.2.4 Balancing Pro- and Anti-Competitive Effects Under Article 81(3)

Recital 6 requires balancing any of the beneficial effects mentioned in recital 5 and G 8 (6.2.2 above) against any anti-competitive effects of the licence under Article 81(3). To qualify under Article 81(3), the beneficial effects must be shown to outweigh the restriction of competition:

> 6. The likelihood that such efficiency enhancing and pro-competitive effects will outweigh any anti-competitive effects due to restrictions contained in technology transfer agreements depends on the degree of market power of the undertakings concerned and, therefore, on the extent to which those undertakings face competition from undertakings owning substitute technologies or undertakings producing substitute products.

Guideline 7 adds that there is no inherent conflict between intellectual property rights and competition, as do the US guidelines.[7]

In balancing the pro- and anti-competitive effects of a licence, Gs 18 and 146 state that the beneficial and anti-competitive effect should be balanced under Article 81(3). Consequently, the burden of proof is on those who claim that the licence does not infringe.[8] This is very important. In the US, where the burden under the rule of reason rests on the person alleging illegality, few persons harmed by an infringement win or even bring actions, unless the infringement amounts to price fixing or the limitation of output.[9]

The ECJ has repeatedly insisted that ancillary restraints necessary to make viable a transaction not, in itself, anti-competitive are not anti-competitive and do not infringe Article 81.[10] The Commission, however, adopted a

[7] Antitrust Guidelines for the Licensing of Intellectual Property, 6 April 1995, (1995) 68 ATRR 462, CCH TRR 13,132, [1995] 7 EIPR 3, at point 1.0.

[8] Regulation 1/2003, OJ 2003, L1/1, [2003] 4 CMLR 551, Art 2.

[9] There is no sharp distinction between *per se* illegality and rule of reason analysis in the US these days. There is a continuum: restrictions on price and output are likely to be held illegal and may be condemned without proof of actual harm to consumers. Considerable evidence of consumer harm will be needed to show that vertical agreements between firms that could not have competed without the agreement infringe section 1. *Polygram Holdings Inc v Federal Trade Commission* 416 F 3d (CA, DC, 2005) is the most recent, well-written judgment on the rule of reason.

[10] *Nungesser (LG) KG and Kurt Eisele v Commission* (258/78), 8 June 1982, [1982] ECR 2015, [1983] 1 CMLR 278, CMR 8805, paras 56–58 or *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgalis* (161/84), 29 January 1986, [1986] ECR 353, [1986] 1 CMLR 414, CMR 14245, paras 15–22.

narrow view of such ancillary restraints in the early years. It did so in order to keep control over competition policy and harmonise the rules at a time when the competition policy of Germany and France, the only two Member States with a competition policy, were diametrically opposed. The Commission's powers were broader if any restriction on conduct that was important on the market infringed Article 81(1) and only it had power to apply Article 81(3). This narrow view of ancillary restraints was confirmed by the court of first instance (CFI) in *Métropole Télévision (M6) and Others v Commission III*.[11] To escape Article 81(1) the infringement must be necessary and directly linked to the main transaction.

Now that all the bodies that apply Article 81(1) have power to apply Article 81(3), the distinction between Article 81(1) and (3) has become far less important, but the burden of proof differs. It will be interesting to see whether the CFI and ECJ will continue to apply the concept of ancillary restraints narrowly now that the 15 existing judges in each court have been joined by ten more from Eastern and Southern Europe. On my last visit to the courts, I was delighted to find how many of the judges from the new Member States are familiar with economic theory, and to find that others were already interested and had selected legal secretaries who were familiar with economic concepts as well as with competition policy.

As is stated in recital 12, Gs 9, 37, 65 and 130 add that there is no presumption that licences outside the block exemption, possibly because the ceilings of market share are exceeded, infringe Article 81(1).

6.2.5 Attitude to Horizontal Relationships Stricter than Vertical

Guideline 26 states that:

> In general, agreements between competitors pose a greater risk to competition than agreements between non-competitors. However competition between undertakings that use the same technology (intra-technology competition between licensees) constitutes an important complement to competition between undertakings that use competing technologies (inter-technology competition). For instance, intra-technology competition may lead to lower prices for the products incorporating the technology in question, which may not only produce direct and immediate benefits for consumers of these products, but also spur further competition between undertakings that use competing technologies. In the context of licensing it must also be taken into account that licensees are selling their own product. They are not reselling a product supplied by another undertaking. There may thus be greater scope for product differentiation and quality-based competition between licensees than in the case of vertical agreements for the resale of products.

[11] (T-112/99), 18 September 2001, [2002] ECR II-2459, [2001] 5 CMLR 1236. The judgment may have been overruled by the judgment of the ECJ in *Wouters, Savelbergh and Price Waterhouse v Algemene Raad Van de Nederlandse Orde van Advocaten* (C-309/99), 19 February 2002, [2002] ECR I-1577, [2002] 4 CMLR 913, [2002] CEC 250.

The US guidelines at section 3.3, based on judgments of the Supreme Court and other courts since *Sylvania—Continental TV, Inc v GTE Sylvania Inc*,[12] treat vertical restrictions more favourably than horizontal. They are less likely than horizontal arrangements to be entered into to raise prices by restricting production, since each party has an interest in the other operating at the minimum margin.[13] There are many situations where it will not be possible to persuade anyone to take a licence unless both parties can be protected from free riders. Vertical agreements are subject to a rule of reason, under which it is for the person alleging illegality to establish it. The courts or agencies will seldom attack a provision that increases inter-brand competition merely because it restricts intra-brand competition.

For many years, the European Commission was more concerned by vertical restrictions, which it perceived as dividing the Common Market along national boundaries. US antitrust law has never been so concerned about market integration. So, it was easier to favour vertical agreements. Even so, it was nearly a century before this principle favouring vertical agreements was accepted by the Supreme Court in *Sylvania*.[14] In G 26 the European Commission still stresses the importance of intra-technology competition and requires the efficiencies to be balanced with the anti-competitive effects only under Article 81(3) where the burden of proof is on the person alleging legality. Under the US rule of reason, it is very difficult to show an adverse balance. It is feared that it may be equally difficult to show a favourable one under the EC rules.

6.2.5.1 Relationship Vertical if Unlikely to Compete in the Absence of a Licence

Both the US guidelines and Gs 11 and 12 (EC) treat as actual or potential competitors only those likely to compete in the absence of a licence. The US Guidelines say:

> **3.3 Horizontal and vertical relationships**
> As with other property transfers, antitrust analysis of intellectual property licensing arrangements examines whether the relationship among the parties to the arrangement is primarily horizontal or vertical in nature, or whether it has substantial aspects of both. A licensing arrangement has a vertical component when it affects activities that are in a complementary relationship, as is typically the case in a licensing agreement....
>
> In addition to this vertical component, the licensor and its licensees may also have a horizontal relationship. For analytical purposes, the Agencies ordinarily will

[12] 433 US 36, 53 L Ed 2d 568 (1977).
[13] The post Chicago view is that a supplier or licensor may want to attract marginal buyers downstream and protect its licensee or dealer to provide more pre-sales services than average consumers want to pay for.
[14] *Continental TV, Inc v GTE Sylvania Inc* 433 US 36, 53 L Ed 2d 568(1977).

> treat a relationship between licensor and its licensees, or between licensees, as horizontal when they would have been actual or likely potential competitors in the relevant market *in the absence of the licence*. [my italics]

Examples 5 and 6 in the US guidelines show that the agencies look to see whether the relationship is purely vertical or whether there is also a horizontal relationship upstream—whether the licensee could reasonably have been expected to compete with the licensor if it were not licensed. If the patentee has a broad patent for an important innovation it probably could not and the relationship is vertical.

Example 1 at the end of section 2.3 of the US guidelines[15] takes the same view. The issue is whether a limited territorial licence with field of use restrictions forecloses competition that would have arisen without the licence: does it facilitate the allocation of markets or price fixing between the licensees? There are no such provisions in the example, which merely divided the intellectual property right (ipr) between licensees. So, the agencies would be unlikely to object.

In Europe, Gs 11 and 12 take a similar view. They extend what is provided for in Article 1(1)(j) (5.3.1 above). In deciding whether the parties to a licence are competing undertakings and the agreement subject to stricter scrutiny, one should compare the situation with the licence and its restrictions with the position that would have developed without them. They extend what the regulation provides for the purpose of the regulation to the application of Article 81(1) to agreements outside the terms of the regulation.

This is confirmed generally, not only in relation to technology transfers, but also in relation to Article 81(1) by the Commission's guidelines on Article 81(3).[16] This is one of the most important developments of appreciation in 2004. Most technology licences are granted to firms that could not compete without the licence, either because they have not operated in that market before, or because the licensed technology is superior to the traditional technology being used before the licence was granted. Those licences will be treated as vertical under Article 81(1) and (3) as well as under Articles 3 and 4 of the TTBER.

6.2.5.2 If Licensee has Alternative Technology it is not Licensing, the Parties are not Competitors in the Technology Market for the Purpose of Article 3

In Article 3(3) (5.3.1 above), alternative technology held but not yet licensed by a licensee is treated as not competing with the licensor's technology in the technology market for the purposes of Article 3 (ceilings of market share).

[15] Antitrust Guidelines for the Licensing of Intellectual Property, 6 April 1995, (1995) 68 ATRR 462, CCH TRR 13,132, [1995] 7 EIPR 3 at 3.

[16] OJ 2004, C 101/97, [1004] 4 CMLR 1739; Gs 17 and 18, Appendix 5 below.

Potential competition is not relevant in defining the technology market when applying Article 3. If the licensee subsequently develops alternative technology which it uses to produce products it sells, it would not make the parties competitors for the purposes of Article 3 (G 66). When applying Article 81, however, the parties may be treated as competitors if the licensee's technology remains as effective as the licensor's. Guideline 66, however, treats the policy implemented under Article 3(3) as applying also to the black lists of Article 4.

An exclusive licence to a firm already producing for the product market downstream that owns strong competing technology is capable of restricting competition significantly by excluding the licensee's technology from the market, which would restrict competition if the licensee were important on the product market. The licensee might agree to give up its own technology in order to induce the licensor not to enter the product market or not to license someone else. Such a transaction could be a sham, concealing a cartel and had to be excluded from the group exemption.

An exclusive territory for the licensee may make it more difficult for other firms to compete with it.[17]

6.2.6 Commission Concerned about Dividing Market Power between Licensor and its Licensees

Guideline 15 states:

> Appreciable competitive effects are likely to occur when at least one of the parties has or obtains some degree of market power and the agreement contributes to the creation, maintenance or strengthening of that market power or allows the parties to exploit it.

Where market power is derived from an ipr and is the subject of territorial or field of use restrictions, the licensee may gain market power, but the total market power of licensor and licensees together is not increased. It is thought that the transfer does not contribute to the creation of the market power, but it may contribute to its maintenance or strengthening and enable the licensee to exploit it. I hope that this literal interpretation is not adopted. This view would differ from the US guidelines. Section 3.1 of the US guidelines says that:

> The Agencies will not require the owner of intellectual property to create competition in its own technology.

Only the addition to market power and not its division between licensees infringes. Example 1 at the end of section 2.3 of the US guidelines concerns

[17] *Tetra Pak Rausing SA v Commission* (T-51/89), 10 July 1990, [1990] ECR II-309, [1991] 4 CMLR 334, [1990] 2 CEC 409.

a limited territorial licence with field of use restrictions. The Agencies investigate to see if it forecloses competition that would have arisen without the licence, or whether it facilitates the allocation of markets or price fixing between the licensees. There are no such provisions in the example, which merely divides the ipr between licensees. So, the Agencies are unlikely to object.

The European position is similar to the extent that field of use restrictions are not blacklisted, and a rule of reason analysis is required. Nevertheless, contrary to the US rule of reason, the burden of proof under Article 81(3) is on the person alleging legality. The difference is often decisive. The standard of proof remains to be developed in most jurisdictions. Moreover, some territorial restrictions are treated as hardcore. The European Commission and courts have always been more concerned than the US Agencies about territorial restraints, which they perceive as contrary to a common market.

6.3 GUIDELINES DEALING MAINLY WITH AGREEMENTS OUTSIDE THE REGULATION

6.3.1 No Presumption that Agreements Outside the TTBER Infringe Article 81

The Commission has confirmed that there is no presumption that technology transfer agreements that fall outside the TTBER infringe Article 81(1), provided that there are no hardcore restrictions:

> 130.... there is no presumption that Article 81 applies merely because the market share (ceilings) are exceeded. Individual assessment based on the principles described in these guidelines is required...
>
> 131.... outside the area of hardcore restrictions Article 81 is unlikely to be infringed where there are four or more independently controlled technologies in addition to the technologies controlled by the parties to the agreement that may be substitutable for the licensed technology at a comparable cost to the user....

provided that the substitutes are a commercially viable alternative that constrains the conduct of the parties to the agreement. They may not be if network effects favour the licensed technology (8.1.9.1.1 below).

6.3.2 Market Power

Guideline 132 lists the most important factors relevant when appraising the way in which competition operates on the market in question. They are mostly identical to G 121 of the notice on vertical restraints:[18]

[18] OJ 2000, C291/1, [2000] 5 CMLR 1074.

(a) the nature of the agreement;
(b) the market position of the parties;
(c) the market position of competitors;
(d) the market position of buyers of the licensed products;
(e) entry barriers;
(f) maturity of the market; and
(g) other factors.

The relative strength of these factors will vary from case to case. For instance, a high market share would not be important if entry barriers are low. The nature of the agreement does not depend solely on its terms, if it is differently implemented. What matters is the relationship between the parties and the constraints imposed by the agreement (G 133).

6.3.2.1 Market Shares of Parties and their Cost Advantages

The market shares of the parties provide an indication of the extent of their market power. Guideline 134 states that:

> The higher their market share the greater their market power is likely to be. This is particularly so where the market share reflects cost advantages or other competitive advantages *vis-à-vis* competitors. These competitive advantages may for instance result from being a first mover in the market, from holding essential patents or from having superior technology.

Ever since *Hoffmann-La Roche & Co AG v Commission*,[19] the ECJ and Commission have stressed the importance of market shares when assessing market power, but only if they are likely to endure: in other words, when entry barriers are high and will keep out competitors who might otherwise constrain the market performance of the incumbent.

6.3.2.2 Barriers to Entry

As the Commission says at G 132, where barriers to entry are low, market shares are less relevant. Guideline 138 explains:

> 138. Entry barriers are measured by the extent to which incumbent companies can increase their price above the competitive level without attracting entry. In the absence of entry barriers, easy and quick entry would render price increases unprofitable. When effective entry, preventing or eroding the exercise of market power, is likely to occur within one or two years, entry barriers can, as a general rule, be said to be low.
>
> Entry barriers may result from a wide variety of factors such as economies of scale and scope, government regulations, especially where they establish exclusive rights, state aid, import tariffs, intellectual property rights, ownership of resources

[19] (85/76), 13 February 1979, [1979] ECR 461, [1979] 3 CMLR 211, CMR 8527, paras 40 and 41.

> where the supply is limited due to for instance natural limitations, essential facilities, a first mover advantage or brand loyalty of consumers created by strong advertising over a period of time. Restrictive agreements entered into by undertakings may also work as an entry barrier by making access more difficult and foreclosing (potential) competitors.
>
> Entry barriers may be present at all stages of the research and development, production and distribution processes. The question whether certain of these factors should be described as entry barriers depends particularly on whether they entail sunk costs. Sunk costs are those costs which have to be incurred to enter or be active on a market but which are lost when the market is exited. The more costs are sunk, the more potential entrants have to weigh the risks of entering the market and the more credibly incumbents can threaten that they will match new competition, as sunk costs make it costly for incumbents to leave the market. In general, entry requires sunk costs, sometimes minor and sometimes major. Therefore, actual competition is in general more effective and will weigh more heavily in the assessment of a case than potential competition. [I have divided a single paragraph for ease of comprehension.]

Conditions of entry are as important as substitutes on the demand side of the market, if they operate as fast. The first paragraph states that they are low if a 5 per cent or 10 per cent increase in relative price is likely to attract entry within a year or two. The period mentioned is the test of substitutes on the demand side of the market in the notice on market definition.[20] A year or two is not very long. Sometimes entry requires the erection of new production facilities with specific features which have to be built and planning permission may take years. So, many markets may be treated as being subject to high entry barriers even when potential competition in more than two years may already constrain the performance of the incumbent. A price increase of 5 per cent or 10 per cent is not very large, and in many technically advanced markets competition in quality or adding new functions is likely to be far more important than small price increases. The hypothetical monopoly test may work better in mature markets for standard goods.

The second paragraph lists some possible entry barriers. Whether economies of scale, even up to a large part of the demand, keep out equally efficient firms is controversial. Virtually all economists agree that a favoured position due to government licensing etc amounts to a barrier to entry. The items at the end of the list are more controversial: they may keep out only a less efficient firm. This, however, reflects the case law under Article 82.[21]

The third paragraph is important and reflects the more economic approach followed by the Commission since it adopted its guidelines on vertical agreements.[22] If an investment has little alternative use, economists

[20] Notice on the definition of the relevant market for the purposes of Community competition law, OJ 1997, C372/5, [1998] 4 CMLR 177, para 15.

[21] Eg, *Vitamins-Hoffmann-La Roche & Co AG v Commission* (85/76), 13 February 1979, [1979] ECR 461, [1979] 3 CMLR 211, CMR 8527, paras 41–48.

say it is 'sunk'. Such investments are risky because, if the activity for which they were made is not profitable, most of their value will be lost. Moreover, those dealing with the firm that made them may be able to 'hold up' the investor, by refusing to deal on terms that would enable the investor to cover its average total costs. This is a very important concept, accepted also in the guidelines for vertical distribution agreements, and provides a free rider justification for many kinds of conduct.

6.3.2.3 Maturity of the Market

Guideline 139 states that restrictions of competition are likely to have more negative effects in mature markets where the technology is developed and widespread and demand is relatively stable or declining.

6.3.2.4 Cumulative Effects

As explained by the ECJ in *Delimitis (Stergios) v Henninger Bräu*,[23] if many of the suppliers to a market require buyers to take all or most their requirements from the same source, other suppliers may be foreclosed, even if the supply agreement in issue is made with a small outlet. The same argument applies to a provision in a technology transfer agreement not to use competing technology. Many such provisions are blacklisted by Article 4(1)(c) and (d) in an agreement between competing undertakings.

Conversely, the grant of an exclusive licence to produce by many of the holders of the technology needed in a particular market may foreclose other licensees. There is no duty under Article 81 to supply the undertakings foreclosed: it is the exclusive element in the agreement that may be illegal.

Similar arguments apply to licensing agreements outside the block exemption. Guideline 140 states that relevant factors include the coverage of the relevant market by similar agreements, the duration of agreements, the regulatory environment and conduct that may indicate or facilitate collusion.

6.3.2.5 Market Power of Competitors

The stronger the market power of competitors and the greater their number the more the parties to the licence will be constrained. If, however, there are few competitors and their market position is similar, the risk of collusion to restrict production and raise price is increased (G 136).

[22] OJ 2000, C291/1, [2000] 5 CMLR 1074, Gs 116(4) & 119(9), where the Commission speaks of investments that are 'relationship specific'.

[23] (C-234/89), 28 February 1991, [1991] ECR I-935, [1992] 5 CMLR 210, [1992] 2 CEC 530, paras 24–26.

6.3.2.6 Buyer Power

Where buyers of the product from the licensee or licensees have market power the seller or licensor may be constrained.

Guideline 137 states that

> The first indicator of buying power is the market share of the buyer on the purchase market. This share reflects the importance of his demand for possible suppliers. Other indicators focus on the position of the buyer on his resale market, including characteristics such as a wide geographic spread of his outlets, and his brand image amongst final consumers. In some circumstances buyer power may prevent the licensor and/or the licensee from exercising market power on the market and thereby solve a competition problem that would otherwise have existed. This is particularly so when strong buyers have the capacity and the incentive to bring new sources of supply on to the market in the case of a small but permanent increase in relative prices. Where the strong buyers merely extract favourable terms from the supplier or simply pass on any price increase to their customers, the position of the buyers is not such as to prevent the exercise of market power by the licensee on the product market and therefore not such as to solve the competition problem on that market.[24]

From the last sentence, it seems that G 137 is concerned with the market power of a buyer of the product made with the licensed technology. Under the merger regulation, in *Enso/Stora,*[25] buyer power was accepted as countervailing the dominant position to which the high market shares after the merger might otherwise have led. This precedent must, however, be treated with caution. It is only if buyers can turn to other suppliers that they can constrain the prices of a leading supplier. In *Enso/Stora* the fixed costs of the merging firms were high and variable costs relatively low. So even the smaller buyers could go elsewhere for part of their supply and punish a supplier who overcharged them. This is not always the case. Often a big buyer obtains discounts that exceed the savings in producing and delivering large quantities, but usually its smaller competitors cannot negotiate equally favourable terms.

The second strategy to constrain the performance of the merging firms was that the largest buyer from both Enso and Stora, Tetra Pak, might have induced another supplier into the market by agreeing to buy large quantities from it. Even if the second strategy would have taken more than two years, the threat or fear of it might have more immediate effects. The very large supplier would not want another big supplier to start competing with it later.

[24] See in this respect Case T-228/97, *Irish Sugar*, [1999] ECR II-2969, para 101 (Commission's footnote).

[25] (IV/ M.1225), 25 November 1998, OJ 1999, L254/9, [2000] 4 CMLR 372 (summary only), comment: NERA Competition Brief 9, 'Buyer Power and the *Enso/Stora* Decision', www.nera.com and Lexecon Competition Brief 9, 'Buyer Power and the *Enso/Stora* Decision', www.lexecon.co.uk.

6.3.3 Possible Negative Effects of Restrictive Licence Agreements

From Gs 141–145, the Commission classifies a non-exhaustive list of possible negative effects of restrictive licensing:

> (1) Reduction of inter-technology competition between the companies operating on a technology market or on markets for products incorporating the technologies in question including facilitation of collusion both explicit and tacit;
>
> (2) Foreclosure of competitors by raising their costs, restricting their access to essential inputs or otherwise raising barriers to entry; and
>
> (3) Reduction of intra-technology competition between undertakings that produce products on the basis of the same technology.'

The first item deals with competition between substitutable technologies, as when each party transfers technology to the other and imposes a reciprocal feed or grantback obligation. This would reduce the incentive to compete in developing the technologies (G 142).

The last few words of the first item are explained in G 143. Of course, any voluntary licence is collusive, but that is not what is meant in G 142(1). The guideline refers to facilitating devices that make it easier for firms not to compete with each other, for instance by making it easier to monitor each others' costs in a concentrated market:

> 143. Licensing between competitors may also facilitate collusion. The risk of collusion is particularly high in concentrated markets. Collusion requires that the undertakings concerned have similar views on what is in their common interest and on how the co-ordination mechanisms function. For collusion to work the undertakings must also be able to monitor each other's market behaviour and there must be adequate deterrents to ensure that there is an incentive not to depart from the common policy on the market, while entry barriers must be high enough to limit entry or expansion by outsiders. Agreements can facilitate collusion by increasing transparency in the market, by controlling certain behaviour and by raising barriers to entry. Collusion can also exceptionally be facilitated by licensing agreements that lead to a high degree of commonality of costs, because undertakings that have similar costs are more likely to have similar views on the terms of coordination.[26]

Guideline 144 explains how exclusive licensing and tying may foreclose new technology. Licensees may be restrained from using alternative technology to such an extent that insufficient licensees remain for competitors of the licensor, or holders of alternative technology for the tied product may be foreclosed.

Guideline 145 deals with the converse practice of granting exclusive licences, thereby reducing competition from the undertakings exploiting the

[26] See in this respect para 23 of the Commission Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements, OJ 2001, C3/2 (Commission's footnote).

same technology, for instance, territorial restraints on licensees. Licences may also reduce competition between licensees in other ways. It adds that, in addition, exclusive territories may also deter competition between technologies by raising entry barriers.

6.3.4 Balance Benefits and Detriments in their Actual Context Under Article 81(3)

Guideline 146 states that most restrictive licensing agreements create efficiencies that outweigh their anti-competitive effects. Yet it repeats what it said in G 18. The balancing of positive and negative effects must take place under Article 81(3). The Commission continues to interpret narrowly the ancillary restraints doctrine, which takes an agreement outside Article 81(1). As was said at 6.2.4 above, it may be argued that the ECJ has adopted a wider concept of ancillarity than the Commission and CFI. The point is important because Regulation 1/2003 Article 2 places the burden of proof under Article 81(1) on the person alleging illegality, but under Article 81(3) on the person justifying an agreement that infringes Article 81(1). Since the Commission considers that most restrictive licences increase competition, it is sad that it has arranged for the burden of proof to be against them.

Guideline 147 states that

> The assessment of restrictive agreements under Article 81(3) is made within the actual context in which they occur[27] and on the basis of the facts existing at any given point in time. The exception rule of Article 81(3) applies as long as the four conditions are fulfilled and ceases to apply when that is no longer the case.[28] However, when applying Article 81(3) in accordance with these principles it is necessary to take into account the initial sunk investments made by any of the parties and the time needed and the restraints required to commit and recoup an efficiency enhancing investment. Article 81 cannot be applied without considering the ex ante investment and the risks relating thereto. The risk facing the parties and the sunk investment that must be committed to implement the agreement can thus lead to the agreement falling outside Article 81(1) or fulfilling the conditions of Article 81(3), as the case may be, for the period of time required to recoup the investment.

The first half of the guideline is difficult to reconcile with the second. Since the risk of the original commitment to invest is relevant, one presumably

[27] See Joined Cases 25/84 and 26/84, *Ford Werke AG and Ford of Europe Inc v Commission*, 17 September 1985, [1985] ECR 2725, [1985] 3 CMLR 528, CMR 14144 (Commission's footnote, I have added citations).

[28] See in this respect for example Commission Decision in *TPS*, OJ 1999 L 90, p 6. Similarly, the prohibition of Art 81(1) also only applies as long as the agreement has a restrictive object or restrictive effects (Commission's footnote).

has to put oneself back in time to consider whether the restriction on conduct was reasonably necessary in the light of the circumstances prevailing when the licence was negotiated. Since the Commission assumes that the investment was sunk, the duration must be long enough to warrant the risk. It is not enough to say that when sufficient profits have been earned to recoup the investment, Article 81(3) no longer applies, because that would be to ignore the initial risk and the time value of the investment.

The application of this guideline is hypothetical and difficult. The concept of recoupment after the event is regulatory and goes ill with a system leaving businessmen to make their own assessment of the application of Article 81 as a result of Regulation 1/2003. The whole concept of agreements whose validity changes over time and not only on the occurrence of precisely defined events is uncertain. Technology licensing is usually risky for both parties, but that is no reason for the guidelines to add to it. In deciding whether the parties are competing undertakings, we look *ex ante*, to the situation in the absence of the agreement. I cannot believe that G 147 requires us to look *ex post*. I can understand a competition authority or court saying that too much compensation was given for risky investment, but the period should be at least the minimum needed at the time of the commitment to induce it. Even that is far from certain.

Another way of stating the problem is whether the difficulty of establishing the efficiencies will deter other risky sunk investment. The Commission's focus on inducing the particular investment is unduly narrow and contrary to recital 5.

6.3.5 Analysis of the Four Conditions of Article 81(3)

The guidelines go on to analyse the four conditions for the application of Article 81(3) and again the Commission's reading is very strict. The first condition is that the agreement:

> contributes to improving the production or distribution of goods or to promoting technical or economic progress,

Guideline 148 states:

> i. The first condition of Article 81(3) requires an assessment of what are the objective benefits in terms of efficiencies produced by the agreement.
>
> ii. In this respect, licence agreements have the potential of bringing together complementary technologies and other assets allowing new or improved products to be put on the market or existing products to be produced at lower cost....

In view of the second sentence, it is thought that the first must refer to possible efficiencies, even if they are not actually achieved. Investments are likely to be risky and not all will prove profitable. The circumstances mentioned are no more than examples. Often a licensor lacks the financial or managerial resources to supply the whole common market, and may need to license a larger firm to manufacture for at least some parts of it. Guideline 148 continues:

> iii. Outside the context of hardcore cartels, licensing often occurs because it is more efficient for the licensor itself to license the technology than to exploit it. This may particularly be the case where the licensee already has access to the necessary production assets. The agreement allows the licensee to gain access to a technology that can be combined with these assets, allowing him to exploit new or improved technologies.
>
> iv. Another example of potentially efficiency enhancing licensing is where the licensee already has a technology and where the combination of this technology and the licensor's technology gives rise to synergies. When the two technologies are combined the licensee may be able to attain a cost/output configuration that would not otherwise be possible.
>
> v. Licence agreements may also give rise to efficiencies at the distribution stage in the same way as vertical distribution agreements. Such efficiencies can take the form of cost savings or the provision of valuable services to consumers. The positive effects of vertical agreements are described in the Guidelines on Vertical Restraints.[29] A further example of possible efficiency gains is agreements whereby technology owners assemble a technology package for licensing to third parties.
>
> vi. Such pooling arrangements may in particular reduce transaction costs, as licensees do not have to conclude separate licence agreements with each licensor. Pro-competitive licensing may also occur to ensure design freedom. In sectors where large numbers of intellectual property rights exist and where individual products may infringe upon a number of existing and future property rights, licence agreements whereby the parties agree not to assert their property rights against each other are often pro-competitive because they allow the parties to develop their respective technologies without the risk of subsequent infringement claims.' [I have divided and inserted numbers into a long paragraph for ease of reference.]

The Commission's use of the concept of a technology pool in the later guidelines refers exclusively to a pool where the technology can be licensed to third parties by a single person. The situation where the parties to the pool are able to exploit without liability[30] is dealt with by concepts such as 'design freedom' or 'non-assertion agreements' in the earlier guidelines, which is also called a pool by many.

The third condition of Article 81(3), but considered second in the guidelines, is that the agreement does not:

> impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives.

[29] Cited in note 36 of the guidelines. See in particular paras 115 *et seq*. (Commission's footnote)

[30] See note 57 at 6.4.3 below. It lists the various Gs that refer to design freedom.

Guideline 149 says that the Commission will examine whether individual restrictions make it possible to perform the activity in question more efficiently than would have been the case in the absence of the restriction in question. This extends to an analysis of Article 81 generally, the definition of competing undertakings in TTBER, Article 1(1)(j), and is a most important and welcome change from the earlier draft.

It adds:

> Undertakings invoking the benefit of Article 81(3) are not required to consider hypothetical and theoretical alternatives. They must, however, explain and demonstrate why seemingly realistic and significantly less restrictive alternatives would be significantly less efficient.

This is narrower than in the US, where it is not necessary to explain or demonstrate why a less restrictive alternative would be significantly less efficient. Moreover, the burden of establishing a case under Article 81(3) is on the party claiming it is applicable. Nevertheless, the Commission has moved closer to the American position. Guideline 149 continues:

> If the application of what appears to be a commercially realistic and less restrictive alternative would lead to a significant loss of efficiencies, the restriction in question is treated as indispensable. In some cases, it may also be necessary to examine whether the agreement as such is indispensable to achieve the efficiencies. This may for example be so in the case of technology pools that include complementary but non-essential technologies,[31] in which case it must be examined to what extent such inclusion gives rise to particular efficiencies or whether, without a significant loss of efficiencies, the pool could be limited to technologies for which there are no substitutes. In the case of simple licensing between two parties it is generally not necessary to go beyond an examination of the indispensability of individual restraints. Normally there is no less restrictive alternative to the licence agreement as such.

The efficiencies derived from a patent pool or non-assertion agreement may consist of freedom to design without having to examine a large portfolio of patents to see whether they are valid and whether a line of R & D is likely to infringe any of them. This is accepted in G 148 (see also G 182).

The second condition to Article 81(3), considered as the third by the Commission, is that 'consumers [are allowed] a fair share of the resulting benefit.' The Commission proclaims that the objective of the competition rules is consumer welfare (G 5). So it states in G 150 that 'consumers of the products produced under the licence must at least be compensated for the negative effects of the agreement'. This may be difficult to establish when the benefits and detriments are different in kind.

[31] As to these concepts see section IV; 4.1 below (Commission's footnote referring to Gs 215–222; 6.4.3 below).

The fourth and final condition of Article 81(3) is that the agreement must not:

> afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Guideline 151 says that this:

> presupposes an analysis of remaining competitive pressures on the market and the impact of the agreement on such sources of competition. In the application of the last condition of Article 81(3) the relationship between Article 81(3) and Article 82 must be taken into account. According to settled case law, the application of Article 81(3) cannot prevent the application of Article 82 of the Treaty.[32] Moreover, since Articles 81 and 82 both pursue the aim of maintaining effective competition on the market, consistency requires that Article 81(3) be interpreted as precluding any application of the exception rule to restrictive agreements that constitute an abuse of a dominant position.[33]

Since dominance is often obtained with a share of a narrowly defined market[34] of as little as 40 per cent and, since it is arguable that exclusive provisions in favour of a dominant firm are *per se* abusive,[35] this interpretation excludes the application of Article 81(3) even if competition is far from being eliminated. A dominant position may be obtained under Community law with little power over price, and non-compete provisions may be treated as automatically abusive.

Guideline 152 states that an agreement eliminating one dimension of competition does not necessarily eliminate competition.

> A technology pool, for instance, can result in an industry standard, leading to a situation in which there is little competition in terms of the technological format. Once the main players in the market adopt a certain format, network effects may

[32] See para 130 of the judgment cited in note 2 of the Guidelines. Similarly, the application of Art 81(3) does not prevent the application of the Treaty rules on the free movement of goods, services, persons and capital. These provisions are in certain circumstances applicable to agreements, decisions and concerted practices within the meaning of Art 81(1), see to that effect Case C-309/99, *Wouters*, [2002] ECR I-1577, para 120 (Commission's note).

[33] Case T-51/89, *Tetra Pak (I)*, [1990] ECR II-309. See also para 106 of the Guidelines on the application of Art 81(3) of the Treaty cited in note 2 above (Commission's footnote).

[34] A relative change of price of 5 per cent or 10 per cent may be almost irrelevant in high technology markets, where competition may be for the best and latest technology.

[35] *British Airways plc v Commission* (T-219/99), 17 December 2003, [2004] 4 CMLR 1008, para 293, where the CFI confirmed the Commission's finding of a dominant position over the acquisition of the services of travel agents although BA's share of the market was under 40 per cent. It also confirmed that loyalty rebates capable of ousting competitors constituted an abuse without 'it being necessary to demonstrate that the abuse in question had a concrete effect on the markets concerned. It is sufficient in that respect to demonstrate that the abusive conduct of the undertaking in a dominant position tends to restrict competition, or, in other words, that the conduct is capable of having or likely to have such an effect.' The judgment, which has been subject to much criticism, has been appealed: C-95/04P, OJ 2004, C106/22. There were several special circumstances aggravating the alleged abuse.

See also *Michelin II* (T-203/1), 30 September 2003, [2004] 4 CMLR 923, para 239; appeal pending C-552/03, OJ 2004, C59/13.

> make it very difficult for alternative formats to survive. This does not imply, however, that the creation of a de facto industry standard always eliminates competition within the meaning of the last condition of Article 81(3). Within the standard, suppliers may compete on price, quality and product features. However, in order for the agreement to comply with Article 81(3), it must be ensured that the agreement does not unduly restrict competition and does not unduly restrict future innovation.

It would be difficult to persuade a court or competition authority that the loss of price competition would focus competition on quality, because price competition is so vital. It is thought that the detriments to consumers would have to be balanced against the benefits to them under the earlier conditions of Article 81(3) and some competition must remain under the fourth condition.

6.4 APPLICATION OF ARTICLE 81 TO VARIOUS TYPES OF LICENSING RESTRAINTS (GS 153–235)

This section of the guidelines covers agreements between competitors and between non-competitors. Between competitors, reciprocal agreements are distinguished from other types of agreement. Reciprocal agreements are made between firms licensing technology with similar functions to each other. A cross licence granted under a duty to grantback improvements is not reciprocal unless the technologies perform the same functions. When the parties are not competitors the distinction is not necessary: each licence is treated as separate.

6.4.1 Agreements that do not Restrict Competition within Article 81(1)

Guideline 155 says:

> This section does not deal with obligations in licence agreements that are generally not restrictive of competition within the meaning of Article 81(1). These obligations include but are not limited to:
>
> (a) confidentiality obligations,
> (b) obligations on licensees not to sub-license,
> (c) obligations not to use the licensed technology after the expiry of the agreement, provided that the licensed technology remains valid and in force,
> (d) obligations to assist the licensor in enforcing the licensed intellectual property rights,
> (e) obligations to pay minimum royalties or to produce a minimum quantity of products incorporating the licensed technology, and
> (f) obligations to use the licensor's trademark or indicate the name of the licensor on the product.'

These obligations were white listed under Article 2(1) of Regulation 240/96 and said rarely to restrict competition, but were exempted to provide legal certainty just in case they might exceptionally infringe Article 81(1). It is hoped that this guideline will be treated as a block negative clearance, although there is no legislation providing for one.

6.4.1.1 Royalties

Guideline 156 states that the parties, whether or not competitors, are free to determine the royalties payable. Licences may be granted for a lump sum, a percentage of the sales price or for a fixed amount per item incorporating the licensed product. Software licences may be based on the number of users or per machine.

Between competitors, however, reciprocal running royalties may be treated as price fixing, which is a hardcore infringement.

> 157. It is a hardcore restriction under Article 4(1)(a) if competitors provide for reciprocal running royalties in circumstances where the licence is a sham, in that its purpose is not to allow an integration of complementary technologies or to achieve another pro-competitive aim. It is also a hardcore restriction under Article 4(1)(a) and 4(1)(d) if royalties extend to products produced solely with the licensee's own technology.

The reasoning is that running royalties raise variable cost (Gs 80–81 and 157).[36] Such royalties may be used in a sham licence to disguise a price fixing cartel, but this Guideline has been softened from the draft and applies only when the licence is a sham and not otherwise. I hope the burden of proof is on the person alleging it is a sham.

Guideline 81 states that agreements, whether or not reciprocal, under which royalties are calculated on the basis of sales of all products, even if the licensed technology is not used, contain hardcore restraints because they raise the cost of the licensee using its own or third party technology. Nevertheless, they may exceptionally qualify under Article 81(3) where this was necessary for the grant of a licence, for instance because a component is not sold separately, and where there is no other way to calculate royalties.

Other provisions for royalties between competitors are block exempted up to the ceiling of 20 per cent. Above that market share, Article 81(1) may apply where running royalties are clearly disproportionate to the value of the licence and have a significant effect on prices. In appraising their proportionality, reference will be made to the charges for licences of that or substitutable technology to other licensees. Article 81 may also apply when the level of running royalty per unit increases as output increases (G 158). Where they are not proportionate, the Commission may consider the

[36] Lars Kjolbye, 'The New Commission Guidelines on the Application of Article 81(3): An Economic Approach to Article 81,' [2004] 25 ECLR 566, 575.

licence to be a sham. Guideline 81 may discourage holders of iprs from licensing their competitors.

The parties can normally agree to royalties extending beyond the period where the ipr is valid without infringing Article 81(1) (G 159; and 4.1.4 above). The Commission used to treat these as a tie of the later period after expiry to the earlier period [37] but, as stated in recitals to several earlier block exemptions, the licensee is unlikely to agree to continue paying unless it is part of a negotiated deal, under which royalties for an earlier period are reduced. Sometimes, the licensee may not be able to obtain finance to start production and marketing as easily and cheaply as the licensor, which may provide it on better terms than a bank because it knows more about the business. Consequently, it is less risky. Competition from others using the technology provides an adequate safeguard against excessive pricing by the licensee (G 159).

The Commission used to object to royalties on products made without the licensed technology. Guideline 160 now accepts that the licensed product may be a component or raw material that is not sold separately. When that is the only way of calculating the royalty, the royalty may be based on the sale of the bigger unit that is traded.

6.4.1.2 Restrictions on Production within a Specified Territory (Gs 161–167)

The Commission's use of the words 'exclusive licence' does not correspond to the normal English usage, according to which it means a licence when the licensor agrees not to *exploit* the licensed technology within the licensee's exclusive territory in any way, whether by production, sale or both. Similarly in English a 'sole licence' is one that restrains the licensor from granting any other licence to *exploit* within a territory, but permits him to exploit there itself. The Commission's meaning is described at G 162:

> 162. A licence is deemed to be exclusive if the licensee is the only one who is permitted to *produce* on the basis of the licensed technology within a given territory. The licensor thus undertakes not to produce itself or license others to produce within a given territory. This territory may cover the whole world. Where the licensor undertakes only not to *license other parties to produce* with a given territory, the licence is a sole licence. Often exclusive or sole licensing is accompanied by sale restrictions that limit the parties where they may sell products incorporating the licensed technology.' (My italics)

The distinction drawn between production and sale seems to me formalistic. What is needed to induce investment by licensor or licensee is protection

[37] *AOIP-Association des Ouvriers en Instruments de Précision v Beyrard* (76/29/EEC), 2 December 1975, OJ 1976, L6/8, [1976] 1 CMLR D14, CMR 9801; *Ottung v Klee & Weilbach A/S and Thomas Schmidt A/S* (320/87), 12 May 1889, [1989] ECR 1177, [1990]4 CMLR 915, [1990] 2 CEC 674.

from all sorts of intra-technology competition. A network of exclusive licences providing for each party to produce in different countries gives substantial protection when freight is a large part of the delivered cost and very little when it is negligible (6.4.1.5 below). Nevertheless, the Commission used to exempt manufacturing exclusivity but was more reluctant to exempt restrictions on sales, especially passive sales which it perceived as dividing the Common Market (4.1.1.1 above).

Reciprocal exclusive licensing between competitors is a hardcore infringement, but there are substantial exceptions in Article 4(1)(c)(iii) (5.4.1.4 above) . Remember that the parties may be actual or potential competitors on the product market, or actual competitors on the technology market.

Reciprocal sole licensing between competitors, whereby they agree not to licence their technology to third parties, is block exempted up to the 20 per cent ceiling of cumulative market shares. The Commission is concerned, however, that where the parties have significant market power, such agreements may facilitate collusion by ensuring that the parties are the only sources of output in the market based on the licensed technologies' (G 163).

Non-reciprocal exclusive licences between competitors are also block exempted up to the 20 per cent ceiling of market share. And the exclusive territory or customer group may be protected by active or passive sales restrictions according to G 170 (Article 4(1)(c)(iv)). When the combined market share exceeds 20 per cent, analysis of competitive effects is required. If the licensor has little market power or if, otherwise, it could not exploit within the exclusive territory, the agreement is unlikely to infringe Article 81(1) (G 164). For instance, if the licensor is a research institute or a small research based undertaking and lacks the production and distribution assets effectively to make or market the products, Article 81(1) is unlikely to be infringed.

Where the parties are not competitors, an exclusive licence, even if caught by Article 81(1), is likely to fulfil the conditions of Article 81(3). Exclusivity is usually necessary to induce investment by the licensee, especially if he has to invest substantially to develop the technology further or set up a production line. To preserve the fruits of the licensee's success, the Commission will seldom intervene, irrespective of the territorial scope of the licence (G 165).

The main situation where intervention may be warranted is where a dominant licensee, protected by barriers to entry, obtains an exclusive licence to one or more competing technologies and the licensed technology is a real source of competition on the market (G 166). The guideline does not cite *Tetra Pak I*,[38] which exemplifies this situation. In that case, the licensor was

[38] (88/501/EEC), 26 July 1988, OJ 1988, L272/27, [1990] 4 CMLR 47, CMR 11015. On appeal, *Tetra Pak Rausing SA v Commission* (T-51/89), 10 July 1990, [1990] ECR II-309, [1991] 4 CMLR 334, [1990] 2 CEC 409.

very dominant, the licensed technology was thought by the Commission to be nearly ready for exploitation and the Commission received a complaint. Guideline 166, however, does not limit the Commission's intent to intervene in these circumstances. Firms with little market power have been held dominant: for instance, in *British Airways*[39] the CFI confirmed the Commission's decision that with just under 40 per cent of the market BA was dominant over the acquisition of services from travel agents when there were barriers to new entry.

Where the package of licences creates a *de facto* industry standard, cross licenses between two or more parties who undertake not to license third parties may foreclose others. The Commission will assess such agreements according to the principles it applies to technology pools (6.4.3 below). It will probably require that the technologies supporting the standard be licensed on fair, reasonable and non-discriminatory terms, whatever that may mean (G 167).

6.4.1.3 Sales Restrictions in Agreements between Competitors (Gs 169–171)

In a reciprocal agreement between competitors, restrictions on active *and* passive sales by either party are hardcore restrictions of competition under Article 4(1)(c): they usually infringe Article 81(1), and Article 81(3) is unlikely to apply. They are treated as market allocation at least if either party could realistically have sold into the other's territory without a licence (G 169). The guideline is not very clear in distinguishing *and* from *or*. It is thought that in a reciprocal agreement the provisions are hardcore where either active or passive sales are restricted by either party.

Guideline 170 states that in a non-reciprocal agreement between competitors, Article 4(1)(c)(iv) of the block exemption applies, up to the ceiling of 20 per cent, to a restriction on active or passive sales by either into an exclusive territory or customer group allocated to the other. Above the ceiling, sales restrictions are caught by Article 81(1) when one or both parties have significant market power. Sales restrictions may, however, qualify under Article 81(3) when necessary to the dissemination of the technology, in particular if the licensor has a weak market position in the territory where he exploits the technology and would not have granted the licence without protection, or where the licensee has a weak market position in his territory and has to make significant investment to exploit the technology efficiently.

[39] *British Airways* (2000/74/EC), 14 July 1999, OJ 2000, L30/1, [2000] 4 CMLR 999, [2000] CEC 2,145; appeal (T-219/99), 17 Dec 2003, [2004] 4 CMLR 1008; appeal to ECJ, C-95/04P, OJ 2004, C106/22.

This exception to the hardcore list will be uncertain in application. How much market power is significant and for how long is protection necessary to enter a new territory or serve a customer group? Under Article 81(3) the burden of proof is on the person establishing legality. Despite recital 5, the Commission does not overtly recognise the need for protection also to encourage the licensor to invest in producing the innovation but only to induce licensing once the invention has been discovered (6.4.1.5 below).

In a non-reciprocal agreement, Article 4(1)(c)(v) permits restrictions on active (but not passive) sales into the exclusive territory or customer group of another licensee, provided that the protected licensee was not a competitor of the licensor at the time his licence was granted (G 171). Above the 20 per cent market share, the agreement is likely to be caught by Article 81(1) when the parties have significant market power. It may, however, qualify under Article 81(3) for the time necessary to enable the licensee to penetrate a new territory or customer group where the licensee faces competition from other licensees competing with the licensor and already on the market (G 171).

The distinction between active and passive sales is not defined in this Regulation or these Guidelines, but is explained in the Guidelines on vertical restraints.[40] Almost any promotion is treated as passive and not exempt, even enabling web site customers to click onto their own language. So this exception to the hardcore restrictions is not very helpful. The distinction between protecting the licensor and protecting another licensee seems to me formalistic.

This exception to the hardcore list will also be uncertain in application. How much market power is significant and for how long is protection necessary to enter a new territory or customer group? Nevertheless, these are the key economic issues and some uncertainty may be a small price to pay for abrogating formal rules.

6.4.1.4 Sales Restrictions in Agreements between Non-Competitors (Gs 172–173)

In agreements between non-competitors, sales restriction between licensee and licensor are exempted up to the market shares of 30 per cent each (G 172). The 30 per cent is relevant to the ceilings of market share imposed by Article 3, not just to the firm being protected. If one of the parties exceeds the ceiling, G 172 continues to say that sales restrictions to protect the licensor may fall outside Article 81(1) when, on the basis of objective factors, licensing would not occur without such protection. A licensor cannot be expected to create direct competition with its own technology. It

[40] OJ 2000, C291/1, [2000] 5 CMLR 1074; Gs 50 and 51.

may, however, not be easy to advise whether a factor is objective. It is not enough to have a statement by the relevant manager unless it contains cogent reasoning.

In the absence of such objective factors, sales restrictions on the licensee may be caught by Article 81(1) if the licensor individually has a significant degree of market power, or if there is a cumulative effect from similar arrangements by other licensors, which cumulatively hold a strong position on the market. Again, it will not always be possible to give firm advice. It seems to me that the Commission should be sensitive to the need also to induce the investment to obtain the technology and not only to induce its dissemination after the technology has been acquired (R 5; and 6.4.1.5 below).

Sales restrictions on the licensor, if caught by Article 81(1), are likely to satisfy the conditions of Article 81(3) unless there are no real alternatives to the licensor's technology or such alternatives are licensed by the licensee from third parties. They may be necessary to induce the licensee to invest, as he would otherwise face competition from the licensor who is not burdened with royalty obligations (G 173).

In agreements between non-competitors, restrictions imposed by the licensor on active sales between licensees to protect exclusive territories or customer groups are block exempted up to the ceiling of market share. The TTBER is more permissive than the block exemption for Vertical agreements,[41] which blacklists all restrictions on passive sales but allows some restrictions on active sales to protect licensor or licensees. Licensees are likely to have to invest in manufacturing capacity, whereas dealers are not.

Restrictions on passive sales to restrict one licensee from another are block exempted only for two years from the time when the licensee protected first put products incorporating the licensed technology on the market within its exclusive territory. Thereafter they are unlikely to fulfil the conditions of Article 81(3) (G 174). Nevertheless, if a licensor has not granted a licence for a particular territory, but reserved it for itself and supplies an exclusive dealer there, it can protect its own exclusive territory or customer group and thereby protect the dealer longer than another licensee. In all its group exemptions the Commission has assumed that a holder of technology either licences throughout the Common Market, or produces and sells throughout. In reality, however, many technology holders want to produce and supply nearby markets, but may lack the capital or the desire to build sufficient capacity to supply the whole Common Market and may licence someone to supply parts of it.

Where the licensor or licensee has a market share exceeding 30 per cent the agreement is likely to infringe Article 81(1) if the individual licensee has

[41] Regulation 2790/1999 on the application of Article 81(3) of the Treaty to vertical agreements and concerted practices, OJ 1999, L336/21, [2000] 4 CMLR 398, [2000] 5 ECLR Supp.

significant market power, but may satisfy the conditions of Article 81(3) if necessary to induce investment by the licensee by preventing free riding.

6.4.1.5 Criticism of Distinctions between Production and Sales Exclusivity and between Protection from Active and Passive Sales

The Commission has had difficulty in developing its policy towards the protection of exclusive territories and customer groups. It accepts the argument that unless there is some protection, fear of free riding may discourage licensing. Often, both parties have to make significant and risky sunk investments and would not do so without the expectation of protection. Instead of leaving the parties, NCAs and courts to estimate how much protection is required and, therefore, permissible, it has given us formalistic rules that are easier to apply when the market shares exceed the ceilings and the block exemption cannot apply.

The original drafts of regulation and guidelines were hostile towards exclusive territories or customer groups. The Commission responded positively to comments on the drafts and now the need to induce licensing is accepted as justifying many sales restrictions. Unfortunately, the expectation of protection against potential free riders may also be necessary to induce the original investment in creating the technology (R 5). The firm contemplating such investment may expect greater revenues when it is successful if it is able to grant exclusive rights to its licensees. Each licensee will want protection from imports to its territory as well as from production. Protection against production within an exclusive territory is a substantial inducement to investment if the cost of freight is expected to be an important part of the delivered price. It is marginal for more valuable products, which commercially can be carried far. This formal distinction goes back to the judgment of the ECJ in *Nungesser (LG) KG and Kurt Eisele v Commission.*[42] So, the Commission cannot be blamed.

The Commission has also distinguished protection from active sales into the exclusive territory of licensor or any of its licensees, but not permitted protection from passive sales, which would interfere with the concept of a common market. There is still tension between the competition rules and the idea of a common market with no frontiers. The result may well be that more R & D will be done outside the Common Market, the goods produced outside and sold through a single distributor into the Common Market, although often there will be agreements with national or regional distributors lower down the supply chain that are subject to Article 81. The US guidelines[43] do not make these distinctions and are more concerned to

[42] (258/78), 8 June 1982, [1982] ECR 2015, [1983] 1 CMLR 278, CMR 8805.
[43] Antitrust Guidelines for the Licensing of Intellectual Property, 6 April 1995, (1995) 68 ATRR 462, CCH TRR 13,132, [1995] 7 EIPR 3.

attract investment in R & D and setting up production facilities. The burden of proof to establish efficiencies in the US is on those alleging legality. So mere R & D may be carried on there.

6.4.1.6 Output Restrictions between Competitors (Gs 82 and 175)

Output restrictions in reciprocal licence agreements between competitors constitute a hardcore restriction by virtue of Article 4(1)(b) (Gs 82 and 175; 5.3.1.2 above). Nevertheless, a restriction on a licensee in a non-reciprocal agreement or on only one licensee in a reciprocal agreement is block exempted up to the 20 per cent aggregated market share. Above that, G 175 states that output restrictions on the licensee may restrict competition when the parties have significant market power. Former block exemptions blacklisted output restrictions, but in its Evaluation Report of 2001, the Commission acknowledged that this conflicted with its view that the licensor was usually entitled to transfer technology for limited purposes only.

Where the licensor's technology is substantially better than the licensee's and the output limitation is substantially greater than the licensee's capacity before the licence was granted, the output limitation is of limited effect, even if demand is growing. In the context of Article 81(3), such restrictions may be necessary to persuade the licensor to disseminate its technology as widely as possible (eg a site licence). Where the limited licence leads to a real integration of complementary assets, output restriction may satisfy the conditions of Article 81(3) when the parties do not have substantial market power (G 175). This is a great deal clearer and less formalistic than recital 24 to Regulation 240/96.[44] A site licence—one that entitles the licensee to produce only on a designated site—may restrict production if there is insufficient space on the site to expand. That limitation will qualify under Article 81(3) only if the parties can establish they do not have substantial market power.

6.4.1.7 Output Restrictions between Non-Competitors (Gs 176–178)

In agreements between non-competitors, restrictions on output are not blacklisted and are block exempted up to the 30 per cent ceilings of market share. The main anti-competitive risk is reduced competition between licensees of the same technology. Whether this is significant depends on the market power of licensor and licensees and the extent that the limitation prevents a licensee from satisfying demand for the products incorporating the licensed technology (G 176).

[44] The former block exemption for technology transfer, Commission Regulation 240/96 – Technology transfer, OJ 1996, L31/2, [1996] 4 CMLR 405, [1996] 4 EIPR Supp iv.

Guideline 177 states that the restrictive effects are increased when output limitations are combined with exclusive territories or customer groups. The combination of the two restraints may indicate that the agreements serve to partition markets.

On the other hand, G 178 states that output limitations in agreements between non-competitors may increase competition by promoting the spread of the technology. If the licensor were unable to limit output, it might not grant licences. This is particularly likely where the licensor also produces, unless there are sales restrictions on the licensee selling into a territory or customer group reserved for the licensor.

The guidelines omit the function of output limitations in enabling the holder of technology to grant several bilateral limited licences in order to cover the whole of the Common Market. The expectation of being able to grant several licences limited territorially to cover the whole of the Common Market may also encourage the initial R & D (see recital 5).

The Commission has softened considerably its hostility towards restrictions of output.

6.4.1.8 Field of Use Restrictions between Actual or Potential Competitors (Gs 179–183)

Guideline 179 defines a field of use restriction:

> 179. Under a field of use restriction the licence is limited either to one or more technical fields of application or one or more product markets. There are many cases in which the same technology can be used to make different products or can be incorporated into products belonging to different product markets. A new moulding technology may for instance be used to make plastic bottles and plastic glasses, each product belonging to separate product markets. However, a single product market may encompass several technical fields of use. For instance a new engine technology may be employed in four cylinder engines and six cylinder engines. Similarly, a technology to make chipsets may be used to produce chipsets with up to four CPUs and more than four CPUs. A licence limiting the use of the licensed technology to produce say four cylinder engines and chipsets with up to four CPUs constitutes a technical field of use restriction.

The examples given in the guideline are useful because no one knows what a 'technical field of application' means. The phrase was introduced long ago into Article 2(1)(3), the white list of the block exemption for patent licences.[45]

Guideline 180 distinguishes customer restraints, some of which are blacklisted by Article 4(1)(c) and 4(2)(b). The distinction requires careful drafting.

[45] Commission Regulation 2349/84 – Group exemption for patent licensing agreements, OJ 1984, L219/15, corrections OJ 1985, C113/34, [1984] 2 CLE 389.

One should not identify the customers for whom a particular version of the product is to be produced. It should be 'defined objectively by reference to identified and meaningful characteristics of the licensed product': It might be described as 'a fertility pill for veterinary use', rather than as 'a fertility pill to be sold only to vets!'

Guideline 182 states that field of use restrictions may have pro-competitive effects by encouraging the licensor to license its technology or to license for a lower royalty than he would otherwise charge. In some sectors licensing takes place to obtain design freedom.[46]

Guideline 181 notes that a field of use restriction limits exploitation by the licensee, without limiting that of the licensor. This seems to be anomalous and formalistic. The licensor may want to exploit one field of use, and license other undertakings to exploit others. If it could not limit its own use of the ipr it might not be able to find licensees prepared to invest for exploitation within the field of use granted to each. Not only would this reduce licensing, it would also reduce the incentive to develop the technology.

Guideline 183 states that field of use restrictions in agreements between actual or potential competitors are block exempted up to the 20 per cent ceiling of market share. The Commission's concern is that the licensee will cease to be a competitive force outside the field of use licensed. The competitive risk is greater where reciprocal field of use restrictions are asymmetrical: where each licenses the other for a different field of use, especially if the licensee's production facility is tooled up to use the licensed product as well as to use its own technology to make other products. An agreement likely to lead to the licensee reducing production outside the field of use is likely to infringe Article 81(1). Symmetrical field of use restrictions, whereby each is licensed to use the other's technology in the same field of use, are unlikely to infringe Article 81, because the Commission thinks that they are unlikely to restrict any competition that would have existed without the licence. The reduction of a licensee's production outside the field of use may indicate an underlying market allocation agreement amounting to a hardcore restriction.

6.4.1.9 Field of Use Restrictions between Non-Competitors (Gs 184–185)

Where the parties are not actual or potential competitors, field of use restrictions are block exempted up to the market share ceiling of 30 per cent. These generally are either not anti-competitive or are efficiency enhancing (G 184). According to G 185, in licences between non-competitors, parallel sole or exclusive licences with limited fields of use do not infringe Article 81.

[46] For the pro-competitive effect of licensing to provide design freedom, see also note 219 at 6.4.3 below.

6.4.1.10 Captive Use Restrictions (Gs 186–190)

Captive use restrictions, whether between competitors or not, are block exempted up to the ceilings of market shares. The licensee may be limited to selling the licensed products only for the production of its own products or their repair, excluding the sale of licensed product for incorporation into the products of other producers (G 186; 5.4.1.7 and 5.4.2.2.2 above.)

Guideline 187 states that if the licensee was not an actual or likely potential supplier of components to other producers the captive use restriction does not change the existing situation and the restriction will be appraised as if they were not competitors. If the licensee is an actual or likely potential competitor one must examine the impact of the agreement on this activity. If by tooling up to use the licensor's technology the licensee ceases to use its own technology, the agreement restricts existing competition and may be anti-competitive. This is not, however, the circumstance for which captive use restrictions were first brought within the opposition procedure in the block exemption for know-how agreements.[47] Manufacturers of vehicles wanted to reduce the risk of component manufacturers being unable to supply just in time as the items were needed. They therefore required a licence either to themselves or to another producer to cover any periods when supply was short.

According to G 188, the two main competitive risks from captive use provisions in agreements between non-competitors are (a) a restriction of intra-technology competition on the market for the supply of inputs; and (b) an exclusion of arbitrage between licensees enhancing the possibility for the licensor to discriminate between licensees as to the level of royalties. Guideline 189, however, mentions the pro-competitive possibility of providing a second source of a component, when the licensor would not licence at all or on such favourable terms if the licensee could compete with it. In those circumstances a restriction to captive use is normally not restrictive, or qualifies under Article 81(3) provided the licensee is allowed to sell the licensed product as replacement parts for its own products.

If the licensor is not a component maker, a restriction to captive use may ensure that licensees do not sell to producers that compete with the licensor on other markets. Nevertheless a less restrictive solution is a restriction on selling to certain customer groups reserved to the licensor (G 190).

6.4.1.11 Tying and Bundling (Gs 191–195)

The definitions are provided in G 191.

> 191. In the context of technology licensing tying occurs when the licensor makes the licensing of one technology (the tying product) conditional upon the licensee

[47] Commission Regulation 556/89, OJ 1989, L61/1, [1989] 4 CMLR 774, Art 4(2) and Commission Regulation 240/96 – Technology transfer, OJ 1996, L31/2, [1996] 4 CMLR 405, [1996] 4 EIPR Supp iv, Art 2(1)(13).

taking a licence for another technology or purchasing a product from the licensor or someone designated by him (the tied product). Bundling occurs where two technologies or a technology and a product are only sold together as a bundle. In both cases, however, it is a condition that the products and technologies involved are distinct in the sense that there is distinct demand for each of the products and technologies forming part of the tie or the bundle. This is normally not the case where the technologies or products are by necessity linked in such a way that the licensed technology cannot be exploited without the tied product or both parts of the bundle cannot be exploited without the other. In the following the term "tying" refers to both tying and bundling.

It is not clear why tying should be illegal only if the demand for the tied product is distinct from the tying one and vice versa, although in this respect the US law is similar. Economists do not insist on this condition of illegality and so are unable to help much on the definition of 'a separate product'. Jean Tirole, for instance, thinks it is more helpful to look at tying as one kind of predation.[48]

As under the block exemption for vertical distribution agreements,[49] tying is not blacklisted and, consequently, it is exempted up to the ceilings of market share. The ceilings apply to any relevant technology or product market affected by the licence including the market for the tied product (G 192).

The Commission lists the possible anti-competitive effects of tying in G 193.

193. The main restrictive effect of tying is foreclosure of competing suppliers of the tied product. Tying may also allow the licensor to maintain market power in the market for the tying product by raising barriers to entry since it may force new entrants to enter several markets at the same time. Moreover, tying may allow the licensor to increase royalties, in particular when the tying product and the tied product are partly substitutable and the two products are not used in fixed proportion. Tying prevents the licensee from switching to substitute inputs in the face of increased royalties for the tying product. These competition concerns are independent of whether the parties to the agreement are competitors or not. For tying to produce likely anti-competitive effects the licensor must have a significant degree of market power in the tying product so as to restrict competition in the tied product. In the absence of market power in the tying product the licensor cannot use his technology for the anti-competitive purpose of foreclosing suppliers of the tied product. Furthermore, as in the case of non-compete obligations, the tie must cover a certain proportion of the market for the tied product for appreciable foreclosure effects to occur. In cases where the licensor has market power on the market for the tied product rather than on the market for the

[48] Jean Tirole, 'How to analyse tying,' (2005) 1 Competition Policy International, 1; see 8.1.9.3.1 below for the position under Art 82.

[49] Regulation 2790/1999, OJ 1999, L336/21, [2000] 4 CMLR 398, [2000] 5 ECLR Supp.

tying product, the restraint is analysed as non-compete or quantity forcing, reflecting the fact that any competition problem has its origin on the market for the "tied" product and not on the market for the "tying" product[50].

Chicago economists object that there is only one monopoly profit to be made from market power over the tying product. To the extent that customers would not otherwise take the tied product, they would be willing to pay less for the tying product. This assumes, however, that the market for the tied product is perfectly competitive and that the tied and tying products are used in fixed proportions. The arguments about raising rivals' costs when they have to enter both markets to sell the tied product or persuade someone else to supply the tying product are widely accepted. Moreover, tying may facilitate discrimination, to which the Commission is hostile.

The guidelines go on to list possible efficiency gains:

> 194. Tying can also give rise to efficiency gains. This is for instance the case where the tied product is necessary for a technically satisfactory exploitation of the licensed technology or for ensuring that production under the licence conforms to quality standards respected by the licensor and other licensees. In such cases tying is normally either not restrictive of competition or covered by Article 81(3). Where the licensees use the licensor's trademark or brand name or where it is otherwise obvious to consumers that there is a link between the product incorporating the licensed technology and the licensor, the licensor has a legitimate interest in ensuring that the quality of the products are such that it does not undermine the value of his technology or his reputation as an economic operator. Moreover, where it is known to consumers that the licensees (and the licensor) produce on the basis of the same technology it is unlikely that licensees would be willing to take a licence unless the technology is exploited by all in a technically satisfactory way.
>
> 195. Tying is also likely to be pro-competitive where the tied product allows the licensee to exploit the licensed technology significantly more efficiently. For instance, where the licensor licenses a particular process technology the parties can also agree that the licensee buys a catalyst from the licensor which is developed for use with the licensed technology and which allows the technology to be exploited more efficiently than in the case of other catalysts. Where in such cases the restriction is caught by Article 81(1), the conditions of Article 81(3) are likely to be fulfilled even above the market share thresholds.

The first circumstance has been recognised by the Commission ever since it adopted the block exemption for patent licensing.[51] It may go too far. Sometimes a less restrictive possibility is to specify the technical requirements of the complementary product. The guideline suggests that this is not

[50] For the applicable analytical framework see section 2.7 below and paras 138 et seq of the Guidelines on Vertical Restraints ... (Commission's footnote).

[51] Commission Regulation 2349/84 – Group exemption for patent licensing agreements, OJ 1984, L219/15, corrections OJ 1985, C113/34, [1984] 2 CLE 389, Art 2(1).

relevant. The guidelines may be soft law but are likely to be followed by competition authorities anxious to reach the same result as the Commission (3.4 above). The acknowledgement of the second circumstance is welcome. One might wonder whether it is necessary to require the licensee to take the most appropriate catalyst. Would it not be enough to offer him the chance of taking the second licence? A package deal does not amount to tying if the licensee wants both items. Probably the example is justified on the second ground: that the use of the catalyst may produce a better product and be important for the licensor's reputation.

6.4.1.12 Non-Compete Obligations (Gs 196–203)

The case law on non-compete obligations was considered at 4.1.5 and 5.4.1.8 above. Non-compete obligations were called 'single branding' in the guidelines on vertical distribution agreements.[52] In the vertical distribution regulation[53] some were excluded from the benefit of the group exemption, but did not prevent it from applying to other restrictions of competition. Single branding in that Regulation was not confined to non-compete provisions, but included indirect inducements to use only the licensor's technology, such as minimum royalty or output provisions. The technology transfer Gs 202 and 203 seem to look to more than non-compete obligations. They also look to minimum output and minimum royalty provisions that discourage the use of other technology less strongly.

In relation to the TTBER, non-compete obligations are defined in G 196:

> 196. Non-compete obligations in the context of technology licensing take the form of an obligation on the licensee not to use third party technologies which compete with the licensed technology. To the extent that a non-compete obligation covers a product or additional technology supplied by the licensor the obligation is dealt with in the preceding section on tying.

They are not blacklisted and, consequently are exempted up to the ceilings of market shares (G 197). Above the ceilings:

> 198. [t]he main competitive risk presented by non-compete obligations is foreclosure of third party technologies. Non-compete obligations may also facilitate collusion between licensors in the case of cumulative use. Foreclosure of competing technologies reduces competitive pressure on royalties charged by the licensor and reduces competition between the incumbent technologies by limiting the possibilities for licensees to substitute between competing technologies. As in

[52] OJ 2000, C291/1, [2000] 5 CMLR 1074; Gs 138–160.

[53] Regulation 2790/1999 on the application of Article 81(3) of the Treaty to vertical agreements and concerted practices, OJ 1999, L336/21, [2000] 4 CMLR 398, [2000] 5 ECLR Supp.

> both cases the main problem is foreclosure, the analysis can in general be the same in the case of agreements between competitors and agreements between non-competitors. However, in the case of cross licensing between competitors where both agree not to use third party technologies the agreement may facilitate collusion between them on the product market, thereby justifying the lower market share threshold of 20 per cent.

Some might object that there is competition *for* the market even if competition *within* the market is reduced. The licensor has to persuade the licensee to agree to use only the licensor's technology.

Guideline 199 explains that foreclosure may arise when a substantial number of potential licensees are already tied to one or more sources of technology, even if each individual network is within the TTBER. A serious cumulative effect, however, is unlikely to arise unless 50 per cent of the market is tied to one or other licensor and, in that event, the Commission may disapply the TTBER by regulation (Article 7; 5.6 above). This goes beyond the Commission's former practice in non-technology markets, where 40 per cent cumulative foreclosure seemed to trouble it. Above that threshold, the Guideline states that foreclosure is likely only if there are relatively high entry barriers for new licensees. To determine whether entry and expansion are easy, the guideline states that the extent to which distributors are tied to licensees should be considered, as third party technologies have a real possibility of entry only if they have access to production and distribution assets. For this, see the analytical framework of the guidelines on vertical restraints.

Guideline 200 states that the stronger the market power of the licensor the higher the risk of foreclosing rival technologies. Appreciable foreclosure effects may arise even if the non-compete obligations do not cover a substantial part of the market if they are targeted at the most likely licensors, especially where there is only a limited number of potential licensees who use the technology to make an input for their own use. I assume that this is because they are under less pricing pressure than third party buyers.

The pro-competitive effects of non-compete provisions are described in Gs 201–203. They may promote licensing by reducing the risk of the licensee misappropriating the licensed technology, especially know-how. If the licensee uses other technology it may be difficult to determine whether the licensee is also using the licensed technology and makes monitoring of royalty obligations difficult. Second, non-compete provisions may ensure that the licensee has an incentive to invest in and exploit the licensed technology, which is particularly important if the licence is exclusive, and, third, minimum output or royalty obligations may be necessary to induce the licensor to make significant investments that are specific to the licensee, such as training its staff or tailoring the technology to the licensee's needs and to avoid hold up problems. A lump sum payment may, however, be a less restrictive alternative.

6.4.2 Settlement and Non-Assertion Agreements (Gs 204–209)

Guideline 204 does not cite *Bayer & Hennecke*[54] (4.1.2 above) but states that licensing iprs to settle disputes is not as such restrictive of competition since it allows the parties to exploit their technologies after the agreement, but that individual terms may be. It adds that licensing in the context of settlement agreements is treated like any other licence agreement.

It is therefore necessary to decide whether the technology of either or both blocked the other. If it did, the parties are not treated as competitors. Guideline 206 adds that if, in the absence of the licence the licensee could have been excluded from the market, the agreement is probably pro-competitive even if it limits competition between the parties. This seems inconsistent with the statement that a licence to settle disputes is treated like any other licence, but the Commission now uses as its counter the position that would have arisen in the absence of the licence (5.3.1 above).

Guideline 205 states that the TTBER applies if there is no hardcore restriction. If there was no blocking position, however, the parties may well be competitors and there may well be such a restriction. The settlement may be merely a means to restrict competition that existed in the absence of the agreement. Where the parties cross license each other, the imposition of restrictions on the use of their technologies, including restrictions on licensing third parties, may infringe Article 81.

Guideline 207 states that where parties with a significant degree of market power cross license each other, and the agreement imposes restrictions that clearly go beyond what is required to unblock the technologies, the agreement is likely to infringe Article 81(1) even if there was a mutual blocking situation, especially if they allocate markets or fix reciprocal running royalties that have a significant effect on market prices (6.4.1.1 above).

Guideline 208 states that where the parties licence each other and the agreement extends to future developments, it is necessary to assess the effects of the agreement on the parties' incentive to innovate. If they have significant market power and the agreement prevents either party from gaining a competitive lead over the other, it is likely to infringe Article 81(1) and fail to qualify under Article 81(3) because it reduces the incentive to innovate. Unblocking does not require sharing of future innovations. Where, however, the agreement increases the parties' freedom to design by allowing them to develop their respective technologies[55] and does not lead them to use the same technological solutions, they are unlikely to be prevented from innovating.

[54] *Bayer and Hennecke v Söllhöfer* (65/86), [1988] ECR 5249, [1990] 4 CMLR 182, [1990] 1 CEC 220 (4.2.1 above), a decision of a full Court of nine. See comment Valentine Korah, 'No Duty to Licence Independent Repairers to Make Spare Parts: The Renault, Volvo and Bayer & Hennecke Cases', [1988] 12 EIPR 381, at 384.

[55] As regards design freedom, see 6.4.3 at note 57 below.

Guideline 209 says that in the context of a settlement and non-assertion agreement, non-challenge clauses are generally considered to fall outside Article 81(1). This is what the Commission argued in *Bayer & Hennecke*,[56] but the ECJ merely said that such a provision was not necessarily contrary to Article 81(1) and suggested as relevant various rather surprising matters that went to the fairness of the settlement. It may be that this Guideline should give way to the judgment of the ECJ, but it is welcome. The judgment of the ECJ was unfortunate.

6.4.3 Technology Pools (Gs 210–235)

Guideline 210 defines what the Commission means by 'technology pools':

> 210. Technology pools are defined as arrangements whereby two or more parties assemble a package of technology which is licensed not only to contributors to the pool but also to third parties. In terms of their structure technology pools can take the form of simple arrangements between a limited number of parties or elaborate organisational arrangements whereby the organisation of the licensing of the pooled technologies is entrusted to a separate entity. In both cases the pool may allow licensees to operate on the market on the basis of a single licence.

It should be noted, however, that what is often called a patent pool is not included in the Commission's definition. In an industry when many firms hold many iprs or where there are many iprs of dubious validity, it is not unusual to arrange that all or some of the firms will license all the others. This frees each to design its own technology without having to monitor many patents to see if they are valid, and to take a view on the ones of dubious validity. Such an arrangement may reduce transaction costs substantially, and reduce the risk of developing technology that is later found to infringe iprs. [57] If entered into between only two undertakings, it may come within the group exemption provided the market shares do not exceed the relevant ceilings and there are no blacklisted provisions. Its object is unlikely to be joint sales, but the reduction of cost and risk. It is unlikely to infringe Article 81(1) but if it does, is likely to qualify under Article 81(3).

Technology pools frequently support (wholly or partly) a *de jure* or *de facto* industry standard. Different technology pools may support competing standards (G 211).[58]

[56] *Bayer and Hennecke v Söllhöfer* (65/86), [1988] ECR 5249, [1990] 4 CMLR 182, [1990] 1 CEC 220, a decision of a full Court of nine. This is also difficult to reconcile with G 204 (6.4.2 above).

[57] Many of the guidelines refer to the pro-competitive effect of providing design freedom for a firm to develop its own technology without risk of later finding that it infringes someone's ipr: Gs 17, 111, 122, 148, 182 and 208.

[58] For a good analysis of the problems created by standards and ways of reducing the number of cases where the doctrine of essential facilities will have to be invoked, see Maurits Dolmans, 'Standards for standards' (2002) 26 Fordham ILJ 163.

The Commission states that agreements establishing technology pools (even if there are only two parties) do not come within the TTBER because they are not granted for the production of contract products. Technology pools are created to be licensed as a package (G 41). It is thought that this goes further than Article 2(1)) and recital 7. If there are only two parties who are both able to use the pooled patents, it seems to me that the contract is one 'permitting the production of contract products'. Unfortunately, the Guideline seems to be more concerned with specified patents or other iprs than with specified technology, which may not be the same.

In principle, sub-licences granted by the pool may come within the block exemption, but often the ceiling of share of the technology market will be exceeded.

The anti- and pro-competitive effects of pools are described in Gs 213 and 214:

> 213. Technology pools may be restrictive of competition. The creation of a technology pool necessarily implies joint selling of the pooled technologies, which in the case of pools composed solely or predominantly of substitute technologies amounts to a price fixing cartel. Moreover, in addition to reducing competition between the parties, technology pools may also, in particular when they support an industry standard or establish a *de facto* industry standard, result in a reduction of innovation by foreclosing alternative technologies. The existence of the standard and the related technology pool may make it more difficult for new and improved technologies to enter the market.

It is thought that where a pool supports an industry standard, even a de facto one that must be used to enter another market, the members of the pool may be treated as jointly dominant and required to licence outsiders under Article 82 (Chapter 8 below). Article 81 may also apply and the agreement be void. Probably a court or competition authority could order a compulsory licence as a remedy for breach of either Article.

The Guidelines continue:

> 214. Technology pools can also produce pro-competitive effects, in particular by reducing transaction costs and by setting a limit on cumulative royalties to avoid double marginalisation. The creation of a pool allows for one-stop licensing of the technologies covered by the pool. This is particularly important in sectors where intellectual property rights are prevalent and where in order to operate in the market licences need to be obtained from a significant number of licensors. In cases where licensees receive on-going services concerning the application of the licensed technology, joint licensing and servicing can lead to further cost reductions.

Where a single person sells complementary products, it will be rational to reduce its price for each to increase demand not only for that product, but also for the other(s) and vice versa. This is called by economists 'avoiding double marginalisation'. There is an incentive not to charge the same mark up on each product that it would have charged singly. Yet the Commission objected in *Digital*[59] (a case that was settled), arguing that charging less than the stand alone price for two complementary items infringed Article 82. The Guideline lists other cost savings too.

Guidelines 215–219 explain the difference between complements and substitutes and between essential and non-essential technology:

> 216. Two technologies[60] are complements as opposed to substitutes when they are both required to produce the product or carry out the process to which the technologies relate. Conversely, two technologies are substitutes when either technology allows the holder to produce the product or carry out the process to which the technologies relate. A technology is essential as opposed to non-essential if there are no substitutes for that technology inside or outside the pool and the technology in question constitutes a necessary part of the package of technologies for the purposes of producing the product(s) or carrying out the process(es) to which the pool relates. A technology for which there are no substitutes, remains essential as long as the technology is covered by at least one valid intellectual property right. Technologies that are essential are by necessity also complements.

If the pooled technologies are substitutes for each other, royalties may be higher than they would have been without the pool because there is no competition between the technologies. When they are complements transaction costs are likely to be reduced and the royalties are likely to be lower because double marginalisation is avoided (G 217). Sometimes products are partly substitutes and partly complements. If efficiencies are increased by using both technologies, and licensees demand both, they will be treated as complements, even if partly substitutable. In the absence of the pool, licensees would probably demand both (G 218).[61]

Guideline 219 treats the pooling of substitute technologies as a joint sales arrangement, to be treated as a cartel.

> 219. The inclusion in the pool of substitute technologies restricts inter-technology competition and amounts to collective bundling. Moreover, where the pool is substantially composed of substitute technologies, the arrangement amounts to price fixing between competitors. As a general rule the Commission considers that the inclusion of substitute technologies in the pool constitutes a violation of Article 81(1). The Commission also considers that it is unlikely that the conditions of Article 81(3) will be fulfilled in the case of pools comprising to a significant extent

[59] Commission's annual report for 1997, page 153.

[60] The term 'technology' is not limited to patents. It covers also patent applications and intellectual property rights other than patents (Commission's footnote).

[61] Example 6 of the US Antitrust Guidelines for the Licensing of Intellectual Property, 6 April 1995, (1995) 68 ATRR 462, CCH TRR 13,132, [1995] 7 EIPR 3 is different. There, in the market affected by one of two cross licences, the parties were said not to be competitors because one protected invention was such a drastic improvement on the other that the other did not constrain its holder's market conduct, but in the market affected by the other licence they were competitors.

> substitute technologies. Given that the technologies in question are alternative, no transaction cost savings accrue from including both technologies in the pool. In the absence of the pool licensees would not have demanded both technologies. It is not sufficient that the parties remain free to license independently. In order not to undermine the pool, which allows them to jointly exercise market power, the parties are likely to have little incentive to do so.

In example 9 of the US guidelines, to the extent that the patent rights cover technologies that are close substitutes, charges are likely to be higher, but if there are any efficiencies they will be balanced against higher prices and the onus would be on the party alleging illegality.

Guideline 220 states that if all the technologies are essential, they are complements. Consequently, the creation of the pool as such generally does not infringe Article 81(1), but some of the provisions in the licence may do so.

Guideline 221 reminds us that if non-essential complementary patents are included in the pool there is a risk of foreclosing third party technology. If the licensees have already obtained a substitute and paid royalties through the pool, they are unlikely to subscribe for substitute technology. The inclusion of complements amounts to collective bundling. This may create difficulties in practice. What amounts to a substitute? Often there are imperfect substitutes—each may be less good in one respect and better in another. Guideline 221 concludes by stating that when a pool includes non-essential technologies the agreement is likely to infringe Article 81 if the pool has a significant position on the relevant market.

Guideline 222 observes that substitute and complementary technologies may be developed after the creation of the pool. To prevent foreclosure of third party technology it may be necessary to exclude technologies that have ceased to be essential. This may consume the time of scientifically qualified staff. The guideline sets out four other ways of avoiding foreclosure, such as enabling each party to license its iprs independently. Mark Schankerman has observed that if each party is free to licence its own substitute, there can be no foreclosure and he stresses the economies to be obtained by a pool.[62] Cross licensing and pools of substitutes or complements reduce transaction costs and by reducing the risk of litigation avoids the misallocation of R & D.

Guideline 224 sets out the main principles to be applied in appraising licences to the pool:

> (1) The stronger the market position of the pool the greater the risk of anti-competitive effects.
> (2) Pools that hold a strong position on the market should be open and non-discriminatory.

[62] Following work by Lerner and Tirole, at a conference organised by the University of Antwerp and LECG on 10 June 2005.

(3) Pools should not unduly foreclose third party technologies or limit the creation of alternative pools.

225. Undertakings setting up a technology pool that is compatible with Article 81, and any industry standard that it may support, are normally free to negotiate and fix royalties for the technology package and each technology's share of the royalties either before or after the standard is set. Such agreement is inherent in the establishment of the standard or pool and cannot in itself be considered restrictive of competition and may in certain circumstances lead to more efficient outcomes. In certain circumstances it may be more efficient if the royalties are agreed before the standard is chosen and not after the standard is decided upon, to avoid the choice of the standard conferring a significant degree of market power on one or more essential technologies. On the other hand, licensees must remain free to determine the price of products produced under the licence. Where the selection of technologies to be included in the pool is carried out by an independent expert this may further competition between available technological solutions.'

Where the pool is dominant, however, royalty and other licensing terms should be fair and non-discriminatory in order to ensure the pool is open and does not lead to foreclosure and other anti-competitive effects downstream (G 226). This reflects the strong position taken by Commission,[63] ECJ[64] and CFI[65] under Article 82 in relation to foreclosure and discrimination. The US attitude to section 2 of the Sherman Act is far less strict. It is hoped that in *British Airways* the ECJ will require a more realistic investigation into foreclosure and will be less hostile to discrimination, although it is expressly listed in Article 82 EC.[66] The obligation of a dominant firm to license iprs that protect technology indispensible to those operating on an adjacent market is considered at 9.8 below.

Guideline 227 imposes further provisos under Article 81, especially if the pool supports a (*de facto*) industry standard and there is a non-compete provision. To limit the risk of foreclosing third party technologies, the parties must be free to develop competing products and standards and to grant or receive licences outside the pool. Grantback provisions should be non-exclusive and limited to developments that are important to the use of the

[63] *Michelin II* (2002/405/EC), OJ 2002, L143/1, [2002] 5 CMLR 388, [2002] CEC 2503; on appeal, (T-203/01), 30 Sept 2003, [2003] ECR II-4071, [2004] 4 CMLR 923.

[64] *Hoffmann-La Roche & Co AG v Commission* (Vitamins loyalty discounts)(85/76), 13 February 1979, [1979] ECR 461.

[65] British Airways (T-219/99), 17 Dec 2003, [2004] 4 CMLR 1008, on appeal to the ECJ.

[66] In *Syfait, Synetairismos Farmakopoion Aitolias & Akarnanias (Syfait) and Others v Glaxosmithkline AEVE* (C-53/03), 28 October 2004, [2005] 5 CMLR 7 at para 89, A-G Jacobs justified conduct intended to reduce parallel trade on the ground that discrimination by a dominant firm was not anticompetitive in an extreme case where the price discrimination was created by the law of Member States, and where there were high fixed costs and comparatively low variable costs. The ECJ declined jurisdiction under Art 234, so the opinion of the A-G will retain some authority and is very welcome.

pooled technology. This prevents one licensee obtaining a blocking position against the rest (G 228).

Guideline 229 is concerned with the risk that pools may shield invalid patents. Challenge will fail if some of the rights being exploited are declared valid (4.1.2 above). To reduce the risk, any right to terminate in the event of challenge must be limited to the technologies owned by the licensor who is the addressee of the challenge.

Guidelines 230–235 consider the desirable institutional framework governing the pool. If participation in the pool and any standard it supports is open to anyone, it is more likely that the rights included are selected on the basis of price and quality (G 230).

7

Other Kinds of Commercial and Industrial Property Rights

THE GROUP EXEMPTION applies to pure patent, know-how or copyright licences for software. Patent is widely defined to include designs and plant breeders' rights, etc, and applications for these rights (5.2.1 above). The TTBER applies also to mixed licences that cover more than one of these kinds of intellectual property right (ipr). It does not apply to the transfer of traditional copyright for the purpose of reproduction and distribution of the protected work, nor to trademark licences, unless the copyright or trademark are not the primary object of the agreement licensing qualifying technology. The Commission intends to apply the TTBER by analogy to licences of traditional copyright (Guideline 51), which it lacks power to exempt by regulation, but not to trademarks (G 53). Nor will it apply the regulation by analogy to performing rights (G 52). Resale restrictions for performing rights may give rise to less concern on grounds of competition, and single branding may be more worrying.

Until Regulation 772/2004 came into force in May 2004, whether software licences could be brought within the block exemption for vertical distribution agreements was controversial, and doubtful. Licences of software copyright may, however, qualify under the new regulation. The most important remaining problems relate to trademark licences.

7.1 TRADEMARK LICENCES

Trademark licences have been perceived as a method of dividing the Common Market contrary to Article 81(1). In *Consten & Grundi*,[1] a distribution agreement that granted absolute territorial protection against intra-brand competition by enabling the dealer in each Member State to register the manufacturer's second trademark, was condemned. By enabling each dealer to sue parallel traders for trademark infringement, it sheltered the French dealer from all intra-brand competition. In the 1960s there was considerable distrust of iprs, perceived *ex post* as barriers to entry rather than *ex ante* as inducements to various kinds of investment. Moreover, the limitation of iprs to a single Member State made it possible to divide the Common Market, by exercising the right in the Member State of import. To prevent such partitioning, the ECJ developed the doctrine of exhaustion, which was extended to trademarks (2.2 above).

In *Sirena Srl v Eda Srl*,[2] The ECJ held that a trademark did not in itself infringe Article 81, but added that:

> the exercise of that right might fall within the ambit of the prohibitions contained in the Treaty each time it manifests itself as *the subject, the means or result* of a restrictive practice. When a trademark right is exercised by virtue of assignments to users in one or more Member States it is thus necessary to establish in such a case whether such use leads to a situation falling under the prohibitions of Article 81. (my italics)

It was not until *Hag II*,[3] that the ECJ showed any sympathy towards trademark protection:[4]

> 13. Trademark rights are, it should be noted, an essential element in the system of undistorted competition, which the Treaty seeks to establish and maintain. Under such a system, an undertaking must be in a position to keep its customers by virtue of the quality of its products and services, something which is possible only if there are distinctive marks which enable customers to identify those

[1] *Re the Agreement of Grundig Verkaufs GmbH* (64/566/EEC), 23 Sept 1964, JO 2545/64, [1964] CMLR 489; appeal *Etablissements Consten SA and Grundig-Verkaufs GmbH v EEC Commission* (56 & 58/64), 13 July 1966, [1966] ECR 299, [1966] CMLR 418, CMR 8046, para 37.

[2] (40/70), 18 February 1971, [1971] ECR 69, [1971] CMLR 60, CMR 8101, para 9.

[3] *CNL Sucal v Hag* (C-10/89), 17 October 1990, [1990] ECR I-3711, [1990] 3 CMLR 571, [1991] 2 CEC 457.

[4] See, eg, *Sirena Srl v Eda Srl* (40/70), 18 February 1971, [1971] ECR 69, [1971] CMLR 260, CMR 8101, following the extreme disdain of Advocate General Dutheillet de Lamothe, para 14.

> 7. The exercise of a trademark right is particuarly apt to lead to a partitioning of markets and thus to impair the free movement of goods between States which is essential to the Common Market. Moreover a trademark right is distinguishable in this context from other rights of industrial and commercial property, inasmuch as the interests protected by the latter are usually more important, and merit a higher degree of protection, than the interests protected by an ordinary trademark.

products and services. For the trademark to be able to fulfil this role, it must offer a guarantee that all goods bearing it have been produced under the control of a single undertaking which is accountable for their quality.

7.1.1 Trademark Licences are Block Exempted Only if Ancillary

The Commission has never adopted a block exemption for trademarks. It claimed to lack sufficient experience of trademark licensing. It did however make some provision for them in the block exemptions for vertical distribution agreements and technology licensing.

Regulation 2790/99[5] exempting vertical distribution agreements applies to:

> vertical agreements containing ancillary provisions on the assignment or use of intellectual property rights' (recital 3).

This is implemented by Article 2(3), which extends the exemption to

> vertical agreements containing provisions which relate to the assignment to the buyer or use by the buyer of intellectual property rights, provided that those provisions do not constitute the primary object of such agreements and are directly related to the use, sale or resale of goods or services by the buyer or its customers.

The drafting is unfortunate. Often licences of trademarks and technology are complementary: both are needed. Neither is ancillary to the other, and I fear that under the vertical regulation the burden is on the person alleging legality to establish that the other ipr is not the primary object of the transaction, although there is no specific precedent to establish this.[6] There are some helpful vertical Gs: 42–44[7] treating trademarks as ancillary to distribution franchise agreements. [8] These do not apply, however to industrial franchise agreements, which do not come within any block exemption.

Article 1(1)(b) of the TTBER does not include trademarks in its definition of a technology transfer agreement. It extends the regulation only to agreements containing provisions relating to the sale or purchase of products or the licensing or assignment of *other iprs* provided that those provisions *do not constitute the primary object of the agreement and are directly related to the production of primary products*. Article 1(1)(g) defines 'intellectual property rights' to include 'industrial property rights, know-how, copyright and neighbouring rights.' These do not expressly include trademarks.

Since trademarks do not constitute iprs for the purposes of the TTBER, one might have thought that trademark licences are not included in the

[5] Regulation 2790/1999 on the application of Article 81(3) of the Treaty to vertical agreements and concerted practices, OJ 1999, L336/21, [2000] 4 CMLR 398, [2000] 5 ECLR Supp.

[6] It is established by Reg 1/2003, OJ 2003, L1/1, [2003] 4 CMLR 551, art. 2.

[7] Guidelines on Vertical Restraints, OJ 2000, C291/1, [2000] 5 CMLR 1074.

[8] Discussed in Korah and Sullivan, (2002) *Distribution Agreements under the EC competition Rules*, (Oxford, Hart Publishing), para 3.4.10.2.

TTBER. Only if licensing the mark is not the primary object of the agreement, can the licence fall within the vertical regulation.

Technology Transfer G 50 states, however, that:

> 50. The TTBER only covers the licensing of *other types of intellectual property such as trademarks* and copyright, other than software copyright, to the extent that they are directly related to the exploitation of the licensed technology and do not constitute the primary object of the agreement. This condition ensures that agreements covering other types of intellectual property rights are only block exempted to the extent that these other intellectual property rights serve to enable the licensee to better exploit the licensed technology. The licensor may for instance authorise the licensee to use his trademark on the products incorporating the licensed technology. The trademark licence may allow the licensee to better exploit the licensed technology by allowing consumers to make an immediate link between the product and the characteristics imputed to it by the licensed technology. An obligation on the licensee to use the licensor's trademark may also promote the dissemination of technology by allowing the licensor to identify himself as the source of the underlying technology. However, where the value of the licensed technology to the licensee is limited because he already employs an identical or very similar technology and the main object of the agreement is the trademark, the TTBER does not apply.[9]

This was discussed at 5.1 above and is so clearly expressed that it will probably be followed. Nevertheless, it is strange that this guideline applies to trademarks which do not come within the definition in the regulation of intellectual property rights.

Guideline 62 explains that the agreement between licensor and licensee is subject to the TTBER and that between licensee and the buyer of the product is subject to the vertical distribution regulation. The licence itself may however include provisions about the use of trademarks and it is hoped that G 50 will be followed. Alternatively, if the licence includes patents, know-how and/or software, can the restrictions be attached to one of those rights, and the trademark licence be exempt as not being the primary object of the agreement exempt under the TTBER? If the trademark licence would not have been granted without the technology licence and vice versa, the two licences will form part of the same agreement.[10]

Article 2(5) of the vertical group exemption provides:

> This Regulation shall not apply to vertical agreements *the subject matter* of which falls within the scope of any other block exemption regulation.

So, it seems that, if G 50 is followed, it is only to the narrowly limited extent permitted by the TTBER exemption that a trademark licence is block exempted.

[9] See the Commission Decision in *Moosehead/Whitbread*, OJ 1990 L 100, p 32 (Commission's footnote).

[10] *BP Kemi-Atka A/S v BP Kemi A/S and A/S de Danske Spritfabrikker* (79/934/EEC), 5 September 1979, OJ 1979, L286/32, [1979] 3 CMLR 684, CMR 10165.

7.1.2 A Trademark Licence may, however, not Infringe Article 81(1)

There are few decisions or judgments on the licensing of trademarks, but the white lists of the earlier block exemptions for patents and/or know-how may well indicate circumstances in which a trademark licence will not infringe Article 81(1). It must, however, be remembered that trademarks protect trade reputation while patents protect investment in R & D. The distinct policies must be taken into account, as the ECJ looks to the specific subject matter of the particular kind of ipr when applying not only the rules for free movement, but also the competition rules.

Even if accompanying technology transfer, a promise not to challenge the validity of a trademark will not infringe Article 81 unless the mark is important in the licensee's territory.[11] Now that the Commission implies in Gs 134–140 that it is concerned about technology licences only when there is market power, trademark licences should be caught by Article 81 only when the mark confers significant market power.

7.1.3 Exclusive Licence with Restriction on Challenging Validity of Mark

The ECJ has never had occasion to decide whether the judgment in *Nungesser*[12] (4.1.1.2 above) applies to an open exclusive licence of a mark.

Before the Commission accepted generally that exclusive trademark licences infringe Article 81(1) only if there is market power, it exempted exclusive licences, but found them contrary to Article 81(1).[13] In *Moosehead/ Whitbread*,[14] it exempted a know-how and trademark licence, but cleared a limitation on challenging the ownership and validity of the mark on the ground that the mark was little known in the licensed territory.

Moosehead made beer in Canada with a specific yeast and sold it under the mark 'Moosehead'. It was difficult for the supplier of a brand not known locally to enter the English market because most draft beer is sold in pubs. The English licensing laws created an important barrier to the operation of new pubs and, at that time, most pubs were tied to one or other of the brewers. Moreover, most brewers distributed directly to the pubs, discouraging the development of wholesalers. Consequently, foreign brewers sometimes entered into a know-how and trademark licence with a local brewer, which had a substantial network of tied pubs.

[11] *Moosehead/Whitbread*, 7.1.3 below.

[12] *Nungesser (LG) KG and Kurt Eisele v Commission* (258/78), 8 June 1982, [1982] ECR 2015, [1983] 1 CMLR 278, CMR 8805.

[13] *Eg Campari-Re the Agreement of Davide Campari Milano SpA* (78/253/EEC), 23 December 1977, OJ 1978, L70/69, [1978] 2 CMLR 397, CMR 10035.

[14] (90/186/EEC), 23 March 1990, OJ 1990, L100/32, [1991] 4 CMLR 391, [1990] 1 CEC 2127.

Moosehead granted Whitbread the sole and exclusive right to produce and market beer under the Moosehead mark in the British Isles. Moosehead also transferred its mark for the United Kingdom into their joint names and provided Whitbread with the specific yeast and recipe. Whitbread agreed that the type and quality of the beer produced under the contract would comply with the Moosehead specifications and that it would not actively seek customers for the product outside its territory, although it was free to accept unsolicited orders. It also agreed, during the term of the agreement, not to produce or promote within the territory any other beer identified as a Canadian beer. Whitbread agreed not to challenge the validity or ownership of the mark.

Moosehead agreed to provide Whitbread with the special yeast and all the relevant know-how for producing the beer, while Whitbread agreed to comply with Moosehead's directions, to buy the yeast only from Moosehead or a person designated by Moosehead, to use the know-how only for the production of the product, and to keep it confidential. Lawyers might call this 'an exclusive know-how and trademark licence' and their clients, 'an industrial franchise'.

The Commission's realistic analysis under Article 81(1) in relation to the promise by Whitbread not to challenge Moosehead's ownership of the mark or its validity was very welcome. It said:

> 15.4. (a).... A clause in an exclusive trademark licence agreement obliging the licensee not to challenge the ownership of a trademark, as specified in the above paragraph, does not constitute a restriction of competition within the meaning of Article 85(1) (now Article 81(1)). Whether or not the licensor or licensee has the ownership of the mark, the use of it by any other party is prevented in any event, and competition would not thus be affected.

The validity of a trademark may be contested on any ground under national law and in particular on the grounds that it is generic or descriptive in nature. In such an event, should the challenge be upheld, the trademark may fall within the public domain and may thereafter be used without restriction by the licensee and any other party.

> A clause preventing the validity being contested may constitute a restriction of competition within the meaning of Article 85(1), because it may contribute to the maintenance of a trademark that would be an unjustified barrier to entry into a given market.
>
> Moreover in order for any restriction of competition to fall under Article 85(1) (now 81(1)), it must be appreciable. The ownership of a trademark only gives the holder the exclusive right to sell products under that name. Other parties are free to sell the product in question under a different trademark or trade name. Only where the use of a well-known trademark would be an important advantage to any company entering or competing in any given market and the absence of which therefore constitutes a significant barrier to entry, would this clause which impedes the licensee to challenge the validity of the trademark,

> constitute an appreciable restriction of competition within the meaning of Article 85(1).
>
> (b) In the present case Whitbread is unable to challenge both the ownership and the validity of the trademark.
>
> As far as the validity of the trademark is concerned it must be noted that the trademark is comparatively new to the lager market in the territory. The maintenance of the "Moosehead" trademark will thus not constitute an appreciable barrier to entry for any other company entering or competing in the beer market in the UK. Accordingly, the Commission considers that the trademark no-challenge clause included in the agreement, in so far as it concerns its validity ... does not constitute an appreciable restriction of competition and does not fall under Article 85(1).
>
> Furthermore, in so far as this clause concerns ownership, it does not constitute a restriction of competition within the meaning of Article 85(1) for the reasons stated in the first indent of point 15.4 above.

The exclusive trademark licence with a restriction on actively selling outside the territory and a restriction on competing with the Moosehead mark within the territory were, however, found to restrict competition contrary to Article 81(1),[15] but exempted. The exclusive licence foreclosed the other five big brewers from obtaining a licence from Moosehead. The effect on trade between Member States and on competition was appreciable, as Whitbread was large enough to export to other Member States.

The last part of the legal appraisal is difficult to reconcile with the Commission's view about the restraint on challenging the validity of the mark and seems to be a return to the *per se* approach to exclusive territories adopted in earlier decisions on patent licences. The mark was new in the territory and the Commission said that it could not have created much of an entry barrier to the other big brewers. Perhaps it was a compromise between more than one official responsible for the draft decision.

Equally important for technology transfer, the Commission found that the licence did not qualify under the group exemption for know-how licences.[16]

> (16) 1. The block exemption provided by Commission regulation 556/89 applies to agreements combining know-how and trademark licences where, as stated in Article 1(1), the trademark licence is ancillary to that of the know-how. In the present case the principal interest of the parties lies in the exploitation of the trademark rather than of the know-how. The parties view the Canadian origin of the mark as crucial to the success of the marketing campaign, which promotes the product as Canadian beer. Under these circumstances, the provision of the agreement relating to the trademarks is not ancillary and regulation 556/89 therefore does not apply.

[15] See also *Campari-Re the Agreement of Davide Campari Milano SpA* (78/253/EEC), 23 December 1977, OJ 1978, L70/69, [1978] 2 CMLR 397, CMR 10035, paras II.A.1 & III.A.1.

[16] Commission regulation 556/89, OJ 1989, L61/1, [1989] 4 CMLR 774.

This view has prevented industrial franchises qualifying under the know-how regulation (now expired and replaced) even where there was sufficient technical know-how to qualify as 'substantial'. The Commission's position was extreme, because the mark was new in Europe, so the licence was no more crucial than is the mark in any franchising agreement. Usually, the know-how and the mark are complementary to each other. Neither is much use without the other. In such cases, as the Commission held in *Moosehead/Whitbread*, the group exemption does not apply.

It is hoped that with the Commission's current view that economics is important, it would now decide that the exclusivity was not anti-competitive either and that courts and national competition authorities (NCAs) would take a similar view. The industrial franchise increased competition by enabling a foreign lager to be sold in the British Isles.

In a case decided a decade earlier, *Toltecs/Dorcet,*[17] the Commission had condemned a no challenge clause. A Dutch manufacturer agreed not to exercise its rights to the Toltecs mark against BAT, although BAT's mark had not been used for five years and, consequently, was subject to the risk of cancellation. The Commission considered that the restriction was particularly serious as it enabled firms to avoid the obligation to use trademarks, and by congesting national trademark registers, impeded penetration by new branded products. See also *Bayer & Hennecke*[18] (4.1.2 above), where the ECJ denied that there was a *per se* rule against no challenge clauses.

7.1.4 Obligations to Use the Licensor's Trademark on the Licensed Product not Generally Restrictive of Competition

The earlier block exemptions expressly permitted various provisions. Since we no longer have white lists, these provisions are not included in the TTBER. Guideline 155 (6.4.1 above), however, states that various obligations are not generally restrictive of competition. This statement is general and not limited to licences that qualify under the TTBER. They include

> (f) obligations to use the licensor's trademark or indicate the name of the licensor on the product.

This was permitted in the earlier technology transfer block exemption, provided the licensee was allowed to indicate that it was the manufacturer.

In *Burroughs AG and Ets Delplanque and Burroughs AG and Geha-Werke GmbH*[19] the commision cleared such a provision since the licensee

[17] (82/897/EEC, IV/C-30.128), 15 December 1982, OJ 1982, L379/19, [1983] 1 CMLR 412, CMR 10,459; confirmed by the ECJ, *BAT v Commission* (35/83) 30 January 1985, [1985] ECR 363. [1985] CMLR 470, CMR 14166.

[18] (65/86), [1988] ECR 5249, [1990] 4 CMLR 182, [1990] 1 CEC 220, a decision of a full Court of nine. See comment Valentine Korah, [1988] 12 EIPR 381, at 384.

[19] (72/25/EEC and 72/26/EEC), 22 December 1971, JO 1972, L13/47 and 50, [1972] CMLR D67 and D72, CMR 9485 and 9486, para. II.

was permitted to affix other marks. In *Boussois/Interpane*[20] the Commission did not object to a clause allowing the licensee to use its own mark, or that of the licensor with its consent.

Note the last three words of point (f) in G 155. In *Windsurfing International Inc v Commission*[21] the ECJ objected to an obligation to place the licensor's name on the sailboard, which was outside the scope of the patent, since the licensor thereby:

> encouraged uncertainty as to whether or not the sailboard too was covered by the patent and thereby diminishe d the consumer's confidence in the licensees so as to gain a competitive advantage for itself.

7.1.5 Trademark Delimitation Agreements

As the Common Market became integrated, the areas where a brand was familiar expanded and the reputation of marks that had been used by separate holders in different countries spread into each other's areas and became confusing. 'Honest concurrent user' is the term used by English lawyers for the situation. The problem arose more often because of the wide concept of confusion in German law. Some holders of marks that were confusingly similar therefore made delimitation agreements, defining their respective spheres of usage. Such agreements often contained restrictions on challenging each other's mark.

The Commission, confirmed by the ECJ, was concerned that these agreements might restrict competition by allocating markets because the parties would have to create goodwill if selling products into the other's market. On the other hand, when the delimitation agreement was intended to settle a genuine dispute by the least restrictive means and when it would not be necessary to develop a new mark to compete in the sphere of the other brand, the Commission and ECJ accepted trademark delimitation agreements.

In *BAT v Commission*,[22] The ECJ said:

> ...agreements known as "delimitation agreements" are lawful and useful if they serve to delimit, in the mutual interest of the parties, the spheres within which their respective trademarks may be used, and are intended to avoid confusion or conflict between them. That is not to say, however, that such agreements are

[20] *Re the Agreement between Boussois SA and Interpane-Entwicklungs- und Beratungsgesellschaft mbH & Co KG* (87/123/EEC), 15 December 1986, OJ 1987, L50/30, [1988] 4 CMLR 124, CMR 10859, para. 7

[21] (193/83), 25 February 1986, [1986] ECR 611, [1986] 3 CMLR 489, CMR 14271; appeal from Commission decision *Windsurfing International* (83/400/EEC, IV/29.395), 11 July 1983, OJ 1983, L229/1, [1984] 1 CMLR 1.

[22] (35/83), 30 January 1985, [1985] ECR 363, [1985] CMLR 470, CMR 14166, appeal from *Toltecs/Dorcet* (82/897/EEC), 15 December 1982, OJ 1982, L379/19, [1983] 1 CMLR 412, para 33; 7.1.3 above.

> excluded from the application of Article 85 (now Article 81) of the Treaty if they also have the aim of dividing up the market or restricting competition in other ways. As the Court has already stated [*Consten & Grundig*, p 346], the Community system of competition does not allow the improper use of rights under any national trademark law in order to frustrate the Community's law on cartels.

In several cases, the Commission persuaded the parties to solve the problem by agreeing to make the marks more distinctive. In the *Persil* case,[23] for instance, it persuaded the parties to change a market allocation agreement to one that allowed one party to use the mark 'persil' in red letters with the corporate name of the company in small letters in a red oval, while the other was allowed to use a green 'persil' mark.

7.2 TRADITIONAL COPYRIGHT LICENCES

The doctrine of exhaustion applies to copyright in goods, such as books, DVDs or records, but not to performing rights (2.3 above).

There were a few informal decisions of the Commission on copyright other than software reported many years ago in the *Competition Policy Reports* but the law and policy had not then been worked out. Guideline 51 states that:

> Although the TTBER does not cover copyright other than software copyright, the Commission will as a general rule apply the principles set out in the TTBER and these guidelines when assessing such licensing of copyright under Article 81.

The Commission considered that it had no power to grant a block exemption for traditional copyright and my first reaction was to think it could not create such power in a guideline. On second thoughts, however, since the procedural regulation,[24] it is likely that a NCA would follow the Commission's view, and national courts might well do so (3.4 above).

7.3 LICENCES OF PERFORMING AND RENTAL RIGHTS

Exclusive licences of performing rights were considered at 4.1.1.3 above. Exhaustion does not apply to them, and the grant of parallel exclusive licences may lead to absolute territorial protection without infringing Article 81(1).

7.4 CONCLUSION

Where licences of intellectual property rights not within the definition of Article 1(1)(b) of the TTBER are granted, the best advice probably is to

[23] VIIth Report on Competition Policy, (1977), points 138–140.
[24] Regulation 1/2003 on modernisation, OJ 2003, L1/1, [2003] 4 CMLR 551.

establish a file to show that only the minimum of restrictive provisions necessary to ensure that the transaction is viable has been accepted. A national court or the ECJ might decide that the licence promotes rather than restricts competition, at least in the absence of significant market power. Often there will be insufficient market power for anyone to establish that competition is restricted.

7.5 SUBCONTRACTING NOTICE (G 44)

In 1979, the Commission issued a notice on subcontracting[25] stating that in its view certain restrictions on the conduct of those to whom work is given out, and which are required to ensure the continued value of the technology and equipment, do not come within the prohibition of Article 81(1). This is an interesting and early example of the Commission adopting a flexible approach under Article 81(1). If the person requiring the work could not protect its technology, it would probably do it itself, and the result might be less competitive. The person undertaking the manufacture of the product is, therefore, not to be treated as an independent undertaking.

In so far as the technology or equipment is necessary to carry out the work under reasonable conditions, and the undertaking carrying it out could not reasonably obtain access to it otherwise, the sub-contractor may promise not to use it except for the purpose of carrying out the agreement; not to make it available to others; nor to supply the goods resulting from its use to anyone else. Either party may also agree not to disclose secret know-how, and the person doing the work may agree not to use secret manufacturing processes or know-how even after the agreement has expired, until they become public knowledge. It may also agree to a feed- and grant-back clause, which usually must be non-exclusive.

This notice has proved to be very useful. The official who drafted it listened carefully to comments from industry and it is not too tightly circumscribed to be of practical use. This is one of the few examples of the Commission using the adjective 'reasonable' rather than 'directly related'.

[25] Commission notice of 18 December 1978 concerning its assessment of certain subcontracting agreements in relation to Article 85 (1) of the EEC Treaty, OJ 1979, C1/2, CMR 2701.

8

Article 82

ARTICLE 82 FORBIDS as incompatible with the Common Market the abuse of a dominant position in the Common Market or a substantial part of it. The level of market shares are important, as is whether an undertaking has a much larger market share than its largest competitors.[1] Dominant positions have been found with market shares of just under 40 per cent, when there are other factors such as entry barriers[2]—far lower than would suffice for a finding of monopolisation under section 2 of the Sherman Act.

In Europe, it was held early on that the holder of a patent or other intellectual property right does not necessarily enjoy a dominant position: there may be substitutes on either the demand or supply side of the market.[3] The US Supreme Court used to presume a dominant position from the existence of iprs,[4] but modified its views substantially in cases not involving intellectual

[1] *Hoffmann-La Roche & Co AG v Commission* 85/76, [1979] ECR 461, [1979] 3 CMLR 211.

[2] *British Airways* (2000/74/EC), 14 July 1999, OJ 2000, L30/1, [2000] 4 CMLR 999, [2000] CEC 2,145; appeal (T-219/99), 17 Dec 2003, [2004] 4 CMLR 1008; on appeal to ECJ, OJ 2004, C106/22.

[3] *Parke, Davis & Co v Probel* (24/67), 29 Feb 1968, [1968] ECR 55, [1968] CMLR 47, CMR 8054; Deutsche Grammophon v Metro (78/70), 8 June 1971, [1971] ECR 487, [1971] CMLR 631, para 16; *Magill – Radio Telefis Eireann and Others v Commission* (C-241 & 242/91 P), 6 April 1995, [1995] ECR I-743, [1995] 4 CMLR 718, [1995] 1 CEC 400 (ECJ).

[4] *International Salt Co v* US, 332 US 392,68 S Ct 12, 92 L Ed 20 (1947).

property rights (iprs). The Federal Agencies did not follow the Supreme Court but applied a rule of reason even when there was a patent. In *Illinois Tool Works Inc v Independent Ink*,[5] the Court of Appeals for the Federal Circuit, which hears all patent appeals, considered, however, that although the old cases were wrong as demonstrated in extensive literature, it was bound by them. The Supreme Court has granted certiorari. So the issue will be decided soon.

Even a licence that comes within a block exemption from Article 81(1) may amount to the abuse of a dominant position.[6] The TTBER exempts a licence only from Article 81, not from Article 82. A licence by a dominant firm, however, is unlikely to come within the Regulation now that there are ceilings of market share well below the level where dominance is likely to be established.[7]

Some provisions that may be found in technology licences, such as tie-ins, single branding and refusals to supply, may infringe Article 82. Refusals to license and tie-ins relating to iprs will be considered in this chapter.

8.1 REFUSALS TO LICENSE

The second paragraph of Article 82 gives four examples of abuse, two of which may include refusals to grant a licence:

> (b) limiting production, markets or technical development to the prejudice of consumers,...
>
> (c) applying dissimilar conditions to equivalent transactions with other trading parties thereby placing them at a competitive disadvantage,...

Paragraph (b) has been applied to refusals to license, when this may harm consumers. Paragraph (c) applies only when there is discrimination between more than one licensee, when the transactions are equivalent and create a competitive disadvantage to one of them. The requirement of consumer detriment is not spelled out in paragraph (c), but recently, the Commission and ECJ have been far more concerned to protect consumers.

Where there is a serious bottleneck downstream, the ECJ has held that it is abusive for a dominant firm to refuse to supply goods to former customers, any number of them, without an objective justification. The view is based on the French idea current in the 1970s that everyone should have

[5] *Illinois Tool Works Inc v Independent Ink*, 25 Jan 2005, Court of Appeals, Federal Circuit, 396 F 3d 1342.

[6] *Tetra Pak I* (88/501/EEC), 26 July 1988, OJ 1988, L272/27, [1990] 4 CMLR 47, CMR 11015; on appeal *Tetra Pak Rausing SA v Commission* (T-51/89), 10 July 1990, [1990] ECR II-309, [1991] 4 CMLR 334, [1990] 2 CEC 409, para 25.

[7] Article 3 of TTBER sets ceilings of market share at 30 per cent each for licenses between non-competitors, 20 per cent between them for competitors (5.3 above).

equal access to scarce resources.[8] In later judgments mostly on refusals to license iprs, the law has developed differently: where there are exceptional circumstances, there may be a duty for a dominant firm to license at least one undertaking, even if it had never before supplied anyone. The ECJ has only recently used the term 'essential facilities', but the judgments seem to be based on the idea that in very narrowly defined circumstances consumers may want access to be given to undertakings operating in a neighbouring market. It is not clear whether these are parts of the same doctrine.

Refusals to deal may be perceived both as unfair and as reducing competition. The two objections have not been clearly distinguished by the ECJ and are considered together here. The earlier cases seem to have been based primarily on the notion of protecting competitors, but recently, the CFI and ECJ have been stressing that the function of competition law is to protect consumers rather than a particular competitor. Consequently, they have narrowed the obligation of a dominant firm to deal.

There is tension between static competition, which is increased if access is required to the incumbent's facilities which are essential in the market downstream, and dynamic competition, which is frequently considered more important by economists, following Schumpeter. Requiring the dominant incumbent to grant access to third parties may reduce the incentive to invest in an essential facility and the incentive for third parties to duplicate it where possible. Intervention may reduce dynamic competition.

It may also be arbitrary to fix the level of compensation. The level could lie anywhere between the cost of granting the licence (usually minimal) and the opportunity cost: loss of the profit to be made by exploiting the right oneself free of direct competitive restraints.

After the judgments on exhaustion (chapter 2 above), business and its advisers were concerned that the ECJ might extend the cases on refusal to supply to refusals to license. The grant of a compulsory licence may benefit consumers in the short term: more of the protected product will come to the market at lower prices.

Access to an essential facility is often protected by regulation, as in the case of telecommunications and energy, but in *Deutsche Telecom*,[9] the Commission decided that price regulation under national law does not exclude the application of Article 82. Contrast the US Supreme Court in *Trinko,*[10] which narrowed the doctrine of essential facilities almost to

[8] *United Brands* (27/76), 14 February 1978, [1978] ECR 207, [1978] 1 CMLR 429, CMR 8429, para 182, which sets out the position taken by French law.

[9] *Deutsche Telecom* (*re access to local loop*) (2003/707/EC, COMP/C-1/37.451, 37.578, 37.579), 21 May 2003, OJ 2003, L263/9, [2004] 4 CMLR 790, para. 212.

[10] *Verizon Communications IC v Trinko, LLP,* 540 US 398, 124 S Ct. 872, 157 L Ed 2d 823 (2004).

extinction, and the US Court of Appeals from DC in *Covad*,[11] which denied a private action for treble damages in antitrust for failure to perform regulated activities. Sometimes, access granted by the regulator will leave no need for an antitrust action.

In Europe, the scope for a duty on a dominant undertaking to give access may be wider. In *Deutsche Telecom*, the Commission imposed a fine for a margin squeeze by a very dominant former state monopolist, although it reduced by 10 per cent the fine it would have imposed because the wholesale and retail prices had been approved by the national telecommunications regulator and there were no precedents at the time of the infringement holding that compliance with national authority was no defence. One might comment that the national regulator permitted very high charges, but the Commission may treat the national regulation as irrelevant in later cases. EC law imposes a duty to deal on fair and reasonable terms—whatever that may mean—where in the US antitrust would defer to the regulator.

8.1.1 Commercial Solvents

The European case law started with *Commercial Solvents*.[12]

Commercial Solvents was the only firm in the world with know-how that enabled it to make certain chemicals, from which it later became possible to make a drug, ethambutol, for the treatment of patients with tuberculosis. It had previously been supplying this as a paint emulsifier. Zoja, which made ethambutol, used to buy the raw materials from Commercial Solvents, but discovered it could obtain them more cheaply from the paint emulsifiers and asked to be released from its contract with Commercial Solvents. When the supply dried up, Zoja asked Commercial Solvents to supply it again. Commercial Solvents refused. It had a joint venture that was making ethambutol and was supplying the raw materials only to it and to Cyanamid Italiano.

The ECJ confirmed the Commission's interim decision requiring supply on the terms as to price and quantity previously agreed. As observed by A-G Warner, Commercial Solvents was the only source of supply in the world. It had a stranglehold downstream over a significant market. It was possible to set the terms of the mandatory injunction by reference to the earlier terms that had been agreed. Moreover, the valuable use of the raw materials seems to have arisen by chance, although I am not sure that the possibility of a valuable new application being discovered should be relevant. The refusal

[11] *Covad Communication Company et al v Bell Atlantic Corp et al*, March 1, 2005, 398 F 3d 666, 2005-1 Trade Cases P 74, 712 (CADC, 2005).

[12] *Istituto Chemioterapico Italiano SpA and Commercial Solvents Corpn v Commission* (6 & 7/73), 6 March 1974, [1974] ECR 223, [1974] 1 CMLR 309, CMR 8209.

enabled Commercial Solvents to reserve to its joint venture and one other firm a valuable market downstream. It is not clear whether the ECJ was protecting a smaller firm on grounds of fairness, or whether it was protecting those paying for the treatment of tubercular patients.

8.1.2 *Volvo*

The first case involving a refusal to license intellectual property was *Volvo AB v Erik Veng (UK) Ltd.*[13] The ECJ followed A-G Mischo and held that the right to restrain third parties from exploiting the design for front wing panels for a Volvo car 'constitutes the very subject matter of that exclusive right' (paragraph 8). Nevertheless it added in the next paragraph that the exercise of the design right might be forbidden by Article 82 if it involves:

> certain abusive conduct such as the arbitrary refusal to supply spare parts to independent repairers, the fixing of prices for spare parts at an unfair level or a decision no longer to produce spare parts for a particular model even though many cars of that model are still in circulation, provided that such conduct is liable to affect trade between Member States.

It was not alleged that Volvo was doing any of these things, so no one had an interest in disputing the examples which were given by counsel at the hearing. In the situations mentioned, however, the interest of current consumers in access being granted is particularly strong and the intervention of the competition rules does not completely destroy the ipr. So, the trade-off between the dynamic and static considerations was more favourable to granting a licence in these circumstances. It is only the refusal to supply spare parts etc coupled with a refusal to license that abuses (paragraphs 9 and 11). The hypothetical duty to license seems to apply for the benefit of any number of repairers, even though none had been licensed before. This goes further than *Commercial Solvents,*[14] where the incumbent had previously been supplying Zoja.

On the same day, and on very similar facts, in *CICRA v Reynolds,*[15] the ECJ ruled that securing an ipr could not, in itself, amount to an abusive method of eliminating competition. In neither judgment was much attention given to the terms of a compulsory licence as the conditions for requiring one did not prevail, although the ECJ, following A-G Mischo, stated that it was not unfair to charge customers of spare parts a proportion of the design costs, even if the holder had already charged part for original equipment.

[13] (238/87), 5 October 1988, [1988] ECR 6211, [1989] 4 CMLR 122, CMR 14498.

[14] *Istituto Chemioterapico Italiano SpA and Commercial Solvents Corpn v Commission* (6 & 7/73), 6 March 1974, [1974] ECR 223, [1974] 1 CMLR 309, CMR 8209.

[15] (53/87), 5 October 1988, [1888] ECR 6039, [1990] 4 CMLR 265, [1990] 1 CEC 267, para 15.

8.1.3 *Magill*

The Commission and ECJ further limited iprs in the famous *Magill* case.[16] The Commission found that each of the three TV stations that transmitted in Eire and Northern Ireland (separate Member States) was dominant over the listings of its own programmes and enjoyed copyright protection. When Magill started to publish comprehensive weekly listings for all three stations, each TV station successfully sued for copyright infringement. The Commission, confirmed by the court of first instance (CFI) and ECJ, decided that to do so amounted to abuse of a dominant position over the programme information.

The ECJ confirmed that not all iprs confer a dominant position (paragraph 46). It had held in earlier judgments that there may be substitutes on the demand side of the market, barriers to entry on the supply side may not be high and a drug may have serious side effects or not work. Each TV station, however, enjoyed a *de facto* monopoly over the list of its own programmes and was the only source of information that was essential to an undertaking producing an Irish comprehensive TV guide.

The Court confirmed (paragraph 49) that in the absence of Community standardisation or harmonisation, the scope of iprs is a matter for national law, but added that:

> the exercise of an exclusive right by the proprietor may, in exceptional circumstances, involve abusive conduct.

The producer of a comprehensive weekly guide was dependent on the stations for the programme information:

> 54. The appellants' refusal to provide basic information by relying on national copyright provisions thus prevented the appearance of a new product, a comprehensive weekly guide to television programmes, which the appellants did not offer and for which there was a potential demand. Such refusal constitutes an abuse under heading (b) of the second paragraph of Article 86 (now Article 82) of the Treaty.

The refusal was not justified (paragraph 55) and enabled the stations to reserve the market for weekly TV guides to themselves (paragraph 56). In the light of all these circumstances, the ECJ held that the CFI had not erred in law when confirming the Commission's decision.

[16] *Magill TV Guide (Re the): ITP, BBC and RTE v Commission* (89/205/EEC), 21 December 1988, OJ 1989, L78/43, [1989] 4 CMLR 757, [1989] 1 CEC 2,223; on appeal *Radio Telefis Eireann and Others v Commission* (T-69, 70, 76-77 & 91/89), 10 July 1991, [1991] ECR II-485 *et seq*, [1991] 4 CMLR 586 *et seq*, [1991] 2 CEC 114, 147 & 174 (CFI); *Radio Telefis Eireann and Others v Commission* (C-241 & 242/91 P), 6 April 1995, [1995] ECR I-743, [1995] 4 CMLR 718, [1995] 1 CEC 400 (ECJ).

How far the judgment went was controversial. What was exceptional? Were the conditions of paragraph 54 cumulative, as indicated by the conjunction 'and'? Were they exhaustive or might other circumstances be special? Unlike the earlier cases on refusal to supply goods or services but like *Volvo*, the stations had never supplied the information to anyone before.[17] In this the judgment extended the application of Article 82, but the ECJ stressed that it is only in exceptional circumstances that a refusal to license is abusive.

Sir Jeremy Lever has suggested[18] that the result of the judgment was correct. The three stations enjoyed exclusive rights to broadcast and should not be allowed to exclude others from the associated market for guides to their programmes by refusing information as to how the broadcasting franchise was being exercised. He objected strongly, however, to limiting the circumstances to be treated as special to those relevant in *Magill*. The novelty of the product the newcomer wanted to produce might well be relevant, but should not be a requirement.

In my view, the three circumstances treated as special in *Volvo* were different from those in *Magill*. Where the component must fit the complete product, it cannot be new. Both judgments are of the ECJ and of equal status. John Temple Lang has treated[19] the three examples in *Volvo* not as special circumstances, but as examples of a second abuse which enabled the ECJ to hold that a duty to license arose.

Few Member States grant copyright in information.[20] There was no need for copyright to induce publication because the stations needed consumers to be aware of their programmes. Nevertheless, it is questionable on grounds of policy whether competition law should limit iprs. Judges and competition authorities may not have the right backgrounds for the task. It would lead to uncertainty and iprs might not induce sufficient investment were their validity subject to so vague a test.

It has been argued that there was no market downstream since no one produced a comprehensive guide. The ECJ did not address the point, which in my view is bad. Later, it was rejected by the ECJ in its preliminary ruling in *IMS* (8.1.7.3 below). The question should be whether the dominant firm controls an output needed to satisfy potential demand downstream.[21] The situation for consumers is worse if the dominant firm supplies no one than if it supplies at least one independent firm.

[17] Except on restrictive terms to newspapers for a day at a time (longer when weekends or public holidays intervened), *Radio Telefis Eireann and Others v Commission* (T-69, 70, 76–77 & 91/89), 10 July 1991, [1991] ECR II-485 *et seq*, para 9. The CFI had held that these were not substitutes (at para 62 of the CFI's judgment) and on questions of fact the ECJ has no jurisdiction.

[18] At the Fordham University School of Law Thirteenth Annual Conference on International Intellectual Property Law and Policy, 31 March–1 April 2005.

In the earlier cases on refusals to supply goods the ECJ had referred to excluding all competition from a particular undertaking. In *Magill*, at paragraph 56, the Court referred to reserving the market to the dominant firms, which amounts to excluding all competition downstream, not only that of the complainant, although this was not how 'reserving the market for the incumbent' was interpreted earlier in *Télémarketing*.[22] The issue was not important since, on the facts, all competition by anyone had been eliminated.

8.1.4 *Tiercé Ladbroke*

In *Tiercé Ladbroke v Commission*,[23] the CFI confirmed that a refusal to license performing rights will rarely infringe Article 82 and not when the applicant is already the largest supplier in the market downstream. It held, however, that the conditions given in paragraph 54 of *Magill* were alternative: it sufficed if the newcomer wanted access to make a new product *or* one for which there was no substitute.

Since no other licence was granted for Belgium, there was no discrimination and Article 82(c) was not infringed. Since Ladbroke was already the largest supplier of betting services in Belgium, any facility was not essential within Article 82(b).

[19] Barry Hawk (ed) (2003) 'Anticompetitive non-pricing abuses under European and national antitrust law,' (Fordham Corporate Law Inst, New York, Juris, 2004), pp 235–340, 292–298.

[20] At the Fordham IP conference in 2005, Sir Jeremy Lever doubted whether there was copyright in the listings. True, they could not legally have been copied without permission, but the information was not protected.

[21] See *Queensland Wire Industries Pty Ltd v Broken Hill Pty Ltd* (1988) 83 ALR 577, comment Valentine Korah, (2000) 32 *Victoria University of Wellington Law Review* 231, 233 *et seq*; Hanks and Williams, (1990) 17 *Melbourne ULR* 437. The Australian supreme court, its High Court, treated a margin squeeze as a constructive refusal to supply. In my view this was commendable. BHP, which operated the only rolling mill in Australia, refused to supply Queensland Wire with Y bar, out of which BHP's subsidiary was making star pickets – an important component of rural fencing. It charged Queensland Wire for Y bar the price at which its subsidiary was selling star pickets. The High Court reversed the Federal Court which had held that, since BHP never sold Y bar, there was no market for the product and that BHP was not excluding Queensland Wire 'from a market': the relevant prohibition under Australian competition law.

The problem remains at what level the price becomes so high as to amount to a constructive refusal to supply. The advantage of the High Court's judgment is that margin squeezes will be illegal only when there is a duty to supply. Only in a strong case will the static view apply.

[22] *Centre Belge d'Etudes du Marché-Télémarketing SA (CBEM) v Compagnie Luxembourgeoise de Télédiffusion* (311/84), 3 October 1985, [1985] ECR 3261, [1986] 2 CMLR 558, CMR 14246.

[23] (T-504/93), June 12 1997, [1997] ECR II-923, [1997] 5 CMLR 309, [1997] CEC 812; there are several cases called *Ladbroke v Commission*: the appeal in *Tiercé Ladbroke* has been withdrawn.

8.1.5 *Oscar Bronner*

Oscar Bronner[24] is a very important case. It involved requiring access to the only national home delivery service for newspapers in Austria. The delivery service was not protected by any ipr. The judgment and opinion were cited by the ECJ in *IMS* (8.1.7 below), by Advocate-General Jacobs in *Syfait* (8.1.8 below), as well as by the Commission in *Microsoft* (8.1.9 below), and have been influential. In *Bronner*, Advocate-General Jacobs made several important general points:

> 56. First it is apparent that the right to choose one's trading partners and freely to dispose of one's property are generally recognised principles in the law of Member States, in some cases with constitutional status. Incursions on those rights require careful justification.
>
> 57. Secondly, the justification in terms of competition policy for interfering with a dominant undertaking's freedom to contract often requires careful balancing of conflicting considerations. In the long term it is generally pro-competitive and in the interest of consumers to allow a company to retain for its own use facilities which it has developed for the purpose of its business. For example, if access to a production, purchasing or distribution facility were allowed too easily there would be no incentive for a competitor to develop competing facilities. Thus while competition was increased in the short term it would be reduced in the long term. Moreover, the incentive for a dominant undertaking to invest in efficient facilities would be reduced if its competitors were, upon request able to share the benefits. Thus the mere fact that by retaining a facility for its own use a dominant undertaking retains an advantage over a competitor cannot justify requiring access to it.
>
> 58. Thirdly, in assessing this issue it is important not to lose sight of the fact that the primary purpose of Article 82 is to prevent the distortion of competition—and in particular to safeguard the interests of consumers rather than to protect the interests of particular competitors. It may therefore, for example, be unsatisfactory, in a case in which a competitor demands access to raw materials in order to be able to compete with the dominant undertaking on a downstream market in a final product, to focus only on the latter's market power on the upstream market and conclude that its conduct in reserving to itself the downstream market is automatically an abuse. Such conduct will not have an adverse impact on consumers unless the dominant undertaking's final product is sufficiently insulated from competition to give it market power.

After analysing the case law, he added, at paragraph 65, that the essential facilities doctrine was justified only when there was 'a genuine stranglehold on the related market'. The cost of duplication might be enough, especially

[24] *Oscar Bronner GmbH & Co KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co KG and Others* (C-7/97), 26 November 1998, [1998] ECR I-7817, [1999] 4 CMLR 112, [1999] CEC 53.

if the original investment had been made under non-competitive conditions, for instance, partly through public funding.

He added at paragraph 69 that, since the owner does not want to grant access, someone would have to assess the amount of compensation. I would add that this could be anywhere between the cost of granting access (usually minimal) and the opportunity cost of doing so (the income foregone by admitting a competitor). The task would be difficult enough for a regulator, who would have more information about the regulated market, and even more difficult for a court or general competition authority.

The judgment of the ECJ was shorter than the opinion of the A-G. The Court said that:

> 41.... *even if that case-law on the exercise of an ipr were applicable to the exercise of any property right whatever*, it would still be necessary, for the *Magill* judgment to be effectively relied upon in order to plead the existence of an abuse within the meaning of Article 82 of the Treaty in a situation such as that which forms the subject-matter of the first question, not only that the refusal of the service comprised in home delivery be likely to eliminate all competition in the daily newspaper market *on the part of the person requesting the service* and that such refusal be *incapable of being objectively justified*, but also that the service in itself be *indispensable* to carrying on that person's business, in as much as there is no actual or potential substitute in existence for that home-delivery scheme. [My italics]

The Court's first phrase in paragraph 41 suggests that the cases on refusal to license may be distinguished from the earlier judgments on refusals to give access to goods or services. Whether or not iprs are involved, it is not enough for the newcomer to show that access is desirable, it must establish that it is necessary (paragraphs 41 and 45). The Court was not required to state when access is required, it sufficed to indicate that it was not required when there were other ways of delivering newspapers (paragraph 43),[25] or where other publishers were capable of creating a similar facility (paragraph 44). This implies that where two undertakings are able to compete in the neighbouring market there may be no need to require access for a third. This is contrary to the facts of the original judgment in *Commercial Solvents*,[26] where both Istituto and Cyanamid Italiano were making and selling ethambutol.

The Court reverted to the old test that, to be abusive, the refusal must exclude a particular firm (not everyone) from the market downstream (paragraph 41). Neither Advocate-General nor the Court discussed whether Bronner's newspaper was a new product. There were other Austrian newspapers,

[25] The application of the test to the facts was a matter for the national court that had requested a reference.

[26] *Istituto Chemioterapico Italiano SpA and Commercial Solvents Corpn v Commission* (6 & 7/73), 6 March 1974, [1974] ECR 223, [1974] 1 CMLR 309, CMR 8209, 8.1.1 above.

but presumably they attracted different groups of readers. The complainant failed on the ground that since there were other ways of delivering the paper, access was not necessary. Whether the product was sufficiently new did not have to be decided.

In several recent judgments, the CFI has required the Commission to find that the business downstream could not be carried on without access to the facility.[27] A-G Jacobs argued in *Bronner* at paragraph 66 that where a facility has been paid for by the state, it would be particularly difficult for a new entrant to duplicate the facility. One might add that where the incumbent was protected by special or exclusive rights and not subject to close competition, the need for an incentive to investment is less important. The many decisions of the Commission requiring port authorities not to discriminate in favour of their own sailings may be based on their exclusive franchise at the time the port was developed, but this is not expressly mentioned. Often, when nationalised undertakings are liberalised, a national regulator is established with power to control prices, thereby relieving the courts of a task to which they are ill suited.[28]

8.1.6 IMS Appeal to CFI

An interim decision of the Commission required IMS to license its copyright in what was claimed to be a *de facto* industry standard, a set of maps on the basis of which IMS provided localised data to its clients, the pharmaceutical laboratories.[29] IMS had obtained an injunction from a German court to restrain NDC and another from infringing its copyright in the maps. The decision suggests that where a *de facto* industry standard is protected by an ipr and prevents all competition in a neighbouring market, the holder is required to grant a licence. Where an industry standard necessary for a newcomer to enter a market is protected by an ipr it may be sensible to require a licence, even if there was no fraud in establishing the standard. IMS appealed against the interim decisions and requested interim relief, but this remains to be established by the courts.

[27] Eg, *European Night Services (ENS) and Others v Commission* (T-374, 375, 384 & 388/94), 15 September 1998, [1998] ECR II-3141, [1998] 5 CMLR 718, [1998] CEC 955, paras 205–221; appeal from Commission decision (94/663/EC, IV/34.600), 21 September 1994, OJ 1994, L259/20, [1995] 5 CMLR 76.

[28] In *Deutsche Telekom* (COMP/C-1/37.451, 37.578, 37.579), May 21 2003, OJ 2003, L263/9, [2004] 4 CMLR 790; the Commission imposed a fine for squeezing the margins of competitors who wanted access to the local loop, although its prices had been approved by the national reguatory authority. The decision has been appealed *Deutsche Telekom v Commission* (T-271/03), OJ 2003, C264/29. The CFI will have to decide whether compliance with regulation takes conduct outside the competition rules. The matter is currently before the US Supreme Court in *Independent Inc* 416 F3d 29 (CA, DC, 2005), but the Agencies do not take cases where the conduct complies with regulation.

[29] *IMS interim order of Commission* (2002/165/EC, COMP D3/38.044), 2 July 2001, OJ 2002, L59/18, [2002] 4 CMLR 58, [2002] CEC 2,234.

The President of the CFI issued an order[30] suspending the duty to license so that the whole chamber dealing with the case could decide whether there was a duty to supply. He considered that there was a *prima facie* case that the obligation to license went too far and the matter was urgent because once IMS's clients started taking its competitors' data, it might be impossible to win them all back. It was argued that the newcomers did not intend to provide an entirely new service. They wanted to provide the pharmaceutical companies electronically with similar data, which they bought independently of IMS. The question arose whether the conditions set out in paragraph 54 of *Magill* (8.1.3 above) were cumulative and were they exhaustive?

A hearing in the CFI on the Commission's interim order was held and was largely concerned with the extent of switching costs for customers. If they were high, it was more likely that the use of the maps was indispensable. The Commission then withdrew its interim decision prospectively[31] because the Regional Court of Appeal in Frankfurt had quashed the injunction not to use IMS's maps on the ground that IMS did not hold the copyright. The Commission did not suggest that the interim decision might have been excessive when adopted. On 10 March 2005 the CFI decided to terminate its proceedings on the ground that the case now lacked substance, as the Commission's interim order had been effective for only a few weeks and had now been withdrawn.

8.1.7 Preliminary Ruling in IMS

The German court that had granted the injunction had asked the ECJ for a preliminary ruling to ascertain whether IMS had infringed Article 82 by refusing to license.

8.1.7.1 Are the Special Circumstances in Magill Exhaustive?

The ECJ[32] followed *Magill* closely and with no reference to policy. At paragraph 38 it stated that the conditions set out in *Magill* were cumulative and exhaustive. There is an abuse only if:

[30] *IMS Health v Commission* (T-184/01 R II), 26 October 2001, OJ 2002, C144/45, [2002] 4 CMLR 58; confirmed by the President of the ECJ, *NDC Health v Commission* (C-481/01 P(R)), 11 April 2002, [2002] ECR I-3401, [2002] 5 CMLR 44; *IMS Health v Commission* (T-184/01), 10 March 2005, judgment not published yet.

[31] *NDC Health v IMS Health* (2003/741/EC, COMP D3/38.044), 13 August 2003, OJ 2003 L268/69, [2003] 5 CMLR 820. The Commission has claimed that the appeal now lacks any object and should be rejected, but IMS may fear that the withdrawal is only prospective and it is in danger of actions for damages based on the Commission's initial decision.

[32] *IMS Health GmbH & Co KG v NDC Health* (C-418/01), 29 April 2004, [2004] 4 CMLR 1543, paras 48–50. See also Opinion of A-G Tizzano at paras 61–61. The A-G merely cites earlier judgments and the Court's judgment is even shorter.

> 49. The undertaking which requested the licence does not intend to limit itself essentially to duplicating the goods or service already offered on the secondary market by the owner of the copyright but intends to produce new goods or services not offered by the owner of the right and for which there is a potential consumer demand.

This confirms the narrow view of paragraph 54 of *Magill*. For an obligation to license to arise, the potential licensee must intend to introduce a new product for which there is consumer demand and which is not offered by the holder of the right: presumably, case law will have to work out how different and superior the product demanded is from that already supplied. There is considerable controversy about the requirement that the undertaking requiring access must intend to produce something new.[33] Not only is the concept of novelty imprecise, 'intention' is also a slippery word. Perhaps, a minor change to an existing product is not enough; there must be a new kind of product.[34]

In *Volvo* (8.1.2 above) the ECJ had indicated other circumstances that might give rise to a duty to supply, such as refusing to license a repairer to make spare parts coupled with a refusal to supply etc. In *Microsoft*,[35] a decision adopted when the judgment in *IMS* was probably already being translated, although not yet delivered, and it was too late to change anything, the Commission relied on there being other possible exceptional circumstances. The remarks of the ECJ in *Volvo* were not necessary to the decision, whereas those in *IMS* were. The ECJ, however, has not developed a distinction between *obiter dicta* and *ratio decidendi*.

For the reasons given by A-G Jacobs in *Oscar Bronner* (8.1.5 above), I hope that refusals to license rarely amount to an abuse, but there seem to be no good reasons for limiting the doctrine to cases where the newcomer wants to make a new product. In cases dealing with an open exclusive licence, the Commission never found that a product was new, even if it was the best available, but this was rejected by the ECJ in the *Maize Seed* case, a case on the meaning of an 'open exclusive licence',[36] where the

[33] Contrast Derek Ridyard, 'Compulsory Access Under EC Competition Law – A New Doctrine of "Convenient Facilities" and the Case for Price Regulation,' [2004] 11 ECLR 669, who fears that even minor changes intended by the newcomer would create a duty to give access, with Christian Ahlborn, David S Evans and A Jorge Padilla, 'The Logic & Limits of the "Exceptional Circumstances Test" in *Magill* and *IMS Health*,' (2005) *Fordham ILJ* (forthcoming):

> We say that a product is "new" for the purpose of the implementation of the ECJ test if it satisfies a potential demand by meeting the needs of consumers in ways that existing products fail to do. That is, a new produce *expands* the market at current prices by bringing in consumers whose demands were not previously satisfied.

[34] At a conference organised by the University of Antwerp and LECG, on 10 June 2005, John Temple Lang suggested that para 54 in *Magill* related to a new kind of product and not just a new product. I find the distinction difficult to draw. How different must the new product be to be different in kind?

Commission had found that the improved varieties were not new. In my view, it is unfortunate that the Court attempted to define the criteria of special circumstances in a short phrase.

8.1.7.2 Access must be Essential to Prevent all Competition being Eliminated

Following constant case law, in *IMS* (paragraphs 40–45) the ECJ repeated that for the refusal of access to amount to an abuse, access must be essential. Whether it was essential is a matter for the national court (paragraphs 46 and 47). A-G Tizzano went a little further and stated (paragraphs 84–86) that if there were exceptional switching costs for the customers of the firms wanting access, access would be necessary. This might depend on the extent to which the customers had helped IMS to create a standard and adapted their organisation to the standard.

A-G Tizzano (paragraph 61) said that not only must access be essential to the complainant, the refusal must eliminate all competition on the secondary market,[37] a phrase used also in the judgment, paragraph 52. Until the judgment in *IMS* was delivered, many judgments referred to eliminating all competition *on the part of the person requesting the service or licence.* That is true in the early cases on refusal to supply goods,[38] also in *Bronner* (8.1.5 above). In *Magill* (8.1.3 above) (paragraph 56), the Court referred to the dominant firm reserving the market to itself or its subsidiary, but in *Télémarketing,*[39] it referrred to this as meaning eliminating all competition *on the part of the person requesting the service* (paragraphs 26–27).

If the judgment in *IMS* has settled the matter, a duty to supply may be reduced by supplying an undertaking that is not likely to act very aggressively. There is always a risk, however, that if the price for supply remains high, or the Court is of the view that access is only theoretical (to avoid a duty to supply) the Court might refer back to other cases, such as *Bronner.*

8.1.7.3 Secondary Market may be Potential or Hypothetical

The ECJ accepted that the duty to supply arises only if there are two separate markets, one upstream and the other down, but it followed A-G Tizzano

[35] 8.1.9 below, at para 55.

[36] *Nungesser (LG) KG and Kurt Eisele v Commission* (258/78), 8 June 1982, OJ 1978 L286/23, [1982] ECR 2015, [1983] 1 CMLR 278, CMR 8805, para 53.

[37] In *Magill* (para 56; 8.1.3 above) the ECJ referred to the dominant firms reserving the secondary market to themselves, which amounts to the same thing.

[38] *Istituto Chemioterapico Italiano SpA and Commercial Solvents Corpn v Commission* (6 & 7/73), 6 March 1974, [1974] ECR 223, [1974] 1 CMLR 309, CMR 8209, para 25.

[39] *Centre Belge d'Etudes du Marché-Télémarketing SA (CBEM) v Compagnie Luxembourgeoise de Télédiffusion* (311/84), 3 October 1985, [1985] ECR 3261, [1986] 2 CMLR 558, CMR 14246.

(paragraphs 56–59) and added that 'it is sufficient that a potential market or even a hypothetical market can be identified (paragraph 44):' a question for the national court to answer. This view delights me (8.1.3 above): requiring only a potential or hypothetical market seems to me to be a polite way of rejecting the doctrine that for a duty to supply to arise there must be two markets where transactions are being concluded.[40] It does, however, enable the holder of the essential asset to exploit the primary market.

8.1.7.4 No Justification

No specific observations were made to the Court about whether the refusal was justified. As in many earlier cases, the ECJ said that there is abuse if the refusal is not justified by objective considerations (paragraph 52).

8.1.8 *Syfait*

In *Syfait*[41] the Greek competition authority asked the ECJ for a preliminary ruling. Greek wholesalers had complained that Glaxosmithkline (GSK) had ceased in November 2000 to meet in full their orders for three medicines over which it held a dominant position, and that GSK had stated that it would supply hospitals and pharmacies directly. GSK alleged that parallel exports by the wholesalers had led to significant shortages on the Greek market. The Greek authority accepted that GSK enjoyed a dominant position over the three medicines and observed that all the Member States fix the prices of pharmaceutical products within their territories. Prices in Greece were consistently the lowest among all the Member States.

Eventually, the ECJ declined jurisdiction on the ground that the Greek authority was subject to ministerial influence and, consequently, was not an independent court or tribunal entitled to a preliminary ruling. Advocate-General Jacobs had, however, perceptively analysed the case law and the economic context of the refusal to supply. He accepted (paragraph 66) that on occasion a dominant firm might be under an obligation to supply goods or services, for instance when an interruption would disrupt competition downstream between the incumbent and its customer or, in a narrow range of circumstances, it might have to supply a third party for the first time to avoid exceptional harm to competition. He noted the difference between the earlier case law on refusals to supply goods and the later decisions since *Volvo* (8.1.2 above).

[40] 8.1.3 above, note 21.

[41] *Synetairismos Farmakopoion Aitolias & Akarnanias (Syfait) and Others v Glaxosmithkline AEVE* (C-53/03), [2005] 5 CMLR 7. The ECJ declined jurisdiction under Art 234, so the opinion of the A-G will retain some authority.

Nevertheless, the ECJ had consistently limited the obligation to supply or license by reference to the possibility of objective justification. Consequently A-G Jacobs insisted that a duty to give access does not arise easily or automatically:

> 69.... a dominant pharmaceutical undertaking which restricts the supply of its products does not necessarily abuse its dominant position within the meaning of Article 82 EC merely because of its intention thereby to limit parallel trade.

He concluded that an intention to limit parallel trade might plausibly be one of the relevant circumstances, which would ordinarily render a refusal to supply abusive (paragraph 70). Nevertheless such conduct was capable of objective justification (paragraph 71). The facts of the case were extreme owing to the control over prices and distribution exercised in differing ways by Member States (paragraphs 76–85):

(a) Price differences were imposed by national law: the common market was not partitioned by the dominant firm but by various kinds of control over price and distribution imposed by Member States (paragraph 84).
(b) If parallel imports were permitted it would be impossible for the pharmaceutical companies to ensure adequate supplies in each Member State, because they would all be sourced from the country where the maximum price was lowest. Moreover, they were subject to regulation by national law that restrained suppliers from withdrawing a drug once introduced (paragraph 86).
(c) The national regulations were segregated. So, a duty to supply any quantity demanded might lead to the medicines not being supplied at all in the countries where the maximum price was low, or at least might lead to supply being delayed (paragraphs 87 and 91).

These arguments had been raised and dismissed by the ECJ in the early cases on exhaustion, but the Commission is now looking more to economic arguments, A-G Jacobs is well respected and his opinion cogent. He restricted the application of his view strictly, which may make it more acceptable.

In paragraphs 89–91 the Advocate-General analysed the economics of the innovative pharmaceutical industry, with substantial investment in high fixed costs, which were mostly sunk (of little use save for developing the particular drug), and relatively low variable costs. This made it rational for the pharmaceutical companies to sell wherever they could cover their variable cost. The mere fact that this might be possible does not ensure that a producer could recover its total costs if that price were generalised throughout the Community. This statement impliedly accepts that unilateral discriminatory pricing does not necessarily infringe Article 82. It is widely accepted by economists, most of which advocate 'Ramsey pricing'(2.1.2 above).[42]

Usually parallel trade leads to consumers in the lower priced countries paying less, but that is not the position for medicines, where the government normally bears the cost. In some Member States, the government pays as much for medicines subject to parallel trade as for those bought by wholesalers directly from the producer at a higher price.

He concluded, therefore that for a pharmaceutical producer to restrict supplies:

> 100.... to limit parallel trade is capable of justification as a reasonable and proportional measure in defence of that undertaking's commercial interests. Such a restriction does not protect price disparities, which are of the undertaking's own making, not does it directly impede trade, which is rather blocked by public service obligations imposed by the Member States. To require the undertaking to supply all export orders placed with it would in many cases impose a disproportionate burden given the moral and legal obligations on it to maintain supplies in all Member States. Given the specific economic characteristics of the pharmaceutical industry a requirement to supply would not necessarily promote either free movement or competition, and might harm the incentive for pharmaceutical undertakings to innovate. Moreover, it cannot be assumed that parallel trade would in fact benefit either the ultimate consumers of pharmaceutical products or the Member States as primary purchasers of such products.

The opinion is clearly limited to markets subject to specific controls such as those exercised by Member States over the pharmaceutical industry. Competition is distorted by the control over prices and distribution. The reasons for desiring Ramsey pricing in this industry are also clearly set out. I hope that this will encourage the institutions to follow the Advocate-General. He has not fired a broadside in favour of limiting exports.

The Greek competition authority probably should apply the opinion of the Advocate-General as being the best available authority. If this results in approving of GSK's policy of restricting supply, the Greek dealers who pressed the competition authority to request a reference may well appeal the decision to a court, which may well seek a preliminary ruling. Meanwhile, A-G Jacobs will have retired and the term of many of the judges will have expired. The judicial work will have to be redone, but doubtless Mr Jacobs' opinion will be studied.

[42] FP Ramsey, 'A Contribution to the Theory of Taxation,' (1929) 37 *Economic Journal* 47–61. Provided that no price is below variable cost, no one is worse off if most of the sunk overhead is recovered from those willing to pay more and most buyers are better off. In the low priced market, supplies will be available for those able and willing to pay the variable cost, and this may even provide some contribution to the overhead, which would benefit those who have to pay more. Economists, virtually all of them, generalise the theory and argue that supply will be most efficient if the overhead is recovered from different markets in inverse proportion to the elasticity of demand.

If the opinion is followed, there are now four situations when a duty for a dominant firm to supply may arise:

(a) when access is required by a former customer to prevent a dominant firm extending its dominance to a neighbouring market and is essential if the former customer is to carry on its business (the early cases from *Commercial Solvents*[43] to *Télémarketing*[44] and *Tetrapak II*.[45] Either consumer harm within Article 82(b) or discrimination as between equivalent transaction within Article 82(c) would have to be established;
(b) when the licence is required by an undertaking, not necessarily a former customer, who intends to make a new product for which there is actual or potential demand, provided that the input is essential for producing such a product (*Volvo, Magill*, *Bronner, IMS*); in this case discrimination is unlikely and consumer harm should be established under Article 82(b), and
(c) it can plausibly be argued that the obligation arises when supply is limited with an intention to limit parallel trade (*Syfait*),
(d) where a legal or de facto industry standard is protected by iprs. This seems to be the view of the Commission in its decision in *IMS* and in *Microsoft.*

These categories are probably not closed. From the Commission's decisions in *IMS* (8.1.6 above) and *Microsoft* (8.1.9 below) and from the opinion in *Syfait*, it may also be argued that all three classes of refusal may be objectively justified in the light of the specific circumstances of the industry. The justifications vary depending on the specific facts of the case.

8.1.9 The Commission's Decision in *Microsoft*

The Commission fined Microsoft nearly 500 million euros for leveraging its dominance over the market for licensing operating systems for client personal computers (PCs) to operating systems for entry level group work servers (server) and to streaming media players.[46] The fine is the largest ever

[43] *Istituto Chemioterapico Italiano SpA and Commercial Solvents Corpn v Commission* (6 & 7/73), 6 March 1974, [1974] ECR 223, [1974] 1 CMLR 309, CMR 8209.

[44] *Télémarketing–Centre Belge d'Etudes du Marché-Télémarketing SA (CBEM) v Compagnie Luxembourgeoise de Télédiffusion* (311/84), 3 October 1985, [1985] ECR 3261, [1986] 2 CMLR 558, CMR 14246.

[45] *Tetra Pak International SA v EC Commission* (C-333/94 P), 14 November 1996, [1996] ECR I-5951, [1997] 4 CMLR 662, [1997] CEC 186.

[46] *Microsoft/ W2000* (COMP/C-3/37.792), decision made on 24 March 2004, appeared on the Commission's web site on 21 April 2004. It is unlikely to be published in the OJ. The Commission is seeking power to take individual decisions without providing the 20 language versions required for the OJ. It hopes to be able to publish all its individual decisions on its website in the original language(s). It is reported in [2005] 4 CMLR 965.

imposed on a single firm, even for a leading role in a multinational cartel. Various important terms are defined in the decision including:

> 37.... operating systems are system software products that control the basic functions of a computer and enable the user to make use of such a computer and run application software on it.
>
> 57. The present case focuses on "work group services", which are the basic structure services that are used by office workers in their day-to-day work, namely sharing files stored on servers, sharing printers, and the "administration" of how users and groups of users can access these services and other services of the network (for example, applications installed on client PCs or servers). "Work group operating systems" are operating systems designed and marketed to deliver these services collectively to relatively small numbers of client PCs linked together in small to medium-sized networks.
>
> 63. "Streaming media players" are capable of reading content "streamed" over the internet without waiting for downloading.

In its decision, the Commission objected that Microsoft was overwhelmingly dominant over PC operating systems and had been so at least since 1996 (paragraphs 471–472).[47]

Microsoft had abused that dominant position contrary to Article 82 in two ways: first, it had leveraged its dominant position over operating systems for client PCs into the complementary market for server operating systems, by denying interface information to competitors in the server market with the result that third parties' server operating systems did not work well together with Windows servers and client operating systems (paragraphs 779–784). By excluding competitors, Microsoft removed the incentive for them to innovate. The Commission added that Microsoft has already reached a dominant position in the market for work group server operating systems (paragraph 541).

Second, Microsoft was leveraging its dominant position over operating systems for PCs also into the market for media players by integrating the software into its operating systems for PCs. Microsoft alleged that contractual ties had ceased as a result of Microsoft's settlement in the US with the Department of Justice and several States.[48]

8.1.9.1 Dominant Position over Operating Sytems for Client Personal Computers (PCs)

Since 1996, Microsoft has licensed over 90 per cent of the operating systems for client personal computers (PCs) (Windows).[49]

[47] References to (paras) in 8.1.9 are to the numbered paras of the Commission's decision.

[48] The latest Status Report on compliance with the US consent decree, stated that interface information for client-server interoperability was the only area where Microsoft had not yet revealed sufficient information. It may have been waiting for the Commission's decision.

[49] Various measures of market share are given at paras 431–435 of the Commission's decision, but all are over 90 per cent.

8.1.9.1.1 Entry barriers – network effects and switching costs – middleware
There is a strong incentive for consumers to use the Microsoft Windows operating systems for PCs, so that their computers can communicate well with more people. This is called a 'network effect'[50] (paragraph 438 of Commission's decision). A market with strong network externalities is one where customers want the product more intensely the greater the number of other customers there are. The usual example given is that your phone is more useful the greater the number of other people have one too. Moreover, there is an indirect network effect, another barrier to entry, in that independent suppliers of applications software will target Windows, since it is the most popular operating system for PCs, and thereby increase their potential client base (paragraph 449). It is costly in time and money as well as being risky to design an application to be compatible with additional operating systems (paragraphs 448–453). Consequently more applications are written to be compatible with Microsoft Windows and, in turn, this increases the inducement for consumers to take a license to use Windows operating systems for PCs. It is sometimes called the 'applications barrier to entry' (paragraph 459).

A third barrier to entry exists if it is expensive for customers to change systems, whether because of the need to invest in new equipment or because of the need to learn how to maintain or use the new system.[51] This is called 'switching' or 'learning costs.'

Direct and indirect network effects and switching costs are not illegal. They result from the technology and not from exclusionary conduct of the firm whose market power they buttress. Network effects increase consumer welfare by enabling them to communicate with more other consumers and with suppliers of complementary products. Suppliers may compete *for* the market rather than *in* the market and devote resources to winning the race for the next technological development. Nevertheless, once an undertaking has achieved a large share of a network market it becomes difficult for competitors to enter or survive, even if their technology is superior and made available more cheaply, as fewer applications will be designed to be compatible with the new operating system and there are fewer clients with whom customers can communicate at least until the next generation of technology.

There may be switching costs also in changing to a system that is otherwise more desirable. The market may 'tip' in favour of the incumbent beyond

[50] Microsoft itself recognised 'the importance of network effects in commercial software' at paras 449 and 451. As regards the network effect on the media software market, see paras 420–422.

[51] Network effects and switching costs as well as the relevant markets are clearly explained, at somewhat great length than in my text by Roberto Pardolesi and Andrea Renda, 'The European Commission's Case against Microsoft: Kill Bill,' (2004) 27 *World Competition Law and Economics Review* 513, at pp 521–535.

the next generation of technical development, although some economists doubt whether this happens frequently.[52] There is little that a competition authority can do to enable competition to develop in a network industry other than ensuring that competition for the next generation of technology and for linked markets of complementary products remains open so that there is competition *for* the market.

If only part of an industry is a natural monopoly, it may be possible to keep remaining markets in the industry competitive. A competition authority has a strong incentive to intervene to prevent the monopolist of one part of the system extending its market power to adjacent markets before those markets 'tip' too. Intervention may reduce dynamic competition and the incentive to invest in the original technology, and it is difficult to predict whether a market is about to tip. If, however, all the connected markets are supplied mainly by the same incumbent, direct and indirect network effects and switching costs may make it difficult for a newcomer to challenge the original monopoly.

A possible way of overcoming the applications entry barrier is the creation of portable middleware: a platform designed to be compatible with several operating systems and which can support many applications. In that way, applications compatible with the middleware can be 'ported' or used with other operating systems. Once, however, one brand of such middleware comes to be widely used, the market may tip. The holder of the middleware may become dominant and the market be little more competitive than with the original dominance over operating system for PCs.[53] Those providing new applications will make them compatible with the first middleware platform to display many application programme interfaces and those developing operating systems for PCs will make them compatible with the first middleware platform with sufficient interfaces to which new applications can be connected.[54] It may, however, be possible for more than one brand of middleware to develop before that market tips.

Before it acknowledged that it was dominant, Microsoft argued (paragraphs 465–468) that competition is different in markets for information technology (IT), where there is a series of races to be first in marketing new technology and a constant threat from new technology being developed by others. In other words, competition is *for* the market rather than *in* the

[52] Ibid, p 528, note 51.

[53] I am indebted for this observation to Eyal Sage, a specialist competition lawyer practising in Tel Aviv.

[54] The Commission suggests at para 972 that although media players do not display enough APIs (applications programming interfaces) to amount to middleware for general purposes, one could amount to middleware for limited purpose programmes, in particular for media applications. More important, programmes such as Java, in connection with a media player might function as middleware today. Consequently Microsoft has a motive to foreclose the media player market to protect its dominance over operating systems for PCs.

market. The Commission rejected the view that this weakened Microsoft's dominant position, although it might reduce its duration in the future. The rejection by the Commission seems to me to be questionable. Concern about future entry may constrain a dominant firm's current conduct, because once independent entry occurs on a sufficient scale to be viable it will face competition, which may reduce its profits substantially for the indefinite future. Limit pricing may be at a level above a competitive price, but well below a monopoly price, although this would be difficult to establish.

8.1.9.1.2 Overwhelmingly dominant position Microsoft now acknowledges that with Windows, it enjoys a dominant position over Operating Systems for PCs (paragraph 429) and the Commission found that its share of the relevant market has been over 90 per cent since 2000 (paragraphs 431–432). Microsoft controlled a *de facto* industry standard for operating systems for PCs. At paragraph 435, the Commission said:

> Microsoft, with its market shares of over 90 per cent, occupies almost the whole market—it therefore approaches a position of complete monopoly, and can be said to hold an overwhelming dominant position.

The Commission cited the opinion of A-G Fennelly in *Compagnie Maritime Belge*,[55] suggesting that the special responsibility of a very dominant firm might be greater than of a less dominant undertaking. The Commission did not rely only on massive market shares, but also on the barriers to entry due to network effects, the applications barrier to entry and switching costs and other factors (paras 448–464). In the end, Microsoft admitted that it held a dominant position over operating systems for client PCs.

The Commission found that Microsoft was dominant also over operating systems for servers (paragraph 541). Its shares of the various products averaged at least 60 per cent (paragraphs 491, 493 and 499). Moreover, applications software could be run on work group servers, so an applications barrier to entry existed (paragraph 516), although it was not as high as for client PC operating systems. The Commission also found other network effects, such as the ease with which customers can find support officers skilled in the leading system (paragraphs 517–522). The finding of a dominant position in the server market was not important for the finding of abuse.

8.1.9.2 Refusal to Supply Interface Information to Competitors Selling Servers

The Commission alleged *inter alia* that Microsoft had extended its dominant (quasi monopoly) position over operating systems for client PCs for

[55] (C-395/96 P), 16 March 2000, [2000] ECR I-1365, [2000] 4 CMLR 1076, paras 132 and 137.

many years to the adjacent markets in operating systems for servers (paragraphs 533, 779–781, 1065).[56] The Commission decided that withholding the information necessary to design competing programs for work group servers compatible with Windows was an abuse (paragraphs 779–784) and risked eliminating competition from the server market (paragraphs 585–589 and 692), stifling innovation and reducing consumers' choice by locking them in.[57] It foreclosed competitors from designing work group servers fully compatible with Windows. At paragraphs 548–559, the Commission briefly considered several of the judgments on refusals to license in special circumstances (8.1.2–8.1.6 above). It decided that the special circumstances mentioned in *Magill*[58] were not exhaustive (paragraph 555), contrary to the ruling of the ECJ (8.1.7 above) the following month in *IMS* that they were.

8.1.9.2.1 Circumstances that were special The Commission found several individual circumstances that in combination made the circumstances special, but they differed from those found in *Magill* (8.1.3 above) and *IMS* (8.1.7 above). It found that Microsoft's refusal to supply the complainant, Sun Microsystems, was part of broader conduct of not supplying vendors of work group servers information necessary to achieve interoperability (paragraphs 573–577). It involved disruption of previous patterns of cooperation when full interface information had been made available (paragraphs 578–584). This observation may be an attempt to bring the case within the early case law on a refusal to supply goods and services to an existing customer (8.1.1 above), but the relevance of the disruption was not spelled out.

The Commission added that Microsoft's conduct created a significant risk of eliminating competition in the supply of work group servers (paragraphs 585–692) and harming consumers (paragraph 692). If Sun Mycrosystems and other providers of work group servers were unable to compete, innovation by them would cease. If they lack the interface protocols for Windows, there will be no point in their investing in innovation which they cannot use, but can sell only to the dominant incumbent. In the past, they had introduced new features that customers had bought. If they are finally

[56] Earlier the US DOJ had attacked Microsoft for extending its market power over Windows PC operating systems to the complementary market for internet browsers. This prevented Netscape from attracting enough applications software to become satisfactory middleware that might have removed the applications barrier to entry into the market for client PCs.

[57] Francois Leveque, 'Innovation, Leveraging and Essential Facilities: Interoperability Licensing in the EU Microsoft Case,' (2005) 28 *World Competition Law and Economics Review* 71.

[58] 8.1.3 above. The ECJ's preliminary ruling in *IMS* (8.1.6 above), was decided a month after the Commission's decision and did not mention the Commission's view of what circumstances are special.

squeezed out of the market, the only innovations will be those introduced by Microsoft and its incentive to innovate will be reduced if it faces no competition (paragraph 725).

Operating systems for servers were complements to those for PCs and, for some purposes, substitutes. When Microsoft first entered the server market, it supplied full interface information. Its software for servers was then inferior to that of its competitors. Making competitors' servers work well with Windows operating systems for PCs enabled it to sell more licenses for the latter. Moreover, if other servers worked well with Windows operating system for PCs, the value of the latter was higher (paragraphs 587–589). Microsoft was able to extract the full value of its dominant position over operating systems for PCs: it was indifferent whether it obtained royalties from other producers of servers or increased its sales of licences of operating systems for PCs.

Once Microsoft's work group server's operating systems gained acceptance, Microsoft ceased to supply as much information (paragraph 588). The Commission pointed out that that was rational. Other suppliers of servers were competitors whose market shares were declining (paragraphs 590–597).[59] Although the Commission did not state that the market for servers had already tipped in favour of Microsoft, it said that rivals' products were marginalised and, in turn, this buttressed Microsoft's dominance over operating systems for PCs (paragraph 769). The incompatibility referred to conduct that took place in the tied market—non disclosure of interface information contained in server operating systems—not in the tying market, as the traditional theory about leveraging assumes. Can there be leveraging within the same market?

8.1.9.2.2 Microsoft's justification Microsoft's justification for refusing to supply the interface information was that the information was the result of massive research and development, much of it protected by intellectual property rights (paragraphs 709 and 783). In rejecting this defence, the Commission adopted a concept of the function of intellectual property rights that had not been greatly developed in the EC case law (2.1.1 above):

> 711. The central function of intellectual property rights is to protect the moral rights in a right-holder's work and ensure a reward for the creative effort. But it is also an essential objective of intellectual property law that creativity should be stimulated for the public good. A refusal by an undertaking to grant a licence may, under exceptional circumstances, be contrary to the general public good by constituting an abuse of a dominant position with harmful effects on innovation and on consumers.

[59] Francois Leveque, 'Innovation, Leveraging and Essential Facilities: Interoperability Licensing in the EU Microsoft Case,' (2005) 1 *World Competition Law and Economics Review* 71, at pp 82–85.

The focus on moral rights is not in the common law tradition, but is widely accepted in civil law systems. The idea of a reward for creative effort may come from the early cases on exhaustion (2.1.1 above) and the civil law justification for intellectual property rights. The essential objective is stimulating creativity for the general good, but it begs the question as to how this should be done. The decision merely asserts that copyright will not prevail in exceptional circumstances and this had already been decided in *Magill* (8.1.3 above). The exceptional circumstances in this case, however, were different from those in *Magill* and *IMS* or in *Volvo* (8.1.2, 8.1.3 and 8.1.7 above).

8.1.9.3 Tying the Operating System for Windows Media Player (WMP) to the Operating System for PCs also Constitutes Abuse of a Dominant Position

A streaming media player is one that continues to download content as it plays it, without the listener having to wait (paragraph 63). The Commission defined the relevant market to include only streaming MPs, to the exclusion of software for downloading music as well as classical playback devices such as CDs and DVDs (paragraphs 407–425).

The Commission found that since 1999 Microsoft had tied the Windows streaming Media Player (WMP) to Windows[60] contrary to Article 82(b) (paragraphs 978–984). To demonstrate that Microsoft's conduct in tying WMP to Windows operating systems for PCs was abusive, the Commission stated that there are four elements to tying:

> 794. (i) the tying and tied goods are separate products; (ii) the undertaking concerned is dominant in the tying market; (iii) the undertaking concerned does not give customers a choice to obtain the tying product without the tied product; and (iv) tying forecloses competition.

8.1.9.3.1 Products distinct At paragraphs 801–803, the Commission cited the CFI's judgment in *Hilti AG v Commission*[61] and the ECJ's judgment in *Tetra Pak International SA v EC Commission II*,[62] holding that the test of distinctiveness was separate demand for the tied product, and this was indicated by the market supplying alternative media players. These cases related to tying by contract, not to tying by integration (8.1.9.3.3 below). So, it is not clear that they apply when there are no contractual restrictions. Article 82(d) exemplifies as an abuse:

[60] It had earlier tied WMPs to Windows OS for PCs, but these WMPs were not streaming (para 986).
[61] (T-30/89), 12 December 1991, [1991] ECR II-1439, [1992] 4 CMLR 16, [1992] 1 CEC 155, paras 66–67.
[62] (C-333/94P), 14 November 1996, [1996] ECR I-5951, [1997] 4 CMLR 662, [1997] CEC 186 (ECJ), para 36.

> making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

These words are not apt to cover technological integration where the buyer enters into no supplementary obligations. It may be for this reason that the Commission relied on Article 82(b). It took pains to establish detriments to consumers.

Many economists do not find the criterion of distinct markets helpful and have little to say about defining it. Jean Tirole [63] observes that the concept is vague and offers perverse incentives to a dominant firm. He cites as an example the vendor of software facing a security threat. It could take more care to remove weak spots in the code, but would be tying and might infringe Article 82 if, instead, it provides anti-virus protection with the software. His general thesis is that it is better to treat tying as a form of predatory practice. Which strategy the software vendor should use to secure the software against invasion should depend on which method is more effective, and the cost of provision.

Nevertheless, in relation to tying the US courts also rely on the products being distinct. If we must talk of tying only if there is distinct demand, it is submitted that one should look to the tying rather than the tied product. The Commission did not establish that there was distinct demand for the tying product for the Windows operating system for PCs without the WMP. It is unlikely that there was because no charge was made for the WMP.

Signor Mario Monti stated that the Commission had followed the rule of reason adopted in the US in *Microsoft III*.[64] This, however, is not correct. The 'separate consumer' test, which was adopted by the Commission, is the modified *per se* illegality test that was thought dangerous and rejected by the Court of appeals for DC in *Microsoft III*.[65]

8.1.9.3.2 Overwhelming dominant position The Commission had already found an overwhelming dominant position in operating systems for PCs with a market share exceeding 90 per cent and high entry barriers consisting mainly of direct and indirect network effects and switching costs (8.1.9.1 above).

8.1.9.3.3 Consumers deprived of choice The software for the WMP was integrated and commingled technically with that for the Windows operating system for PCs. In the past, Microsoft had required computer manufacturers (OEMs) who were licensed to install the Windows operating systems

[63] 'The Analysis of Tying Cases: A Primer,' (2005) 1 *Competition Policy International* 1, p 8.
[64] *Microsoft*, 87 F Supp 2d 30 (2000).
[65] David Evans and Jorge Padilla, 'Tying Under Article 82 EC and the Microsoft Decision – A Comment on Maurits Dolmans and Thomas Graf,' (2004) 27 *World Competition Law and Economics Review* 503.

for PCs also to preinstall the WMP and no competing media players on the computers they produced. Microsoft alleged, however, that this practice had stopped as a result of the commitments made to settle the US litigation (paragraphs 315 and 796–798).[66] Should integration be treated as tying? The Commission considered the distinction irrelevant (paragraph 828) as WMP would be installed and could not be removed. Consumers were deprived of the choice to take the operating system for PCs without the WMP.

The Commission relied also on Article 82(d), the provision usually treated as defining tying as:

> making the conclusion of contracts subject to the acceptance by the other parties of supplementary obligations which...

The other parties, however, did not accept supplementary obligations.

In my view, the Commission should not have been so concerned with the concept of tying, but should have relied only on Article 82(b) or on the general words of Article 82. The practices listed as examples of an abuse have been held not to be exhaustive.[67] The effect of denying consumers' choice may be similar to tying, but the Commission was misleading in citing cases on tying to show that the products must be distinct (8.1.9.3.1 above).

Microsoft's conduct had effects different from classical tying. The traditional objection is that the dominant firm extends its market power from the tying to the tied market: that it enabled Microsoft to obtain higher prices for the WMP. It was however, supplying the player for free. The Commission was worried more by the ubiquity of the WMP—the indirect network effect—which it thought made it difficult for suppliers of other media players to compete. It was concerned that the integration buttressed Microsoft's dominant position over operating systems for client PCs.[68]

> 826 The third element of illegal tying pursuant to Article 82 of the Treaty is that customers are not given the choice of acquiring the tying product without the tied product. The dominant undertaking renders the availability of the dominant (tying) product conditional on the customer's simultaneous acquisition of the tied product.
>
> 827.... By virtue of Microsoft's licensing model, OEMs must license Windows with WMP installed. Microsoft would not offer a licence which would cover Windows without WMP. OEMs which choose to install an alternative media

[66] When the US Court of Appeals for the District of Columbia Circuit held that tying would be judged under a rule of reason, the allegation of tying was dropped and not dealt with further. Nevertheless, Microsoft agreed to suppress the WMP icon so it was not visible to buyers of Windows OS for PCs.

[67] *Europemballage Corporation and Continental Can Co Inc v Commission* (6/72), 21 February 1973, [1973] ECR 215, [1973] CMLR 199, CMR 8171, paras 18–27.

[68] This is often the main reason for tying.

player on Windows can only do so in addition to WMP. If a user buys Windows in a retail store, the same considerations apply.

8.1.9.3.4 Foreclosure of competitors The fourth element of tying alleged by the Commission is foreclosure (paragraphs 835–842). At paragraphs 837–838 the Commission considered the judgments about loyalty inducing rebates (*Hoffmann-La Roche*,[69] *Van den Bergh Foods*,[70] *Michelin II*[71] and *British Airways*[72]) and, while noting that the CFI in *British Airways* and *Michelin II* had stated that conduct that tends to foreclose is abusive whether or not it has such an effect, went on, in some detail, to analyse the foreclosure by Microsoft (from paragraph 841).

With Microsoft's share of the market for operating systems for PCs at over 90 per cent, the WMP was ubiquitous (paragraphs 843–848). In 2002, 121 million client PC operating systems were shipped and on 114 million the WMP was pre-installed. The Commission analysed the possibility of selling media players through the Internet and other channels and found that they were far less satisfactory than pre-installation (paragraphs 858–876).

Just as most servers are designed by third parties to work on the most popular operating system for PCs, the content providers and software developers tend to target the most popular media player as their platform (paragraphs 879–896). Microsoft's share of the player market increased after it started to tie its player to its operating system (paragraph 944) although it has still not attained a dominant position. The Commission did not accept that this was the result of competition on the merits (paragraphs 947-951). It compared various commercial reviews, many of which concluded that other media players were technically better.

It concluded that Microsoft had used Windows to distribute the WMP leaving its competitors at a disadvantage (paragraph 979). Tying raises the applications barriers to entry that protects Windows operating system for PCs and will facilitate the erection of such a barrier for WMP (paragraph 980). A position of strength in a market with network effects is sustainable. This shields Microsoft from effective competition from potentially more efficient vendors of media players. It reduces the talent and capital invested in media players, including its own (paragraph 981). Moreover, tying enables Microsoft anti-competitively to expand its position in adjacent media-related software markets (paragraph 982). It sends messages that

[69] *Hoffmann-La Roche & Co AG v Commission* (85/76), 13 February 1979, [1979] ECR 461.

[70] *Van den Bergh Foods Ltd v Commission* (T-65/98), 23 October 2003, [2003] ECR II-4653, [2004] 4 CMLR 14.

[71] *Michelin II* (2002/405/EC), OJ 2002, L143/1, [2002] 5 CMLR 388, [2002] CEC 2,503; on appeal (T-203/01), 30 Sept 2003, [2003] ECR II-4071, [2004] 4 CMLR 923.

[72] (T-219/99), 17 Dec 2003, [2004] 4 CMLR 1008. An appeal has been lodged.

deter innovation in any technologies in which Microsoft could conceivably take an interest and tie with Windows in the future (paragraph 983).

Whether the market for media players is about to tip is, however, disputed.[73] Microsoft had been integrating its WMP with the operating systems for PCs for many years and has integrated a streaming player since 1999 but was still not dominant in the media player market (paragraphs 302–314).[74] David Evans and Jorge Padilla doubt whether the inclusion of the WMP even foreclosed: many users have more than one media players.[75] The choice of the media player to use at a particular moment may depend on which is compatible with the particular content to be played.

8.1.9.3.5 Justification Like other kinds of abuse,[76] tying may be justified in specific circumstances provided any restriction of choice is proportionate to the benefit to consumers.[77] The Commission considers that the burden of proof for the final condition is on the dominant firm.

The Commission did not consider whether investing massive amounts in designing the WMP and then giving it away free amounted to predation. It seems to consider that sales at or above long run incremental costs (LRIC) are not predatory. The cost of licensing the WMP is virtually nil, so was little below LRIC. In any event, the Commission had mounted a powerful challenge to leveraging and did not need to consider predation.

8.1.9.4 Remedies for the Infringements

8.1.9.4.1 Fine The Commission imposed the largest fine ever on a single firm[78]—497 million euros—more than for any one firm condemned even for price fixing, although at the time the conduct took place it was not clear that taking advantage of direct and indirect network effects constituted an abuse. Indeed, that still has to be established in the CFI. Requiring OEMs

[73] Roberto Pardolesi and Andrea Renda, 'The European Commission's Case against Microsoft: Kill Bill,' (2004) 27 *World Competition Law and economics Review* 513, at p 528, note 54.

[74] No specific market share of WMP is mentioned. However, at para 843, the Commission cited one report stating that in August 2003, 45 per cent of users said WMP was the player they used most. para 943 states WMP has an over 90 per cent installation rate on client PCs worldwide. However, as many users have more than one media player, the above-mentioned statistics may not indicate the actual strength of WMP in the relevant market. Without alleging another dominant position, the Commission merely observes that WMP is as ubiquitous on PCs worldwide as is Windows (para 844).

[75] 'Tying Under Article 82 EC and the Microsoft Decision – A Comment on Maurits Dolmans and Thomas Graf,' (2004) 27 *World Competition Law and Economics Review* 503, at pp 506–508.

[76] Eg refusals to supply (8.1.9.2 above).

[77] See Maurits, Dolman and Thomas Graf (???), 'Analysis of Tying under Article 82: The European Commission's Microsoft Decision in Perspective,' [2004] 27 *World Competition Law and Economics Review* 225, at pp 235–237.

[78] Para 1080 and Art 3 of the decision.

to pre-install the WMP and not other players was abusive but the practice had been abrogated as part of the settlement with the US authorities. Since the WMP is integrated in Windows, pre-instalment is no longer necessary. In this sense, the Commission took the view that the US settlement did not remove all competition concerns with respect to bundling: see paragraphs 315 and 798. The large fine may not be as disproportionate as alleged by some critics when compared to the amount that Sun will receive to settle its litigation against Microsoft. The amount of the fine was doubled because of Microsoft's substantial financial resources and the need to deter (paragraph 1076).

8.1.9.4.2 Obligation to supply interface information for servers The specific remedies are far reaching. The remedy imposed for the server market is to require Microsoft to make available the necessary interface information to its competitors in work group servers on reasonable and non-discriminatory terms (paragraphs 998–1009 and Article 5 of the decision: 8.1.9.4 below). The facts are in dispute, but the Commission considers that the protection of iprs and the need to retain Microsoft's incentives to innovate is outweighed by the impact of the remedy on the innovative activities of the whole industry, and therefore cannot constitute an objective justification (paragraph 783).

Microsoft is required to disclose the interface information but it is only the protocols needed to design compatible work group servers that must be disclosed, not the source code (paragraphs 999–1000, 1004 and Article 5 of the decision). The Commission concluded at paragraph 999 that 'this includes direct interconnection and interaction between a Windows work group server and a Windows client PC'. This includes information used for the Microsoft work group server operating system, whether contained in the Windows client operating system or in that for servers?

Since access to the source code is not being required, the Commission said that, Microsoft's fears of cloning were not justified (paragraphs 713–722). So, requiring access would not reduce Microsoft's incentives to innovate (paragraph 729). This statement seems to me to be too broad: the incentive must have been considerably reduced.

The criteria for fixing the royalty that Microsoft may charge for access are not made clear, except that it must not amount to the opportunity cost of granting the licence—the loss of being the only supplier of servers with seamless access to Windows.[79] To say that Microsoft must not discriminate

[79] In the US, if there was any liability, the opportunity cost would probably be the appropriate criterion, as the Agencies do not object to the market power of the holder of an ipr, only to licences that increase that market power. Antitrust Guidelines for the Licensing of Intellectual Property, 6 April 1995, (1995) 68 ATRR 462, CCH TRR 13,13 2, [1995] 7 EIPR 3. Section 3.1 states, 'the agencies will not require the owner of intellectual property to create competition in its own technology.' After *Trinko, Verizon Communications IC v Trinko, LLP,* 540 US 398 (2004), however, they would be unlikely to require a licence under section 2 of the Sherman Act.

between the price charged to the part of its undertaking dealing with servers and its competitors is capable of avoidance. If it wants to increase the royalty payable by third parties, it can charge more to its server subsidiary or division. It should be indifferent to which part of the undertaking earns the profit. The order not to discriminate is useful, however, in providing how much information need be given—as much as Microsoft is giving to its own affiliated companies. In the absence of a competitive market there is no widely recognised way of determining what price is reasonable. The Commission has ordered that Microsoft pay a monitor to supervise compliance with the order (paragraphs 1043–1048), but the problem remains: what pricing criteria is the monitor to apply?

The question arises whether the Commission should continue to order compulsory supply without defining the criteria on which the royalty is fixed.[80] I have no satisfactory criteria to suggest. The lack of criteria is one of the reasons for seldom requiring supply. Some arbitrary test will have to be set by the Commission, perhaps a proportion of the licensee's sales, as is fixed by some Member States for the compulsory licensing of performing rights in records.

Where a nationalised industry has been privatised or a firm that has been granted special or exclusive rights has incurred substantial sunk costs, a regulator may be appointed to control its conduct and prices. Then, however, the investment was either paid for by taxpayers, or made when the firm was protected from close competition. To confiscate part of the value does not seem to me grossly unfair, unless the asset was subsequently sold to a third party. A firm not subject to much competition is not so much concerned about incentives to innovate.[81] Microsoft, however, invested billions of dollars when subject to competition from other firms including IBM, the market leader at the time. Requiring access deprives it of a valuable asset acquired when the market was more competitive.

See also *Clear Communications Ltd v Telecom Corporation of New Zealand* (1992) 5 TCLR 166 (High Court), test approved by Privy Council in *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385. The High Court of New Zealand which sat with an economist, adopted the test of opportunity cost, there called the Baumol/Willig rule. The Privy Council refused to reverse this. Appeals to the Privy Council from New Zealand have, however, been abolished and it is not clear that its precedents will continue to be followed in that country. If opportunity cost may be charged, inefficient bypass will be avoided, but the entry and expansion of new firms will be slow.

[80] It did much the same thing in its decision against *IMS* (8.1.7 above). The CFI has removed the *IMS* case from its file, now that the Commission has withdrawn its interim decision, EUR-Lex – 62001B0184(02).

[81] Sometimes special or exclusive rights are granted in return for a service, such as a duty of universal service. Even so, the firm is unlikely to be subject to acute competition as long as others are not allowed to compete.

The CFI refused to suspend the remedies[82] and Microsoft has said that it will abide by the Commission's order. The disclosure must be on reasonable and non-discriminatory terms (paragraphs 1005–1009).

The obligation to supply the existing and future protocols will last as long as Microsoft is using them, not only to license OEMs, but also as long as it provides on-line self-help support for a product on its web site (paragraphs 1000–1002).

8.1.9.4.3 The remedy for tying The remedy for tying of the WMP to Windows is defined in terms of effects, which should prevent formalistic avoidance of the order (paragraphs 1012–1014). It has been broadly drafted to cover not only the current versions of Windows and WMP, but also versions later to be released (paragraphs 1011–1014 and Article 6 of the decision).

The remedy ordered will not be easy to apply and the Commission has insisted on the appointment of a trustee to monitor it. So, the Commission is arranging for the appointment of a monitoring trustee to be paid by Microsoft and to whom disputes can be submitted (paragraphs 1043–1048 and Article 7). The trustee will have to make many difficult or arbitrary decisions involving billions of euros. Should the Commission impose remedies the scope of which is so unclear?

Microsoft and the Commission are still disputing whether the remedy is extra-territorial: The operative part of the decision does not address the territorial scope of its remedies (Articles 5–6). It seems that the remedy for unbundling is not extra-territorial: at paragraph 1011 the Commission said the untying remedy would apply 'to Windows licensed directly to end users (home users via retail and corporate customers) and licensed to OEMs for sale in the EEA'. The Commission argues that the remedies should benefit competitors who operate in the Common Market, even in relation to sales outside it. This is disputed by Microsoft.

8.1.9.4.4 Remedy not suspended by CFI On appeal, the CFI refused to suspend the order of the Commission against Microsoft pending a decision on the substance.[83] There was a *prima facie* case in favour of Microsoft, but it had not established that the matter was urgent. Microsoft has not withdrawn its appeal, which may protect it from treble damages in the US while awaiting the final decision.

Microsoft's dominant position over both computer operating systems and work group servers was not disputed. The President confined his order

[82] *Microsoft Corporation v Commission* (T-201/04 R), 22 December 2004, OJ 2005, C69/16, [2005] 4 CMLR 406 (CFI interim order, refusing to suspend remedies granted by Commission. It is much easier to read this than the Commission's lengthy decision.).

[83] *Microsoft Corporation v Commission*, (T-201/04 R), 22 December 2004, OJ 2005, C69/16, [2005] 4 CMLR 406.

to examining the single plea alleging an infringement of Article 82 (paragraph 202).

There remain several questions of principle to be settled by the CFI.

(1) Were the exceptional circumstances defined by the ECJ in *IMS* required for the finding of an abuse, or were they were merely sufficient, leaving room for other special circumstances? That, however is too important to be resolved in an interim decision (paragraph 206).
(2) Is it relevant that the information required from Microsoft is secret, and far more valuable than the essential facility in *Magill* and *IMS* (paragraph 207)? The parties dispute whether the interface protocols were indispensable. The parties disagree as to the extent of interoperability required. This requires a thorough examination of the facts by the whole chamber.

The President added that Microsoft's objective justification of its refusal to supply Sun Microsystems could not be rejected outright as unfounded. Microsoft's patents and copyright had not been held valid by a national court (paragraph 221), which might distinguish *Magill* and *IMS*. It is for the court dealing with the substance to consider whether the Commission had made a manifest error in evaluating the respective identified.

The President, therefore, concluded that Microsoft had made a *prima facie* case for suspension, but found that it had not established that the matter was urgent. Financial loss is insufficient to establish urgency, as compensation can be claimed after the final judgment.

A hearing is expected in the Spring of 2006, but judgment is unlikely before 2006 and there may yet be an appeal to the ECJ.

8.1.9.4.5 Comment The existence of a dominant position over PC operating systems was not challenged, only the finding of an extension of market power to neighbouring markets.

The traditional objection to tying, that Microsoft extended its near-monopoly in PC operating systems to adjacent markets, was mentioned only to justify the timing of the remedy for tying, when the Commission said that tying must be prevented before the market tips (paragraph 1016). It did not add that if tying is allowed to continue, it might be impossible for a new entrant to compete for the next generation of technology for operating systems for PCs or media players. Indeed the Commission did not refer to competition for the next generation of IT. However, at paragraphs 972 and 974, the Commission observes that the media player can be deemed a necessary component of a potential platform threat to Microsoft and that tying WMP may reduce the prospect of successful entry into the market for PC operating systems.

I am more concerned about the decision on the WMP than that on servers, although the latter extends the law. The Commission does not expressly state that the market had tipped in favour of Microsoft, only that competition had become difficult. It is not easy to know when a market is about to tip.

The Commission's decision is controversial and, as was expected, Microsoft has appealed against it.[84] The Commission took great care over its preparation and the file was subject to peer review, but the Chief Economist had formerly advised Microsoft, and was 'conflicted out'. One of his officials considered the draft decision carefully.

I would have liked to see a longer discussion of the earlier cases on refusal to supply or license and more economic theory. I would have liked the decision to have been based more clearly on the danger of the adjacent markets tipping in favour of Windows. The CFI is unlikely to deal with these matters, given its limited jurisdiction, but in his interim order its President stated that further analysis was required on a number of issues, including the application of the set of exceptional circumstances considered exhaustive in *IMS*. I would also have liked the territorial scope of the remedy for server operating systems to have been specified. By the time the CFI has given judgment,[85]and possibly the ECJ, the market will have moved on. The judgment will however be important as a precedent in other network markets.

The interface information is to be given to anyone prepared to pay a reasonable and non-discriminatory price for it in order to provide operating systems for work group servers. The facility must be essential, but how many firms must be given access? Under the early case law, access was required to more than one undertaking that had had previous dealing with the dominant firm. In *Oscar Bronner v Mediaprint,*[86] the ECJ implied that once two undertakings operated a national delivery service, compulsory access would not be justified. Once the essential facility is being made available to one competitor, there ceases to be a complete monopoly.[87] On the other hand, the Commission would like to make the dominant firm's resources available to everyone. The problem of setting a reasonable price for access is eased when the essential facility was created by a joint venture,[88] as the original formula may not need much alteration[89] when providing for newcomers.

[84] *Microsoft Corporation v Commission* (T-201/04), OJ 2004, C179/18; for the order of the President of the CFI refusing to suspend the remedies (T-201/04 R), 22 December 2004, OJ 2005, C69/16, [2005] 4 CMLR 406.

[85] A hearing is expected in the Spring of 2006.

[86] (C-7/97), 26 November 1998, [1998] ECR I-7817, [1999] 4 CMLR 112, [1999] CEC 53, 8.1.4 above.

[87] Discrimination might be abusive under Art 82(c) if the transactions are equivalent (8.1 above).

[88] As in the first American case, *US v Terminal Railroad of St. Louis Association* 224 US 383, 32 S.Ct.507, 56 L Ed 810 (1912).

[89] It may be necessary to raise the amount to take inflation and risk into account.

Would access to interface information have been required had Microsoft been less dominant over PC operating systems, or if it had not already achieved a dominant position in the work group server market?

Much remains to be decided about the duty to grant access. The Commission still fails to decide the criteria on the basis of which a charge for access may be made, but provides only a mechanism for someone else to settle the price in case of dispute—a formula that did not work in *IMS*.

8.2 BIBLIOGRAPHY

AHLBORN, C, EVANS, DS & PADILLA, J (2005) 'The Logic and Limits of the "Exceptional Circumstances test" in Magill and IMS Health' *28 Fordham ILJ* 1109

DOLMANS, M (2002) 'Standards for standards' 26 *Fordham ILJ* 163.

DOLMANS, M and GRAF, T (2004) 'Analysis of Tying under Article 82:The European Commission's Microsoft Decision in Perspective,' 27 *World Competition Law and Economics Review* 225, 235–237.

EVANS, D and PADILLA, J (2004) 'Tying Under Article 82 EC and the Microsoft Decision—A Comment on Maurits Dolmans and Thomas Graf,' 27 *World Competition Law and Economics Review* 503.

FORRESTER, IS (2005) 'Article 82: Remedies in Search of Theories' *28 Fordham ILJ* 919

FOX, EM (2005) 'A tale of two jurisdictions and an Orphan Case: Antitrustln Intellectual Property, and Refusals to Deal' *28 Fordham ILJ* 952

Conference organised by Damien Geradin, www.gclc.coleurope.be on the modernisation of Article 82. A written comment on the modernisation of Article 82 is expected shortly.

GITTA, D (2005) 'Strong Medicine for Competition Ills: the Judgment of the European Court of Justice in the *IMS Health* action and its implications for Microsoft Corporation,' 15 *Duke Journal of Comparative and International Law* 155.

KOVACIC, WE and REINDL, A (2005) 'An Interdisciplinary Approach to Improving Competition Policy and Intellectual Property Policy' *28 Fordham ILJ* 1062

LEVEQUE, F (2005) 'Innovation, Leveraging and Essential Facilities: Interoperability Licensing in the EU Microsoft Case' *World Competition Law and Economics Review*.

PARDOLESI, R and RENDA, A (2004) 'The European Commission's Case against Microsoft: BILL K,' 27 *World Competition Law and Economics Review* 513.

RITTER, C (2005) 'Refusal to Deal and "essential Facilities": Does Intellectual Property Require Special Deference Compared to Tangible Property?,' 28 *World Competition Law and Economics Review* 281 and many article cited therein.

VENIT, JS (2005Article 82: The last Frontier-Fighting Fire with Fire?' *28 Fordham ILJ* 1157

9

General Comment on iprs and Competition

9.1 WAYS IN WHICH EC LAW DIFFERS FROM US LAW AND IS LESS STRICT THAN PREVIOUSLY

THERE ARE MANY ways in which the Regulation and Guidelines as well as the application of Article 82, are stricter than the antitrust laws in the United States and the question arises how far this will encourage firms to perform R & D outside Europe, particularly in the United States, arrange for manufacture there and ship the products to Europe. This would result in the loss of high quality jobs and income within the Common Market.

One of the most important differences between the US and EC is that the US was already integrated when the Sherman Act was passed. Market integration has been very important throughout the history of the EC and, until recently, vertical agreements were perceived as isolating Member States from each other. Often an exclusive distributor was appointed for a whole Member State. Later, the Commission found that licences were often granted to manufacture and sell within a particular Member State and territorial limitations that resulted in absolute territorial protection were seen as hardcore restraints. They were not perceived as ancillary restraints necessary to induce investment, as in the US (6.2.5 above).

This may not lead to significant chilling of R & D in Europe in as much as territorial restraints may be needed at lower levels of trade by a firm arranging for the distribution in Europe of goods made in the US by exploiting the intellectual property right (ipr).

Despite the EC Treaty being based on an open market economy, there has been a tradition in many Member States of considerable state intervention. Many important industries have been subject to state regulation or ownership. Intervention with the free market is often considered desirable. The underlying philosophy in the United States has recently been far more libertarian. The minimum market share for a finding of monopolisation contrary to section 2 of the Sherman Act is at least 68 per cent, although an intent to monopolise may be found with market shares not much lower than for an infringement of Article 82.

The Chicago School had a huge influence on the US courts in the 1970s and many law schools employ economists to bring out the likely economic consequences of transactions. The Chicago philosophy has been questioned recently and many of its tenets subjected to qualifications, but the pendulum has not swung back all the way. Lawyers in Europe have become interested in economic arguments more recently.

Another of the reasons that the US Supreme Court has been cutting back on the application of antitrust may be the possibility for victims to bring treble damage actions. For instance, the US Supreme Court recently cut back the doctrine of essential facilities in *Verizon Communications IC. v Trinko,*[1] as has the Court of Appeal for the Federal Circuit in *Covad*.[2] Antitrust does not apply to a sector that is regulated, but both sets of control may apply simultaneously in Europe (8.1 and 8.1.5).

The Federal Agencies in the US have not presumed market power from the existence of an ipr which is used to tie another product. This is contrary to case law in the US Supreme Court,[3] when it was more hostile to tying than it has been since. In *Illinois Tool Works Inc v Independent Ink,*[4] the Court of Appeals for the Federal Circuit, which hears all patent appeals, considered that the old cases were wrong, but that it was bound by them. The Supreme Court has granted certiorari. So the issue will be decided soon. In the EC, it was decided at an early stage by the ECJ that a patent would not necessarily result in a dominant position: there might be substitute products.[5] Nevertheless, a dominant position is more easily found in the EC than in the US and if it is much conduct is subject to control under Article 82, which would not be treated as monopolisation or even as attempted monopolisation under section 2.

Since *Sylvania*,[6] most vertical agreements have been treated in the US under the rule of reason and not as illegal *per se*. It is very difficult to establish an

[1] *Verizon Communications IC v Trinco LLP,*540 US 398 (2004), 124, S Ct. 872, 157 L Ed 2d 823.

[2] *Covad Communication Company et al v Bell Atlantic Corpn et al* March 1, 2005, 398 F 3d 666, 365 US App DC 78.

[3] *International Salt Co v US*, 332 US 392, at 394, and *US v Loew's Inc*, 371 US 38, 83, S Ct 97, 9 L Ed 2d 11 (1962).

[4] *Illinois Tool Works Inc v Independent Ink*, 25 Jan 2005, Court of Appeals, Federal Circuit, 396 F 3d 1342.

[5] *Parke, Davis & Co v Probel* (24/67), 29 Feb 1968, [1968] ECR 55, [1968] CMLR 47, CMR 8054, and several other cases.

[6] *Continental TV, Inc v GTE Sylvania Inc* 433 US 36, 53 L Ed 568. (1977).

infringement under the rule of reason and most licences between those who could not have competed without the agreement and the restrictions it imposed are treated as valid. In Europe, during the formative 1960s and 1970s, any consensual restriction of freedom important on the market was treated as infringing Article 81. The Commission (EC) requires efficiencies to be justified, established and quantified under Article 81(3) (6.3.5 above – G 149). By virtue of Article 2 of Regulation 1/2003, the burden of proof is on the person claiming efficiencies. The difference in the burden of proof is often decisive.

A further problem in Europe is that the application of Article 81(3) is limited imprecisely in time. It is a declaration as of today. Circumstances may change, the parties may obtain more market power, and the agreement no longer merit exemption. Consequently judgments or decisions of competition authorities may not remain effective, adding greatly to uncertainty.

It is only recently that the Commission has treated the counterfactual as being what would probably have occurred without the licence and without the restrictions (6.2.1 above). The European Commission is more concerned by intra-technology competition than the US Agencies and courts (6.2.5 above and G 12). This is important as most licences are vertical agreements between parties that could not have competed without the agreement. They would be subject to a rule of reason analysis in the US, where there is a heavy onus on the person alleging illegality. In Europe, any efficiencies would need to be established and quantified by the person alleging legality.

The ceilings of market shares may be difficult to apply and create uncertainty, but they do represent a more economic approach. More terms can be block exempted if the parties lack much market power. There is no test of market power that is easy to apply, and market shares may be the best limit that could be drawn in a block exemption when individual examination of the markets affecting a licence cannot be determinative, save for withdrawing the exemption. Business will have to make up its own mind whether its contemplated licences are legal and may have to avoid Article 81 without a clear safe haven. We are almost back to the US position where there is no block exemption, but in Europe efficiencies made possible by restrictions on conduct that are important will have to be established and quantified.

The Agencies in the US are concerned only when additional market power is created, not when a licensor divides its market power with licensees.[7] The European draft guidelines were very hostile towards exclusive territories,

[7] Example 1 to US guidelines; 6.2.6 above.

which were perceived as dividing the Common Market along national boundaries. The hostility has been reduced in the actual guidelines, but we have formalistic distinctions between restricting production and restricting sales that are unknown in the US (6.4.1.5 above). Usually a licensee committing itself to setting up a production line needs protection from both.

I remain concerned that the EC position is in many ways stricter than that in the US. This may encourage firms to perform their R & D and produce the results outside the Common Market, exporting the products to the Common Market. This avoids the wider scope of Article 82 and the special responsibility of dominant firms to give access to essential facilities. Perhaps the most important difference is the burden of proof required to establish efficiencies. The EC willingness to challenge prices approved by a national regulator is also disturbing.

9.2 MORE ECONOMIC APPROACH WELCOME

Nevertheless, the guidelines mark substantial movement from the old case law to a more economic approach, mostly looking *ex ante* rather than *ex post*. Much can now be justified that would have been attacked previously.

Perhaps the most important change is that in deciding whether the parties are competitors, the counterfactual is the position that would have emerged in the absence of the licence and its restrictions. This turns into vertical agreements most licences that would have been considered horizontal once licensor and licensee were exploiting the ipr. The analysis *ex ante* extends further than in deciding whether the parties are competitors. If, without protection from free riders, a licensee would not have been prepared to invest in production, limitations on its exploitation do not restrict any competition that is possible.

A more obvious change is that the block exemption now covers licences of design rights and software copyright. I can see no reason why these should be treated differently from patents and know-how. The only reason for not including traditional copyright was lack of power to do so under Regulation 19/65.[8]

The current block exemption is limited to agreements between not more than two undertakings. That, too, is due to the limited powers conferred by Regulation 19/65. When power was taken to grant a block exemption for distribution agreements between more than two parties,[9] the amendment

[8] OJ Spec Ed, 1965, 35, amended by Council Regulation 1215/99, OJ 1999, L148/1.

[9] Council Regulation 1215/99, amending Regulation 19/65 on the application of Article 81(3) (ex Art 85(3)) of the Treaty to certain categories of agreements and concerted practices, vires for group exemptions, OJ 1999, L148/1.

did not extend to technology transfer, and it took two years to get the legislation through. The Commission did not want to wait this time. The limitation to bilateral agreements may give rise to difficulties, but where the parties are not competitors, the agreements may not infringe Article 81.

10

General Conclusion

FUNDAMENTALLY, COMPETITION AND property pursue the same aims—consumer welfare, together with the increase in the use of valuable investment. The law of property grants an exclusive right in the hope that this will induce people to make investments in things that people want to use. The investor will be able to use the fruits of the investment itself, rent out or sell it to others. This should lead to the optimal amount of investment being made.

Problems arise in the case of intellectual property rights (iprs) because it is difficult to know where the investment should be made. The law favours successful investors who may have obtained important rights with little effort, but other possible remedies, such as awarding research funds to likely winners, or the state buying successful innovations, are thought not to be practical.

The US Agencies conducted hearings in 2003[1] and we expect a report at the end of 2005 on the extent to which antitrust should override iprs. The hearings disclosed less conflict than had been expected.

The cost of awarding iprs is that perceived *ex post* they operate as barriers to entry, sometimes to very important assets. Antitrust in the US has not attempted to provide access through treating refusals to license as monopolisation. In the EC, however, the Commission and courts were relatively willing to require access but only where the incumbent has a strong monopoly and a stranglehold downstream. Both Commission and EC courts have had great difficulty in deciding what other conditions are required for refusal of access to constitute an abuse of a dominant position and the case law has been far from consistent.

The EC Commission is preparing a paper on the reform of Article 82 and it is hoped that it will not extend the doctrine of refusal to supply too far. My concern is that the Commission adopts very narrow market definitions on the basis of a change of relative price of 5 per cent or 10 per cent. This may work fairly well for commodities where the market is competitive, but

[1] Hearings of the Department of Justice and the Federal Trade Commission, 2002 on antitrust law and intellectual property, report, 'To promote Innovation: the Proper Balance of Competition and Patent Law and Policy', 2003.

not where a firm has significant market power and there is no evidence of what a competitive price would be, nor where the market power is based on investments in developing an essential facility in a network market. The Commission is reconsidering the way it defines markets. Pressure is building for such an enquiry. The ECJ is stressing that some dominant positions are very strong. If the doctrine of refusal to license were confined to such cases, refusal to supply would be a less frequent disincentive to investment, but this may not be true in the pharmaceutical industry, where markets are usually confined to medicines for a particular problem.

BIBLIOGRAPHY

FULLER, CB (1981) 'Economic Issues Relating to Property Rights in Trademarks: Export Bans, Differential Pricing, Restrictions on Resale and Repackaging' 6 *ELR* 162.

DOLMANS, M (2002) 'Standards for standards' 26 *Fordham ILJ* 163.

DOLMANS, M and Graf, T (2004) 'Analysis of Tying under Article 82:The European Commission's Microsoft Decision in Perspective,' 27 *World Competition Law and Economics Review* 225, 235–237.

EVANS, D and PADILLA, J (2004) 'Tying Under Article 82 EC and the Microsoft Decision – A Comment on Maurits Dolmans and Thomas Graf,' 27 *World Competition Law and Economics Review* 503.

Conference organised by Damien Geradin, www.gclc.coleurope.be on the modernisation of Article 82. A written comment on the modernisation of Article 82 is expected shortly.

GITTA, D (2005) 'Strong Medicine for Competition Ills: the Judgment of the European Court of Justice in the *IMS Health* action and its implications for Microsoft Corporation,' 15 *Duke Journal of Comparative and International Law* 155.

GORMLEY, LW (1985) *Prohibiting Restrictions of Trade within the EEC: The Theory and Applications of Articles 30–36 of the EEC Treaty* (Elsevier Science).

HANSEN, H (ed) vols 1–7 *Fordham International Intellectual Property Law and Policy* (New York, Juris Publishing).

12th *Annual Conference on International Intellectual Property Law and Policy*, CD and website www.fordhamipconference.com.

KEELING, DT (2003) *Intellectual Property Rights in EU law,* Vol 1*, Free movement and Competition Law.* (Oxford, OUP), second volume on competition in preparation.

KERSE, C (1996) 'Block Exemptions under Article 81(3): The Technology Transfer Regulation – Procedural Issues' 6 *ECLR* 331.

KORAH, V (2004) *An Introductory Guide to EC Competition Law and Practice*, 8th edn, (Oxford, Hart) chs 5, 10 and 11.

—— (1997) *Technology Transfer and the EC Competition Rules* (Oxford, OUP). (An analysis of the former group exemption.)

—— (1989) *Know-how licensing Agreements and the EEC Competition Rules, Regulation 556/89*, (Oxford, ESC/Sweet and Maxwell).

—— (1985) *Patent Licensing and EEC Competition Rules: Regulation 2349/84*, (Oxford, ESC/Sweet and Maxwell).

—— (2004) 'Draft Technology Transfer Block Exemption,' 25 *ECLR* 247.

KORAH, V and O'SULLIVAN, D (2002) *Distribution Agreements under the EC Competition Rules* (Oxford, Hart Publishing).

LEVEQUE, F (2005) 'Innovation, Leveraging and Essential Facilities: Interoperability Licensing in the EU Microsoft Case' *World Competition Law and Economics Review* 71.

PARDOLESI, R and RENDA, A (2004) 'The European Commission's Case against Microsoft: Kill Bill,' 27 *World Competition Law and Economics Review* 513.

RIDYARD, D and LEWIS, D (1998) 'Parallel Trade in Patented Medicines – Economics in Defence of Market Segmentation' *Int TLR* 14.

RITTER, C (2005) 'Refusal to Deal and "essential Facilities": Does Intellectual Property Require Special Deference Compared to Tangible Property?,' 28 *World Competition Law and Economics Review* 281 and many article cited therein.

LANG, JT (2003) 'Anticompetitive non-pricing abuses under European and national antitrust law,' in Barry Hawk (ed) *Fordham Corporate Law Inst* (New York, 2004), pp 235–340.

US Department of Justice and Federal Trade Commission, *Antitrust Guidelines for the Licensing of Intellectual Property*, 6 April 1995, CCH, Trade Regulation Report, 13, 132, BNA ATRR 462.

VAN BAEL and BELLIS, (2004) *Competition Law of the European Community,* 4th edn, (Kluwer Law International), ch 6.

WAELBROECK, DF (1985) 'Les Conventions de Délimitation des Marques Face au Droit Communautaire' *Cahiers de Droit Européen* 402.

WAELBROECK, M (1976) 'The Effect of the Rome Treaty on the Exercise of National Industrial Property Rights' 21 *Antitrust Bull* 99.

Appendix 1

Excerpts from the Treaty establishing the European Community[1]

PART ONE
PRINCIPLES

Article 2

The community shall have as its task, by establishing a common market and an economic and monetary union and by implementing common policies or activities referred to in Articles 3 and 4, to promote throughout the Community a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, equality between men and women, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement of the quality of the environment, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States.

Article 3

1. For the purposes set out in Article 2, the activities of the Community shall include, as provided in this Treaty and in accordance with the timetable set out therein:

(a) the prohibition, as between Member States, of customs duties and quantitative restrictions on the import and export of goods, and of all other measures having equivalent effect;
(b) a common commercial policy;
(c) an internal market characterised by the abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital;
(d) measures concerning the entry and movement of persons in the internal market as provided for in Title IV;
(e) a common policy in the sphere of agriculture and fisheries;
(f) a common policy in the sphere of transport;

[1] Almost all the Articles of the EC Treaty were renumbered when the Treaty of Amsterdam came into operation on the first of May 1999. The new numbers have been used here. The previous numbers are given in brackets.

(g) a system ensuring that competition in the internal market is not distorted;
(h) the approximation of the laws of Member States to the extent required for the functioning of the common market;
(i) the promotion of coordination between employment policies of the Member States with a view to enhancing their effectiveness by developing a coordinated strategy for employment;
(j) a policy in the social sphere comprising a European Social Fund;
(k) the strengthening of economic and social cohesion;
(l) a policy in the sphere of the environment;
(m) the strengthening of the competitiveness of Community industry;
(n) the promotion of research and technological development;
(o) encouragement for the establishment and development of trans-European networks;
(p) a contribution to the attainment of a high level of health protection;
(q) a contribution to education and training of equality and to the flowering of the cultures of the Member States;
(r) a policy in the sphere of development cooperation;
(s) the association of the overseas countries and territories in order to increase trade and promote jointly economic and social development;
(t) a contribution to the strengthening of consumer protection;
(u) measures in the spheres of energy, civil protection and tourism.

2. In all the activities referred to in this Article, the Community shall aim to eliminate inequalities, and to promote equality, between men and women.

Article 10 (ex 5)

Member States shall take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of this Treaty or resulting from action taken by the institutions of the Community. They shall facilitate the achievement of the Community's tasks.

They shall abstain from any measure which could jeopardise the attainment of the objectives of this Treaty.

CHAPTER 2
PROHIBITION OF QUANTITATIVE RESTRICTIONS BETWEEN MEMBER STATES

Article 28 (ex 30)

Quantitative restrictions on imports and all measures having equivalent effect shall be prohibited between Member States.

Article 30 (ex 36)

The provisions of Articles 28 and 29 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States.

PART THREE
COMMUNITY POLICIES

TITLE VI
COMMON RULES ON COMPETITION, TAXATION AND APPROXIMATION OF LAWS

CHAPTER 1
RULES ON COMPETITION

Section 1
Rules applying to Undertakings

Article 81 (ex 85)

1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

(a) directly or indirectly fix purchase or selling prices or any other trading conditions;
(b) limit or control production, markets, technical development, or investment;
(c) share markets or sources of supply;
(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreements or decisions prohibited pursuant to this article shall be automatically void.
3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

— any agreement or category of agreements between undertakings;
— any decision or category of decisions by associations of undertakings;
— any concerted practice or category of concerted practices;

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Article 82 (ex 86)

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States.

Such abuse may, in particular, consist in:

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
(b) limiting production, markets or technical development to the prejudice of consumers;
(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

Article 86 (ex 90)

1. In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 12 and Articles 81 to 89.
2. Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community.
3. The Commission shall ensure the application of the provisions of this Article and shall, where necessary, address appropriate directives or decisions to Member States.

PART SIX

GENERAL AND FINAL PROVISIONS

Article 295 (ex 222)

This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership.

Appendix 2

Regulation No 19/65/EEC of the Council of 2 March 1965 on application of Article 85 (3) of the Treaty to Certain Categories of Agreements and Concerted Practices

(OJ 36, 6.3.1965 p. 533) as amended by Council Regulation (EC) No 1215/1999 of 10 June 1999 (OJ L 148, 15.6.1999 p. 1)

THE COUNCIL OF THE EUROPEAN ECONOMIC COMMUNITY,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 87 thereof;

Having regard to the proposal from the Commission;

Having regard to the Opinion of the European Parliament[1];

Having regard to the Opinion of the Economic and Social Committee[2];

Whereas Article 85 (1) of the Treaty may in accordance with Article 85 (3) be declared inapplicable to certain categories of agreements, decisions and concerted practices which fulfil the conditions contained in Article 85 (3);

Whereas the provisions for implementation of Article 85 (3) must be adopted by way of regulation pursuant to Article 87;

Whereas in view of the large number of notifications submitted in pursuance of Regulation No 17[3] it is desirable that in order to facilitate the task of the Commission it should be enabled to declare by way of regulation that the provisions of Article 85 (1) do not apply to certain categories of agreements and concerted practices;

Whereas it should be laid down under what conditions the Commission, in close and constant liaison with the competent authorities of the Member States, may exercise such powers after sufficient experience has been gained in the light of individual decisions and it becomes possible to define categories of agreements and concerted practices in respect of which the conditions of Article 85 (3) may be considered as being fulfilled;

Whereas the Commission has indicated by the action it has taken, in particular by Regulation No 153,[4] that there can be no easing of the procedures prescribed by Regulation No 17 in respect of certain types of agreements and concerted practices that are particularly liable to distort competition in the common market;

Whereas under Article 6 of Regulation No 17 the Commission may provide that a decision taken pursuant to Article 85 (3) of the Treaty shall apply with retroactive effect; whereas it is desirable that the Commission be also empowered to adopt, by regulation, provisions to the like effect;

Whereas under Article 7 of Regulation No 17 agreements, decisions and concerted practices may, by decision of the Commission, be exempted from prohibition in particular if they are modified in such manner that they satisfy the requirements of Article 85 (3); whereas it is desirable that the Commission be enabled to grant like exemption by regulation to such agreements and concerted practices if they are modified in such manner as to fall within a category defined in an exempting regulation;

Whereas, since there can be no exemption if the conditions set out in Article 85 (3) are not satisfied, the Commission must have power to lay down by decision the conditions that must be satisfied by an agreement or concerted practice which owing to special circumstances has certain effects incompatible with Article 85 (3);

HAS ADOPTED THIS REGULATION:

Article 1

1. Without prejudice to the application of Regulation No 17 and in accordance with Article 81(3) of the Treaty the Commission may by regulation declare that Article 81(1) shall not apply to:

(a) categories of agreements which are entered into by two or more undertakings, each operating, for the purposes of the agreement, at a different level of the production or distribution chain, and which relate to the conditions under which the parties may purchase, sell or resell certain goods or services,
(b) categories of agreements to which only two undertakings are party and which include restrictions imposed in relation to the acquisition or use of industrial property rights, in particular of patents, utility models, designs or trade marks, or to the rights arising out of contracts for assignment of, or the right to use, a method of manufacture or knowledge relating to the use or to the application of industrial processes.

2. The regulation shall define the categories of agreements to which it applies and shall specify in particular:

(a) the restrictions or clauses which must not be contained in the agreements;
(b) the other conditions which must be satisfied.

3. Paragraphs 1 and 2 shall apply by analogy to categories of concerted practices.

Article 1a

A regulation pursuant to Article 1 may stipulate the conditions which may lead to the exclusion from its application of certain parallel networks of similar agreements or concerted practices operating on particular market; when these circumstances are fulfilled the Commission may establish this by means of regulation and fix a period at the expiry of which the Regulation pursuant to Article 1 would no longer be applicable in respect of the relevant agreements or concerted practices on that market; such period must not be shorter than six months.

Article 2

1. A regulation pursuant to Article 1 shall be made for a specified period.
2. It may be repealed or amended where circumstances have changed with respect to any factor which was basic to its being made; in such case, a period shall be fixed for modification of the agreements and concerted practices to which the earlier regulation applies.

Article 3

A regulation pursuant to Article 1 may stipulate that it shall apply with retroactive effect to agreements and concerted practices to which, at the date of entry into force of that regulation, a decision issued with retroactive effect in pursuance of Article 6 of Regulation No 17 would have applied.

Article 4

1. A regulation pursuant to Article 1 may stipulate that the prohibition contained in Article 85 (1) of the Treaty shall not apply, for such period as shall be fixed by that regulation, to agreements and concerted practices already in existence on 13 March 1962 which do not satisfy the conditions of Article 85 (3), where:

— within three months from the entry into force of the Regulation, they are so modified as to satisfy the said conditions in accordance with the provisions of the regulation; and
— the modifications are brought to the notice of the Commission within the time limit fixed by the regulation.

2. Paragraph 1 shall apply to agreements and concerted practices which had to be notified before 1 February 1963, in accordance with Article 5 of Regulation No 17, only where they have been so notified before that date.
3. The benefit of the provisions laid down pursuant to paragraph 1 may not be claimed in actions pending at the date of entry into force of a regulation adopted pursuant to Article 1; neither may it be relied on as grounds for claims for damages against third parties.

Article 5

Before adopting a regulation, the Commission shall publish a draft thereof and invite all persons concerned to submit their comments within such time limit, being not less than one month, as the Commission shall fix.

Article 6

1. The Commission shall consult the Advisory Committee on Restrictive Practices and Monopolies:

(a) with regard to a regulation pursuant to Article 1 before publishing a draft regulation and before adopting a regulation;
(b) with regard to a regulation pursuant to Article 1a before publishing a draft regulation if requested by a Member State, and before adopting a regulation.

2. Article 10 (5) and (6) of Regulation No 17, relating to consultation with the Advisory Committee, shall apply by analogy, it being understood that joint meetings with the Commission shall take place not earlier than one month after dispatch of the notice convening them.

Article 7

1. Where the Commission, either on its own initiative or at the request of a Member State or of natural or legal persons claiming a legitimate interest, finds that in any particular case agreements or concerted practices to which a regulation adopted pursuant to Article 1 of this Regulation applies have nevertheless certain effects which are incompatible with the conditions laid down in Article 85 (3) of the Treaty, it may withdraw the benefit of application of that regulation and issue a decision in accordance with Articles 6 and 8 of Regulation No 17, without any notification under Article 4 (1) of Regulation No 17 being required.
2. When in any particular case agreements or concerted practices to which a regulation adopted pursuant to Article 1 applies have certain effects which are incompatible with the conditions laid down in Article 81(3) of the Treaty in the territory of a Member State, or in part thereof, which has all the characteristics of a distinct market, the competent authority in that Member State may on its own initiative or at the request of the Commission or of natural or legal persons claiming a legitimate interest withdraw the benefit of application of that regulation.

Article 8

The Commission shall, before 1 January 1970, submit to the Council a proposal for a Regulation for such amendment of this Regulation as may prove necessary in the light of experience.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 2 March 1965.

For the Council
The President
M. COUVE DE MURVILLE

(1) OJ No 81, 27.5.1964, p. 1275/64.
(2) OJ No 197, 30.11.1964, p. 3320/64.
(3) OJ No 13, 21.2.1962, p. 204/62 (Regulation No 17 as amended by Regulation No 59 – OJ No 58, 10.7.1962, p. 1655/62 – and Regulation No 118/63/EEC – OJ No 162, 7.11.1963, p. 2696/63.
(4) OJ No 139, 24.12.1962, p. 2918/62.

Appendix 3

Commission Regulation (EC) No 772/2004 of 7 April 2004 on the Application of Article 81(3) of the Treaty to Categories of Technology Transfer Agreements

(Text with EEA relevance)

This Regulation has been downloaded from the Commission's website; final version adopted on 7 April 2004. The original texts appeared in OJ 2004, L123/11.

The italic headings in the text and references to articles, recitals and guidelines have been inserted by Valentine Korah and Andrej Fatur. They do not form part of the regulation. The abbreviations A, R and G are used to mean Article, Recital or Guideline respectively. The annotations are in italic to distinguish them from the Regulation itself. G 34–129 relate to the construction of the regulation, G 130–235 to the treatment of agreements outside the regulation.

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Vires

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation No 19/65/EEC of 2 March 1965 on application of Article 85(3) of the Treaty to certain categories of agreements and concerted practices[1] and in particular Article 1 thereof,

Having published a draft of this Regulation[2],

After consulting the Advisory Committee on Restrictive Practices and Dominant Positions,

Whereas:

Vires

(1) Regulation No 19/65/EEC empowers the Commission to apply Article 81(3) of the Treaty by Regulation to certain categories of technology transfer agreements and corresponding concerted practices to which only two undertakings are party, which fall within Article 81(1).

Former regulation

(2) Pursuant to Regulation No 19/65/EEC, the Commission has, in particular, adopted Regulation (EC) No 240/96 of 31 January 1996 on the application of Article 85(3) of the Treaty to certain categories of technology transfer agreements[3].

Evaluation report [A 0]

(3) On 20 December 2001 the Commission published an evaluation report on the transfer of technology block exemption Regulation (EC) No 240/96[4]. This generated a public debate on the application of Regulation (EC) No 240/96 and on the application in general of Article 81(1) and (3) of the Treaty to technology transfer agreements. The response to the evaluation report from Member States and third parties has been generally in favour of reform of Community competition policy on technology transfer agreements. It is therefore appropriate to repeal Regulation (EC) No 240/96.

Simplify – economic approach – market share [A 3], black list [A 4], excluded restrictions [A 5]

(4) This Regulation should meet the two requirements of ensuring effective competition and providing adequate legal security for undertakings. The pursuit of these objectives should take account of the need to simplify the regulatory framework and its application. It is appropriate to move away from the approach of listing exempted clauses and to place greater emphasis on defining the categories of agreements which are exempted up to a certain level of market power and on specifying the restrictions or clauses which are not to be contained in such agreements. This is consistent with an economics based approach which assesses the impact of agreements on the relevant market. It is also consistent with such an approach to make a distinction between agreements between competitors and agreements between non-competitors.

Benefits of technology licensing – efficiency – pro-competitive [G 17]

(5) Technology transfer agreements concern the licensing of technology. Such agreements will usually improve economic efficiency and be pro-competitive as they can reduce duplication of research and development, strengthen the incentive for the initial research and development, spur incremental innovation, facilitate diffusion and generate product market competition.

Balance between pro and anti-competitive effect depends on market power [As 3, 4, 5; Gs 18–21]

(6) The likelihood that such efficiency-enhancing and pro-competitive effects will outweigh any anti-competitive effects due to restrictions contained in technology transfer agreements depends on the degree of market power of the undertakings concerned and, therefore, on the extent to which those undertakings face competition from undertakings owning substitute technologies or undertakings producing substitute products.

Must license licensee to produce – not sub-contracting R & D, or technology pools [A 2(1); Gs 41–45]

(7) This Regulation should only deal with agreements where the licensor permits the licensee to exploit the licensed technology, possibly after further research and development by the licensee, for the production of goods or services. It should not deal with licensing agreements for the purpose of sub-contracting research and development. It should also not deal with licensing agreements to set up technology pools, that is to say, agreements for the pooling of technologies with the purpose of licensing the created package of intellectual property rights to third parties.

Need not define whether caught by Article 81(1)

(8) For the application of Article 81(3) by regulation, it is not necessary to define those technology transfer agreements that are capable of falling within Article 81(1). In the individual assessment of agreements under Article 81(1), account has to be taken of several factors, and in particular the structure and the dynamics of the relevant technology and product markets.

Includes ancillary restraints [A 1(1)(b); Gs 42, 49]

(9) The benefit of the block exemption established by this Regulation should be limited to those agreements which can be assumed with sufficient certainty to satisfy the conditions of Article 81(3). In order to attain the benefits and objectives of technology transfer, the benefit of this Regulation should also apply to provisions contained in technology transfer agreements that do not constitute the primary object of such agreements, but are directly related to the application of the licensed technology.

Ceiling of combined market shares – agreements between competitors 20% [As 3(1), 1(1)(j); Gs 10–1216, 19–26, 65–72, 131]

(10) For technology transfer agreements between competitors it can be presumed that, where the combined share of the relevant markets accounted for by the parties does not exceed 20% and the agreements do not contain certain severely anti-competitive restraints, they generally lead to an improvement in production or distribution and allow consumers a fair share of the resulting benefits.

Ceiling of individual market shares – agreements between non-competitors 30% [A 3(2); Gs 10–12, 16, 65–72]

(11) For technology transfer agreements between non-competitors it can be presumed that, where the individual share of the relevant markets accounted for by each of the parties does not exceed 30% and the agreements do not contain certain severely anti-competitive restraints, they generally lead to an improvement in production or distribution and allow consumers a fair share of the resulting benefits.

No presumption above market share ceilings [A 3; Gs 9, 37, 65, 69, 130]

(12) There can be no presumption that above these market share thresholds technology transfer agreements do fall within the scope of Article 81(1). For instance, an exclusive licensing agreement between non-competing undertakings does often not fall within the scope of Article 81(1). There can also be no presumption that, above these market share thresholds, technology transfer agreements falling within the scope of Article 81(1) will not satisfy the conditions for exemption. However, it can also not be presumed that they will usually give rise to objective advantages of such a character and size as to compensate for the disadvantages which they create for competition.

Black lists [A 4(1), (2); Gs 13–15, 74–106]

(13) This Regulation should not exempt technology transfer agreements containing restrictions which are not indispensable to the improvement of production or distribution. In particular, technology transfer agreements containing certain severely anti-competitive restraints such as the fixing of prices charged to third parties should be excluded from the benefit of the block exemption established by this Regulation irrespective of the market shares of the undertakings concerned. In the case of such hardcore restrictions the whole agreement should be excluded from the benefit of the block exemption.

Excluded restrictions [A 5; Gs 14,107–116]

(14) In order to protect incentives to innovate and the appropriate application of intellectual property rights, certain restrictions should be excluded from the block exemption. In particular exclusive grant back obligations for severable improvements should be excluded. Where such a restriction is included in a licence agreement only the restriction in question should be excluded from the benefit of the block exemption.

Not eliminate competition [A 3–5]

(15) The market share thresholds, the non-exemption of technology transfer agreements containing severely anti-competitive restraints and the excluded restrictions provided for in this Regulation will normally ensure that the agreements to which the block exemption applies do not enable the participating undertakings to eliminate competition in respect of a substantial part of the products in question.

Commission may withdraw exemption [A 6(1); Gs 34, 117–122 Reg 1/2003, A 29(2)]

(16) In particular cases in which the agreements falling under this Regulation nevertheless have effects incompatible with Article 81(3), the Commission should be able to withdraw the benefit of the block exemption. This may occur in particular where the incentives to innovate are reduced or where access to markets is hindered.

NCAs may withdraw [A 6(2); Gs 117–122; Regulation 1/2003 A 29(2)]

(17) Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty[5] empowers the competent authorities of Member States to withdraw the benefit of the block exemption in respect of technology transfer agreements having effects incompatible with Article 81(3), where such effects are felt in their respective territory, or in a part thereof, and where such territory has the characteristics of a distinct geographic market. Member States must ensure that the exercise of this power of withdrawal does not prejudice the uniform application throughout the common market of the Community competition rules or the full effect of the measures adopted in implementation of those rules.

Commission may render exemption non-applicable by regulation [A 7; Gs 123–129]

(18) In order to strengthen supervision of parallel networks of technology transfer agreements which have similar restrictive effects and which cover more than 50% of a given market, the Commission should be able to declare this Regulation inapplicable to technology transfer agreements containing specific restraints relating to the market concerned, thereby restoring the full application of Article 81 to such agreements.

Restrictions at different levels of trade [As 2(1) & 1(1)(b); Gs 39, 42, 48, 49]

(19) This Regulation should cover only technology transfer agreements between a licensor and a licensee. It should cover such agreements even if conditions are stipulated for more than one level of trade, by, for instance, requiring the licensee to set up a particular distribution system and specifying the obligations the licensee must or may impose on resellers of the products produced under the licence. However, such conditions and obligations should comply with the competition rules applicable to supply and distribution agreements. Supply and distribution agreements concluded between a licensee and its buyers should not be exempted by this Regulation.

Article 82

(20) This Regulation is without prejudice to the application of Article 82 of the Treaty,

HAS ADOPTED THIS REGULATION:

Article 1
Definitions [G 1]

1. For the purposes of this Regulation the following definitions shall apply:

(a) 'agreement' means an agreement, a decision of an association of undertakings or a concerted practice; *[A 2(1)]*

(b) 'technology transfer agreement' *[Gs 46–53]* means a patent licensing agreement *[A1(1)(h); G 46]*, a know-how licensing agreement *[A1(1)(i); Gs 46, 47]*, a software copyright licensing agreement *[G 46, 51]* or a mixed patent, know-how or software copyright licensing agreement, including any such agreement containing provisions which relate to the sale and purchase of products *[A4(2); R19; G 49]* or which relate to the licensing of other intellectual property rights or the assignment of intellectual property rights, *[Gs 49, 50, 57, 61–63]* provided that those provisions do not constitute the primary object of the agreement and are directly related to the production of the contract products *[R 9; G 42]*; assignments of patents, know-how, software copyright or a combination thereof where part of the risk associated with the exploitation of the technology remains with the assignor, in particular where the sum payable in consideration of the assignment is dependent on the turnover obtained by the assignee in respect of products produced with the assigned technology, the quantity of such products produced or the number of operations carried out employing the technology, shall also be deemed to be technology transfer agreements;

(c) 'reciprocal agreement' *[A 4(1)(b), G 78]* means a technology transfer agreement where two undertakings grant each other, in the same or separate contracts, a patent licence, a know-how licence, a software copyright licence or a mixed patent, know-how or software copyright licence and where these licences concern competing technologies or can be used for the production of competing products;

(d) 'non-reciprocal agreement' [A4(1) (b) & (c) (ii),(iv); Gs 55, 78–81] means a technology transfer agreement where one undertaking grants another undertaking a patent licence, a know-how licence, a software copyright licence or a mixed patent, know-how or software copyright licence, or where two undertakings grant each other such a licence but where these licences do not concern competing technologies and cannot be used for the production of competing products;

(e) 'product' means a good or a service, including both intermediary goods and services and final goods and services *[G 43]*;

(f) 'contract products' means products produced with the licensed technology *[G 43]*;

(g) 'intellectual property rights' includes industrial property rights, know-how, copyright and neighbouring rights *[G 50]*;

(h) 'patents' means patents, patent applications, utility models, applications for registration of utility models, designs, topographies of semiconductor products, supplementary protection certificates for medicinal products or other products for which such supplementary protection certificates may be obtained and plant breeder's certificates *[G 46]*;

(i) 'know-how' means a package of non-patented practical information, resulting from experience and testing, which is *[G 47]*:

  (i) secret, that is to say, not generally known or easily accessible,

(ii) substantial, that is to say, significant and useful for the production of the contract products, and

(iii) identified, that is to say, described in a sufficiently comprehensive manner so as to make it possible to verify that it fulfils the criteria of secrecy and substantiality;

[Gs 26–33, 66–68, 76–122]

(j) 'competing undertakings' means undertakings which compete on the relevant technology market and/or the relevant product market, that is to say:

Actual competitors on technology market [Gs 20, 28, 30, 66, 68]

(i) competing undertakings on the relevant technology market, being undertakings which license out competing technologies without infringing each others' intellectual property rights (actual competitors on the technology market); the relevant technology market includes technologies which are regarded by the licensees as interchangeable with or substitutable for the licensed technology, by reason of the technologies' characteristics, their royalties and their intended use;

Actual or potential competitors on product market [Gs 20, 28, 29, 67, 68]

(ii) competing undertakings on the relevant product market, being undertakings which, in the absence of the technology transfer agreement, are both active on the relevant product and geographic market(s) on which the contract products are sold without infringing each others' intellectual property rights (actual competitors on the product market) or would, on realistic grounds, undertake the necessary additional investments or other necessary switching costs so that they could timely enter, without infringing each others' intellectual property rights, the(se) relevant product and geographic market(s) in response to a small and permanent increase in relative prices (potential competitors on the product market); the relevant product market comprises products which are regarded by the buyers as interchangeable with or substitutable for the contract products, by reason of the products' characteristics, their prices and their intended use;

(k) 'selective distribution system' means a distribution system where the licensor undertakes to license the production of the contract products only to licensees selected on the basis of specified criteria and where these licensees undertake not to sell the contract products to unauthorised distributors; *[A 4(1)(b)(vi), 4(1)(c); G 105]*

(l) 'exclusive territory' means a territory in which only one undertaking is allowed to produce the contract products with the licensed technology, without prejudice to the possibility of allowing within that territory another licensee to produce the contract products only for a particular customer where this second licence was granted in order to create an alternative source of supply for that customer;

(m) 'exclusive customer group' means a group of customers to which only one undertaking is allowed actively to sell the contract products produced with the licensed technology;
(n) 'severable improvement' means an improvement that can be exploited without infringing the licensed technology.

2. The terms 'undertaking', 'licensor' and 'licensee' shall include their respective connected undertakings.

'Connected undertakings' means:

(a) undertakings in which a party to the agreement, directly or indirectly:
  (i) has the power to exercise more than half the voting rights, or
  (ii) has the power to appoint more than half the members of the supervisory board, board of management or bodies legally representing the undertaking, or
  (iii) has the right to manage the undertaking's affairs;
(b) undertakings which directly or indirectly have, over a party to the agreement, the rights or powers listed in (a);
(c) undertakings in which an undertaking referred to in (b) has, directly or indirectly, the rights or powers listed in (a);
(d) undertakings in which a party to the agreement together with one or more of the undertakings referred to in (a), (b) or (c), or in which two or more of the latter undertakings, jointly have the rights or powers listed in (a);
(e) undertakings in which the rights or the powers listed in (a) are jointly held by:
  (i) parties to the agreement or their respective connected undertakings referred to in (a) to (d), or
  (ii) one or more of the parties to the agreement or one or more of their connected undertakings referred to in (a) to (d) and one or more third parties.

Article 2
Exemption [A 1(1)–(i); Gs 34–35]

Pursuant to Article 81(3) of the Treaty and subject to the provisions of this Regulation, it is hereby declared that Article 81(1) of the Treaty shall not apply to technology transfer agreements *[A 1(1)(a), 1(1)(b)]* entered into between two undertakings *[Gs 38–40, 52]* permitting the production of contract products. *[Rs 7, 19; Gs 41–45, 63, 64]*

Duration, [Gs 54, 55]

This exemption shall apply to the extent that such agreements contain restrictions of competition falling within the scope of Article 81(1). The exemption shall apply for as long as the intellectual property right in the licensed technology has not expired, lapsed or been declared invalid or, in the case of know-how, for as long as the know-how remains secret, except in the event where the know-how becomes publicly known as a result of action by the licensee, in which case the exemption shall apply for the duration of the agreement.

Article 3
Market share thresholds [A 1(1)(j); Rs 4, 6, 12, 15; Gs 20–23, 25, 27, 31, 35, 65–73, 131]

Between competitors [R 10; Gs 12, 66, 67, 69, 71, 131]

1. Where the undertakings party to the agreement are competing undertakings, the exemption provided for in Article 2 shall apply on condition that the combined market share of the parties does not exceed 20% on the affected relevant technology and product market.

Between non-competitors [R 11; Gs 12, 68, 69, 71]

2. Where the undertakings party to the agreement are not competing undertakings, the exemption provided for in Article 2 shall apply on condition that the market share of each of the parties does not exceed 30% on the affected relevant technology and product market.

Technology markets [Gs 23, 70–73]

3. For the purposes of paragraphs 1 and 2 the market share of a party on the relevant technology market(s) is defined in terms of the presence of the licensed technology on the relevant product market(s). A licensor's market share on the relevant technology market shall be the combined market share on the relevant product market of the contract products produced by the licensor and its licensees.

Article 4
Hardcore restrictions [Rs 4, 6, 13, 15; Gs 74–106, 212, 223]

Between competing undertakings [A 1(1)(j); Gs 76–95]

1. Where the undertakings party to the agreement are competing undertakings, the exemption provided for in Article 2 shall not apply to agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object:

Price fixing

(a) the restriction of a party's ability to determine its prices when selling products to third parties *[Gs 79–81, 156–160]*;

Output limitation

(b) the limitation of output, except limitations on the output of contract products imposed on the licensee in a non-reciprocal agreement or imposed on only one of the licensees in a reciprocal agreement *[G 82, 83, 175–177]*;

Allocation of markets or customers

(c) the allocation of markets or customers except *[Gs 84–93, 163, 168–174, 180, 181, 183]*:

Field of use or product restriction on licensee

(i) the obligation on the licensee(s) to produce with the licensed technology only within one or more technical fields of use or one or more product markets *[Gs 90, 179–184]*,

Field of use, product restriction or exclusive territory to protect the other party in a non-reciprocal licence

(ii) the obligation on the licensor and/or the licensee, in a non-reciprocal agreement, not to produce with the licensed technology within one or more technical fields of use or one or more product markets or one or more exclusive territories reserved for the other party *[Gs 86, 179–185]*,

Sole licence

(iii) the obligation on the licensor not to license the technology to another licensee in a particular territory *[G 88]*,

No poaching by either party on other's exclusive territory or customer group in non-reciprocal licence

(iv) the restriction, in a non-reciprocal agreement, of active and/or passive sales by the licensee and/or the licensor into the exclusive territory or to the exclusive customer group reserved for the other party *[Gs 87, 170]*,

Active sales ban to protect another licensee in non-reciprocal licence

(v) the restriction, in a non-reciprocal agreement, of active sales by the licensee into the exclusive territory or to the exclusive customer group allocated by the licensor to another licensee provided the latter was not a competing undertaking of the licensor at the time of the conclusion of its own licence *[G 89]*;

Captive use restriction

(vi) the obligation on the licensee to produce the contract products only for its own use provided that the licensee is not restricted in selling the contract products actively and passively as spare parts for its own products *[Gs 92, 186–187]*,

Alternative source

(vii) the obligation on the licensee, in a non-reciprocal agreement, to produce the contract products only for a particular customer, where the licence was granted in order to create an alternative source of supply for that customer *[G 93]*;

Restriction on licensee using or developing own technology

(d) the restriction of the licensee's ability to exploit its own technology or the restriction of the ability of any of the parties to the agreement to carry out research and development, unless such latter restriction is indispensable to prevent the disclosure of the licensed know-how to third parties *[Gs 81, 94, 95, 157]*.

Non-competing undertakings [Gs 35, 61–64, 96–106]

2. Where the undertakings party to the agreement are not competing undertakings, the exemption provided for in Article 2 shall not apply to agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object: *[Gs 61–64, 96–106]*

Price fixing

(a) the restriction of a party's ability to determine its prices when selling products to third parties, without prejudice to the possibility to impose a maximum sale price or recommend a sale price, provided that it does not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties *[G 97]*;

Territorial or customer restriction on passive sales by licensee

(b) the restriction of the territory into which, or of the customers to whom, the licensee may passively sell the contract products, except *[Gs 98, 99, 174, 180]*:

To protect exclusive territory or customer group of licensor

(i) the restriction of passive sales into an exclusive territory or to an exclusive customer group reserved for the licensor *[G 100]*,

To protect exclusive territory or customer group of another licensee

(ii) the restriction of passive sales into an exclusive territory or to an exclusive customer group allocated by the licensor to another licensee during the first two years that this other licensee is selling the contract products in that territory or to that customer group *[G 101]*,

Captive sales

(iii) the obligation to produce the contract products only for its own use provided that the licensee is not restricted in selling the contract products actively and passively as spare parts for its own products *[Gs 102, 186, 187]*,

Alternative source

(iv) the obligation to produce the contract products only for a particular customer, where the licence was granted in order to create an alternative source of supply for that customer *[Gs 103, 188–190]*,

Separate wholesale and retail trade

(v) the restriction of sales to end users by a licensee operating at the wholesale level of trade *[G 104]*, *Selective distribution*

(vi) the restriction of sales to unauthorised distributors by the members of a selective distribution system *[G 105]*;

Selective distribution

(c) the restriction of active or passive sales to end-users by a licensee which is a member of a selective distribution system and which operates at the retail level, without prejudice to the possibility of prohibiting a member of the system from operating out of an unauthorised place of establishment.

If parties become competing [Gs 31, 68]

3. Where the undertakings party to the agreement are not competing undertakings at the time of the conclusion of the agreement but become competing undertakings afterwards, paragraph 2 and not paragraph 1 shall apply for the full life of the agreement unless the agreement is subsequently amended in any material respect.

Article 5
Excluded restrictions [Rs 4, 6, 15; Gs 35, 107]

1. The exemption provided for in Article 2 shall not apply to any of the following obligations contained in technology transfer agreements *[G 108]*:

Exclusive grant back

(a) any direct or indirect obligation on the licensee to grant an exclusive licence to the licensor or to a third party designated by the licensor in respect of its own severable improvements to or its own new applications of the licensed technology *[R 14; Gs 109–111]*;

Exclusive assignment back

(b) any direct or indirect obligation on the licensee to assign, in whole or in part, to the licensor or to a third party designated by the licensor, rights to its own severable improvements to or its own new applications of the licensed technology *[Gs 109–111]*;

No challenge

(c) any direct or indirect obligation on the licensee not to challenge the validity of intellectual property rights which the licensor holds in the common market, without prejudice to the possibility of providing for termination of the technology transfer agreement in the event that the licensee challenges the validity of one or more of the licensed intellectual property rights *[Gs 112, 113]*.

Restriction on using own technology if not competing

2. Where the undertakings party to the agreement are not competing undertakings, the exemption provided for in Article 2 shall not apply to any direct or indirect obligation limiting the licensee's ability to exploit its own technology or limiting the ability of any of the parties to the agreement to carry out research and development, unless such latter restriction is indispensable to prevent the disclosure of the licensed know-how to third parties *[Gs 114–116]*.

Article 6
Withdrawal in individual cases [R 16; Gs 34, 117–122]

Commission may withdraw

1. The Commission may withdraw the benefit of this Regulation, pursuant to Article 29(1) of Regulation (EC) No 1/2003, where it finds in any particular case that a technology transfer agreement to which the exemption provided for in Article 2 applies nevertheless has effects which are incompatible with Article 81(3) of the Treaty, and in particular where:

Third party technology foreclosed [G 120]

(a) access of third parties' technologies to the market is restricted, for instance by the cumulative effect of parallel networks of similar restrictive agreements prohibiting licensees from using third parties' technologies;

Potential licensees foreclosed [G 120]

(b) access of potential licensees to the market is restricted, for instance by the cumulative effect of parallel networks of similar restrictive agreements prohibiting licensors from licensing to other licensees;

Technology not exploited without objective justification [G 120]

(c) without any objectively valid reason, the parties do not exploit the licensed technology.

NCA may withdraw if distinct geographic market

2. Where, in any particular case, a technology transfer agreement to which the exemption provided for in Article 2 applies has effects which are incompatible with Article 81(3) of the Treaty in the territory of a Member State, or in a part thereof, which has all the characteristics of a distinct geographic market, the competition authority of that Member State may withdraw the benefit of this Regulation, pursuant to Article 29(2) of Regulation (EC) No 1/2003, in respect of that territory, under the same circumstances as those set out in paragraph 1 of this Article.

Article 7
Non-application of this Regulation [R 18; Gs 34, 123–129]

By regulation to specific provisions if parallel networks of similar technology transfer agreements cover more than half of a relevant market

1. Pursuant to Article 1a of Regulation No 19/65/EEC, the Commission may by regulation declare that, where parallel networks of similar technology transfer agreements cover more than 50% of a relevant market, this Regulation is not to apply to technology transfer agreements containing specific restraints relating to that market.
2. A regulation pursuant to paragraph 1 shall not become applicable earlier than six months following its adoption *[G 128]*.

Article 8
Application of the market-share thresholds

1. For the purposes of applying the market-share thresholds provided for in Article 3 the rules set out in this paragraph shall apply.

The market share shall be calculated on the basis of market sales value data. If market sales value data are not available, estimates based on other reliable market information, including market sales volumes, may be used to establish the market share of the undertaking concerned.

The market share shall be calculated on the basis of data relating to the preceding calendar year.

The market share held by the undertakings referred to in point (e) of the second subparagraph of Article 1(2) shall be apportioned equally to each undertaking having the rights or the powers listed in point (a) of the second subparagraph of Article 1(2).

2. If the market share referred to in Article 3(1) or (2) is initially not more than 20% respectively 30% but subsequently rises above those levels, the exemption provided for in Article 2 shall continue to apply for a period of two consecutive calendar years following the year in which the 20% threshold or 30% threshold was first exceeded.

Article 9
Repeal

Regulation (EC) No 240/96 is repealed.

References to the repealed Regulation shall be construed as references to this Regulation.

Article 10
Transitional period

The prohibition laid down in Article 81(1) of the Treaty shall not apply during the period from 1 May 2004 to 31 March 2006 in respect of agreements already in force on 30 April 2004 which do not satisfy the conditions for exemption provided for in this Regulation but which, on 30 April 2004, satisfied the conditions for exemption provided for in Regulation (EC) No 240/96.

Article 11
Period of validity

This Regulation shall enter into force on 1 May 2004.

It shall expire on 30 April 2014.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 7 April 2004 (as corrected in OJ 2004 L127).

For the Commission
Mario Monti
Member of the Commission

(1) OJ 36, 6.3.1965, p. 533/65. Regulation as last amended by Regulation (EC) No 1/2003 (OJ L 1, 4.1.2003, p. 1).
(2) OJ C 235, 1.10.2003, p. 10.
(3) OJ L 31, 9.2.1996, p. 2. Regulation as amended by the 2003 Act of Accession.
(4) COM(2001) 786 final.
(5) OJ L 1, 4.1.2003, p. 1. Regulation as amended by Regulation (EC) No 411/2004 (OJ L 68, 6.3.2004, p. 1).

Appendix 4

Guidelines on the Application of Article 81 of the EC Treaty to Technology Transfer Agreements (2004/C 101/02)

(Text with EEA relevance)

Headings (centred and in italics) to most of the individual guidelines have been added by Valentine Korah, and key words within the guidelines have been italicised to make it easier for the reader to navigate through the text.

I. INTRODUCTION

1. These guidelines set out the principles for the assessment of technology transfer agreements under Article 81 of the Treaty. Technology transfer agreements concern the licensing of technology where the licensor permits the licensee to exploit the licensed technology for the production of goods or services, as defined in Article 1(1)(b) of Commission Regulation (EC) No 773/2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements (the TTBER)[(1)].

Guidance on Article 81 only – not Article 82

2. The purpose of the guidelines is to provide guidance on the application of the TTBER as well as on the application of Article 81 to technology transfer agreements that fall outside the scope of the TTBER. The TTBER and the guidelines are without prejudice to the possible parallel application of Article 82 of the Treaty to licensing agreements[(2)].

Application not mechanical

3. The standards set forth in these guidelines must be applied in light of the *circumstances specific to each case*. This excludes a mechanical application. Each case must be assessed on its own facts and the guidelines must be applied reasonably and flexibly. Examples given serve as illustrations only and are not intended to be exhaustive. The Commission will keep under review the functioning of the TTBER

and the guidelines in the new enforcement system created by Regulation 1/2003[3] to consider whether changes need to be made.

Subject to construction by courts

4. The present guidelines are without prejudice to the interpretation of Article 81 and the TTBER that may be given by the Court of Justice and the Court of First Instance.

II. GENERAL PRINCIPLES

1. Article 81 and intellectual property rights

Consumer welfare

5. The aim of Article 81 as a whole is to protect competition on the market with a view to promoting *consumer welfare and an efficient allocation of resources*. Article 81(1) prohibits all agreements and concerted practices between undertakings and decisions by associations of undertakings[4] which may affect trade between Member States[5] and which have as their object or effect the prevention, restriction or distortion of competition[6]. As an exception to this rule Article 81(3) provides that the prohibition contained in Article 81(1) may be declared inapplicable in the case of agreements between undertakings which contribute to improving the production or distribution of products or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefits and which do not impose restrictions which are not indispensable to the attainment of these objectives and do not afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products concerned.

Exhaustion of iprs

6. Intellectual property laws confer exclusive rights on holders of patents, copyright, design rights, trademarks and other legally protected rights. The owner of intellectual property is entitled under intellectual property laws to prevent unauthorised use of his intellectual property and to exploit it, *inter alia*, by licensing it to third parties. Once a product incorporating an intellectual property right has been put on the market inside the EEA by the holder or with his consent, the intellectual property right is exhausted in the sense that the holder can no longer use it to control the sale of the product[7] (principle of Community exhaustion). The right holder has no right under intellectual property laws to prevent sales by licensees or buyers of such products incorporating the licensed technology[8]. The principle of Community exhaustion is in line with the essential function of intellectual property rights, which is to grant the holder the right to exclude others from exploiting his intellectual property without his consent.

No inherent conflict between iprs and competition

7. The fact that intellectual property laws grant exclusive rights of exploitation does not imply that intellectual property rights are immune from competition law

intervention. Articles 81 and 82 are in particular applicable to agreements whereby the holder licenses another undertaking to exploit his intellectual property rights[9]. Nor does it imply that there is an inherent conflict between intellectual property rights and the Community competition rules. Indeed, *both bodies of law share the same basic objective of promoting consumer welfare and an efficient allocation of resources. Innovation constitutes an essential and dynamic component of an open and competitive market economy*. Intellectual property rights promote dynamic competition by encouraging undertakings to invest in developing new or improved products and processes. So does competition by putting pressure on undertakings to innovate. Therefore, both intellectual property rights and competition are necessary to promote innovation and ensure a competitive exploitation thereof.

Sunk costs and risk

8. In the assessment of licence agreements under Article 81 it must be kept in mind that the creation of intellectual property rights *often entails substantial investment* and that it is often a risky endeavour. In order not to reduce dynamic competition and to maintain the incentive to innovate, the innovator must not be unduly restricted in the exploitation of intellectual property rights that turn out to be valuable. For these reasons the innovator should normally be *free to seek compensation for successful projects that is sufficient to maintain investment incentives, taking failed projects into account*. Technology licensing may also require the licensee to make significant sunk investments in the licensed technology and production assets necessary to exploit it. Article 81 cannot be applied without considering such *ex ante* investments made by the parties and the risks relating thereto. The *risk* facing the parties and the sunk investment that must be committed may thus lead to the agreement falling outside Article 81(1) or fulfilling the conditions of Article 81(3), as the case may be, for the period of time required to recoup the investment.

No presumption outside regulation

9. In assessing licensing agreements under Article 81, the existing analytical framework is sufficiently flexible to take due account of the dynamic aspects of technology licensing. There is no presumption that intellectual property rights and licence agreements as such give rise to competition concerns. Most licence agreements do not restrict competition and create pro-competitive efficiencies. Indeed, licensing as such is pro-competitive as it leads to dissemination of technology and promotes innovation. In addition, even licence agreements that do restrict competition may often give rise to pro-competitive efficiencies, which must be considered under Article 81(3) and balanced against the negative effects on competition[10]. The great majority of licence agreements are therefore compatible with Article 81.

2. The general framework for applying Article 81

Object or effect of restricting competition

10. Article 81(1) prohibits agreements which have as their object or effect the restriction of competition. Article 81(1) applies both to restrictions of competition

between the parties to an agreement and to restrictions of competition between any of the parties and third parties.

Inter and intra technology

11. The assessment of whether a licence agreement restricts competition must be made within the actual context in which competition would occur *in the absence of the agreement with its alleged restrictions*[11]. In making this assessment it is necessary to take account of the likely impact of the agreement on *inter-technology competition* (ie competition between undertakings using competing technologies) and on *intra-technology competition* (ie competition between undertakings using the same technology) [12]. Article 81(1) prohibits restrictions of both inter-technology competition and intra-technology competition. It is therefore necessary to assess to what extent the agreement affects or is likely to affect these two aspects of competition on the market.

Counter factual

12. The following two questions provide a useful framework for making this assessment. The *first question* relates to the impact of the agreement on *inter-technology competition* while the *second question* relates to the impact of the agreement on *intra-technology competition*. As restraints may be capable of affecting both inter-technology competition and intra-technology competition at the same time, it may be necessary to analyse a restraint in the light of both questions before it can be concluded whether or not competition within the meaning of Article 81(1) is restricted:

Without the agreement

(a) Does the licence agreement *restrict actual or potential competition that would have existed without the contemplated agreement*? If so, the agreement may be caught by Article 81(1). In making this assessment it is necessary to take into account competition between the parties and competition from third parties. For instance, where two undertakings established in different Member States cross licence competing technologies and undertake not to sell products in each other's home markets, (potential) competition that existed prior to the agreement is restricted. Similarly, where a licensor imposes obligations on his licensees not to use competing technologies *and these obligations foreclose* third party technologies, actual or potential competition that would have existed in the absence of the agreement is restricted.

Without the restriction

(b) Does the agreement restrict actual or potential competition that would have existed in the absence of the contractual restraint(s)? If so, the agreement may be caught by Article 81(1). For instance, where a licensor restricts its licensees from competing with each other, (potential) competition that could have existed between the licensees absent the restraints is restricted. Such restrictions include vertical price fixing and territorial or customer sales restrictions between licensees. However, certain restraints may in certain cases not be caught by Article 81(1) when the restraint is objectively necessary for the existence of an agreement of that type or that nature[13]. Such exclusion of the application of Article 81(1) can only be made on the basis of objective factors external to the parties themselves and not the subjective views and characteristics of the parties. The question is not whether the parties in their particular situation would not have accepted to conclude a less restrictive agreement, but whether, given the nature of the agreement and the characteristics of the market, a less restrictive agreement would not have been concluded by undertakings in a similar setting. For instance, territorial restraints in an agreement between non-competitors may fall outside Article 81(1) for a certain duration if the restraints are objectively necessary for a licensee to penetrate a new market. Similarly, a prohibition imposed on all licensees not to sell to certain categories of end users may not be restrictive of competition if such a restraint is objectively necessary for reasons of safety or health related to the dangerous nature of the product in question. Claims that in the absence of a restraint the supplier would have resorted to vertical integration are not sufficient. Decisions on whether or not to vertically integrate depend on a broad range of complex economic factors, a number of which are internal to the undertaking concerned.

Restriction of competition by object or effect

13. In the application of the analytical framework set out in the previous paragraph it must be taken into account that Article 81(1) distinguishes between those agreements that have a restriction of competition as their object and those agreements that have a restriction of competition as their effect. An agreement or contractual restraint is only prohibited by Article 81(1) if its object or effect is to restrict inter-technology competition and/or intra-technology competition.

Restriction of competition by object

14. Restrictions of competition by object are those that *by their very nature restrict competition*. These are restrictions which in light of the objectives pursued by the Community competition rules have such a high potential for negative effects on competition that it is not necessary for the purposes of applying Article 81(1) to demonstrate any actual effects on the market[14]. Moreover, the conditions of Article 81(3) are unlikely to be fulfilled in the case of restrictions by object. The assessment of whether or not an agreement has as its object a restriction of competition is based on a number of factors. These factors include, in particular, *the content of the agreement and the objective aims pursued by it*. It may also be necessary to consider the context in which it is (to be) applied or the actual conduct and behaviour of the parties on the market[15]. In other words, an examination of the facts underlying the agreement and the specific circumstances in which it operates may be required before it can be concluded whether a particular restriction constitutes a hardcore restriction of competition. *The way in which an agreement is actually implemented* may reveal a restriction by object even where the formal agreement does not contain an express provision to that effect. Evidence of *subjective intent* on the part of the parties to restrict competition is *a relevant factor but not a necessary condition*. For licence agreements, 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.

Restriction by effect

15. If an agreement is not restrictive of competition by object it is necessary to examine whether it has restrictive effects on competition. Account must be taken of both *actual and potential effects*(16). In other words the agreement must have *likely* anti-competitive effects. For licence agreements to be restrictive of competition by effect they must affect actual or potential competition to such an extent that on the relevant market *negative effects on prices, output, innovation or the variety or quality of goods and services* can be expected with a reasonable degree of *probability*. The likely negative effects on competition must be *appreciable*(17). Appreciable anti-competitive effects are likely to occur when at least one of the parties has or obtains some degree of *market power* and the agreement contributes to the creation, maintenance or strengthening of that market power or allows the parties to exploit such market power. *Market power is the ability to maintain prices above competitive levels or to maintain output in terms of product quantities, product quality and variety or innovation below competitive levels for a not insignificant period of time*. The degree of market power normally required for a finding of an infringement under Article 81(1) is less than the degree of market power required for a finding of dominance under Article 82.

Market definition

16. For the purposes of analysing restrictions of competition by effect it is normally necessary to define the relevant market and to examine and assess, *inter alia*, the nature of the products and technologies concerned, the market position of the parties, the market position of competitors, the market position of buyers, the existence of potential competitors and the level of entry barriers. In some cases, however, *it may be possible to show anti-competitive effects directly* by analysing the conduct of the parties to the agreement on the market. It may for example be possible to ascertain that an agreement has led to price increases.

Competitive benefits from licensing

17. Licence agreements, however, also have *substantial pro-competitive potential*. Indeed, the *vast majority of licence agreements are pro-competitive*. Licence agreements may promote innovation by allowing innovators to earn returns to cover at least part of their research and development costs. Licence agreements also lead to a dissemination of technologies, which may create value by reducing the production costs of the licensee or by enabling him to produce new or improved products. Efficiencies at the level of the licensee often stem from a combination of the licensor's technology with the assets and technologies of the licensee. Such integration of complementary assets and technologies may lead to a cost/output configuration that would not otherwise be possible. For instance, the combination of an improved technology of the licensor with more efficient production or distribution assets of the licensee may reduce production costs or lead to the production of a higher quality product. Licensing may also serve the pro-competitive purpose of removing

obstacles to the development and exploitation of the licensee's own technology. In particular in sectors where large numbers of patents are prevalent licensing often occurs in order to create design freedom by removing the risk of infringement claims by the licensor. When the licensor agrees not to invoke his intellectual property rights to prevent the sale of the licensee's products, the agreement removes an obstacle to the sale of the licensee's product and thus generally promotes competition.

Balance under A 81(3)

18. In cases where a licence agreement is caught by Article 81(1) the pro-competitive effects of the agreement must be balanced against its restrictive effects in the context of Article 81(3). When all four conditions of Article 81(3) are satisfied, the restrictive licence agreement in question is valid and enforceable, no prior decision to that effect being required[18]. Hardcore restrictions of competition only fulfil the conditions of Article 81(3) in exceptional circumstances. Such agreements generally fail (at least) one of the first two conditions of Article 81(3). They generally do not create objective economic benefits or benefits for consumers. Moreover, these types of agreements generally also fail the indispensability test under the third condition. For example, if the parties fix the price at which the products produced under the licence must be sold, this will generally lead to a lower output and a misallocation of resources and higher prices for consumers. The price restriction is also not indispensable to achieve the possible efficiencies resulting from the availability to both competitors of the two technologies.

3. Market definition

Notice on market definition

19. The Commission's approach to defining the relevant market is laid down in its market definition guidelines[19]. The present guidelines only address aspects of market definition that are of particular importance in the field of technology licensing.

Product and technology markets

20. Technology is an input, which is integrated either into a product or a production process. *Technology licensing can therefore affect competition both in input markets and in output markets*. For instance, an agreement between two parties which sell competing products and which cross license technologies relating to the production of these products may restrict competition on the product market concerned. It may also restrict competition on the market for technology and possibly also on other input markets. For the purposes of assessing the competitive effects of licence agreements it may therefore be necessary to define relevant goods and service markets (product markets) as well as technology markets[20]. The term 'product market' used in Article 3 of the TTBER refers to *relevant goods and service markets in both their geographic and product dimension*. As is clear from Article 1(1)(j) of the TTBER, the term is used merely to distinguish relevant goods and service markets from relevant technology markets.

Product market for final or intermediate products – concrete test

21. The TTBER and these guidelines are concerned with effects both on *product markets for final products and on product markets for intermediate product*s. The relevant product market includes products which are regarded by the buyers as *interchangeable* with or substitutable for the contract products incorporating the licensed technology, *by reason of the products' characteristics, their prices and their intended use*.

Technology market – SSNIP test

22. Technology markets consist of the *licensed technology and its substitutes*, ie other technologies which are regarded by the licensees as interchangeable with or substitutable for the licensed technology, by reason of the *technologies' characteristics, their royalties and their intended use*. The methodology for defining technology markets follows the same principles as the definition of product markets. Starting from the technology which is marketed by the licensor, one needs to identify those other technologies to which licensees could switch in response to a small but permanent increase in relative prices, ie the royalties. An alternative approach is to look at the market for products incorporating the licensed technology (cf paragraph below).

Market shares

23. Once relevant markets have been defined, market shares can be assigned to the various sources of competition in the market and used as an indication of the relative strength of market players. In the case of technology markets one way to proceed is to calculate market shares on the *basis of each technology's share of total licensing income from royalties*, representing a technology's share of the market where competing technologies are licensed. However, this may often be a mere theoretical and *not a practical way to proceed* because of lack of clear information on royalties etc. An *alternative approach*, which is the *one used in Article 3(3)* of the TTBER, is to calculate market shares on the technology market on the *basis of sales of products incorporating the licensed technology on downstream product markets* (see paragraph 70 below). Under this approach all sales on the relevant product market are taken into account, irrespective of whether the product incorporates a technology that is being licensed. In the case of technology markets the *approach of Article 3(3) to take into account technologies that are (only) being used in-house*, is justified. Indeed, this approach is in general a good indicator of the strength of the technology. First, it captures any potential competition from undertakings that are producing with their own technology and that are likely to start licensing in the event of a small but permanent increase in the price for licenses. Secondly, even where it is unlikely that other technology owners would start licensing, the licensor does not necessarily have market power on the technology market even if he has a high share of licensing income. If the downstream product market is competitive, competition at this level may effectively constrain the licensor. An increase in royalties upstream affects the costs of the licensee, making him less competitive, causing him to lose sales. A technology's market share on the product market also captures this element and is thus normally a good indicator of licensor market power. In individual cases outside the safe harbour of the TTBER it may be necessary, where practically possible,

to apply both of the described approaches in order to assess more accurately the market strength of the licensor.

Poles of research

24. Moreover, outside the safe harbour of the TTBER it must also be taken into account that *market share* may not always be a good indication of the relative strength of available technologies. The Commission will therefore, *inter alia*, also have regard to the number of *independently controlled technologies available* in addition to the technologies controlled by the parties to the agreement that may be substitutable for the licensed technology at a comparable cost to the user (see paragraph 131 below).

Innovation markets

25. Some licence agreements may affect innovation markets. In analysing such effects, however, the Commission will normally *confine itself to examining the impact of the agreement on competition within existing product and technology markets*[(21)]. Competition on such markets may be affected by agreements that delay the introduction of improved products or new products that over time will replace existing products. In such cases innovation is a source of potential competition which must be taken into account when assessing the impact of the agreement on product markets and technology markets. In a limited number of cases, however, it may be useful and necessary to also define innovation markets. This is particularly the case where the agreement affects *innovation aiming at creating new products* and where it is possible at an early stage to identify research and development poles[(22)]. In such cases it can be analysed whether after the agreement there will be a sufficient number of competing research and development poles left for effective competition in innovation to be maintained.

4. The distinction between competitors and non-competitors

26. In general, agreements between competitors pose a greater risk to competition than agreements between non-competitors. However, competition between undertakings that use the same technology (*intra-technology competition between licensees*) constitutes an *important complement to competition between undertakings that use competing technologies (inter-technology competition*). For instance, intra-technology competition may lead to lower prices for the products incorporating the technology in question, which may not only produce direct and immediate benefits for consumers of these products, but also spur further competition between undertakings that use competing technologies. In the context of licensing it must also be taken into account that licensees are selling their own product. They are not re-selling a product supplied by another undertaking. There may thus be greater scope for product differentiation and quality-based competition between licensees than in the case of vertical agreements for the resale of products.

Compare situation in the absence of the agreement

27. In order to determine the competitive relationship between the parties it is necessary to *examine whether the parties would have been actual or potential*

competitors in the absence of the agreement. If without the agreement the parties would not have been actual or potential competitors in any relevant market affected by the agreement they are deemed to be non-competitors.

Actual competitors on product or technology market

28. Where the licensor and the licensee are both active on the same product market or the same technology market *without one or both parties infringing the intellectual property rights of the other party*, they are *actual competitors* on the market concerned. The parties are deemed to be actual competitors on the technology market *if the licensee is already licensing out his technology* and the licensor enters the technology market by *granting a license for a competing technology to the licensee*.

Potential competitors on the product market

29. The parties are considered to be potential competitors on the product market *if in the absence of the agreement and without infringing the intellectual property rights of the other party it is likely that they would have undertaken the necessary additional investment to enter the relevant market in response to a small but permanent increase in product prices*. In order *to constitute a realistic competitive constraint* entry has to be likely to occur *within a short period. Normally a period of one to two years* is appropriate. However, in individual cases longer periods can be taken into account. The period of time needed for undertakings already on the market to adjust their capacities can be used as a yardstick to determine this period. For instance, the parties are likely to be considered potential competitors on the product market where the licensee produces on the basis of its own technology in one geographic market and *starts producing in another geographic market* on the basis of a licensed competing technology. In such circumstances, it is likely that the licensee would have been able to enter the second geographic market on the basis of its own technology, unless such entry is precluded by objective factors, including the existence of blocking patents (see paragraph 32 below).

Potential competitors on technology market

30. The parties are considered to be potential competitors on the technology market where they own substitutable technologies if in the specific case the licensee is not licensing his own technology, provided that he would be likely to do so in the event of a small but permanent increase in technology prices. However, for the application of the TTBER potential competition on the technology market is not taken into account (see paragraph 66 below).

Appraise at date of agreement

31. In some cases the parties may become competitors subsequent to the conclusion of the agreement *because the licensee develops and starts exploiting a competing technology*. In such cases it must be taken into account that the parties were non-competitors at the time of conclusion of the agreement and that the agreement was concluded in that context. The Commission will therefore mainly focus on the impact of the agreement on the licensee's ability to exploit his own (competing) technology. In

particular, the *list of hardcore restrictions applying to agreements between competitors will not be applied to such agreements unless the agreement is subsequently amended in any material respect after the parties have become competitors* (cf Article 4(3) of the TTBER). The undertakings party to an agreement may also become competitors subsequent to the conclusion of the agreement where the licensee was already active on the product market prior to the licence and *where the licensor subsequently enters the product market* either on the basis of the licensed technology or a new technology. Also in this case the hardcore list relevant for agreements between non-competitors will continue to apply to the agreement unless the agreement is subsequently amended in any material respect (cf article 4(3) of the TTBER.

Blocking technologies

32. *If the parties own technologies that are in a one-way or two-way blocking position*, the parties are considered to be non-competitors on the technology market. A one-way blocking position exists when a technology cannot be exploited without infringing upon another technology. This is for instance the case where one patent covers an improvement of a technology covered by another patent. In that case the exploitation of the improvement patent pre-supposes that the holder obtains a licence to the basic patent. A two-way blocking position exists where neither technology can be exploited without infringing upon the other technology and where the holders thus need to obtain a licence or a waiver from each other. In assessing whether a blocking position exists the Commission will *rely on objective factors* as opposed to the subjective views of the parties. Particularly convincing evidence of the existence of a blocking position is required where the parties may have a common interest in claiming the existence of a blocking position in order to be qualified as non-competitors, for instance where the claimed two-way blocking position concerns technologies that are technological substitutes. *Relevant evidence* includes court decisions including injunctions and opinions of independent experts. In the latter case the Commission will, in particular, closely examine how the expert has been selected. However, also *other convincing evidence*, including expert evidence from the parties that they have or had good and valid reasons to believe that a blocking position exists or existed, can be relevant to substantiate the existence of a blocking position.

Drastic improvement

33. In some cases it may also be possible to conclude that while the licensor and the licensee *produce competing products*, they are *non-competitors on the relevant product market and the relevant technology market* because the licensed technology represents such a *drastic innovation* that the technology of the licensee has become obsolete or uncompetitive. In such cases the licensor's technology either creates a new market or excludes the licensee's technology from the market. Often, however, it is not possible to come to this conclusion at the time the agreement is concluded. It is usually only when the technology or the products incorporating it have been available to consumers for some time that it becomes apparent that the older technology has become obsolete or uncompetitive. For instance, when CD technology was developed and players and discs were put on the market, it was not obvious that this new technology would replace LP technology. This only became apparent some years later. The parties will therefore be considered to *be competitors*

if at the time of the conclusion of the agreement it is not obvious that the licensee's technology is obsolete or uncompetitive. However, given that both Articles 81(1) and Article 81(3) must be applied in light of the actual context in which the agreement occurs, the *assessment is sensitive to material changes in the facts*. The classification of the relationship between the parties will therefore *change into a relationship of non-competitors*, if at a later point in time the licensee's technology becomes obsolete or uncompetitive on the market.

III. APPLICATION OF THE BLOCK EXEMPTION REGULATION

1. The effects of the Block Exemption Regulation

Direct effects of block exemption

34. Technology transfer agreements that fulfil the conditions set out in the TTBER are block exempted from the prohibition rule contained in Article 81(1). Block exempted agreements are *legally valid and enforceable*. Such agreements can *only be prohibited for the future and only upon withdrawal* of the block exemption by the Commission or a Member State competition authority. Block exempted agreements cannot be prohibited under Article 81 by national courts in the context of private litigation.

A 81(3) – articles 3–5

35. Block exemption of categories of technology transfer agreements is based on the *presumption* that such agreements – to the extent that they are caught by Article 81(1) – *fulfil the four conditions laid down in Article 81(3)*. It is thus *presumed* that the agreements give rise to *economic efficiencies*, that the restrictions contained in the agreements are *indispensable* to the attainment of these efficiencies, that *consumers* within the affected markets *receive a fair share of the efficiency gains* and that the agreements do not afford the undertakings concerned the *possibility of eliminating competition* in respect of a substantial part of the products in question. The market share thresholds (Article 3), the hardcore list (Article 4) and the excluded restrictions (Article 5) set out in the TTBER aim at ensuring that only restrictive agreements that can reasonably be presumed to fulfil the four conditions of Article 81(3) are block exempted.

No need to come within regulation if competition not appreciably restricted

36. As set out in section IV below, many licence agreements fall outside Article 81(1), either because they do not restrict competition at all or because the restriction of competition is not appreciable[(23)]. To the extent that such agreements would anyhow fall within the scope of the TTBER, there is no need to determine whether they are caught by Article 81(1) [(24)].

No presumption that A 81(1) infringed if outside regulation

37. Outside the scope of the block exemption it is relevant to examine whether in the individual case the agreement is caught by Article 81(1) and if so whether the

conditions of Article 81(3) are satisfied. There is no presumption that technology transfer agreements falling outside the block exemption are caught by Article 81(1) or fail to satisfy the conditions of Article 81(3). In particular, the mere fact that the market shares of the parties exceed the market share thresholds set out in Article 3 of the TTBER is not a sufficient basis for finding that the agreement is caught by Article 81(1). Individual assessment of the likely effects of the agreement is required. It is only when agreements contain hardcore restrictions of competition that it can normally be presumed that they are prohibited by Article 81.

2. Scope and duration of the Block Exemption Regulation [A 2]

2.1. Agreements between two parties [A 2]

Technology transfer between two undertakings

38. According to Article 2(1) of the TTBER, the Regulation covers technology transfer agreements 'between two undertakings'. Technology transfer agreements between more than two undertakings are not covered by the TTBER[25]. The decisive factor in terms of distinguishing between agreements between two undertakings and multiparty agreements is whether the agreement in question is concluded between more than two undertakings.

Agreements stipulating conditions for more than one level of trade

39. Agreements concluded by two undertakings fall within the scope of the TTBER even if the agreement stipulates conditions for more than one level of trade. For instance, the TTBER applies to a licence agreement concerning not only the production stage but also the distribution stage, stipulating the obligations that the licensee must or may impose on resellers of the products produced under the licence[26].

Agreements between more than two undertakings

40. Licence agreements concluded *between more than two undertakings* often give rise to the *same issues as licence agreements of the same nature concluded between two undertakings*. In its individual assessment of licence agreements which are of the same nature as those covered by the block exemption but which are concluded between more than two undertakings, the Commission will *apply by analogy* the principles set out in the TTBER.

2.2. Agreements for the production of contract products

Excludes technology pools – section IV.4 below

41. It follows from Article 2 that for licence agreements to be covered by the TTBER they *must concern* '*the production of contract products*', ie products incorporating or produced with the licensed technology. In other words, to be covered by the TTBER the licence must permit the licensee to exploit the licensed technology for

production of goods or services (see recital 7 of the TTBER). The TTBER does *not cover technology pools*. The notion of technology pools covers agreements whereby two or more parties agree to pool their respective technologies and license them as a package. The notion of technology pools also covers arrangements whereby two or more undertakings agree to license a third party and authorise him to license on the package of technologies. Technology pools are dealt with in section IV.4 below.

Licence to sub-license if ancillary

42. The *TTBER applies* to licence agreements for the production of contract products whereby the licensee is also permitted to sublicense the licensed technology to third parties *provided, however, that the production of contract products constitutes the primary object of the agreement*. Conversely, the TTBER does *not apply to agreements that have sublicensing as their primary object*. However, the Commission will apply by analogy the principles set out in the TTBER and these guidelines to such 'master licensing' agreements between licensor and licensee. Agreements between the licensee and sub-licensees are covered by the TTBER.

'Contract products' – non-assertion agreements

43. The term '*contract products*' encompasses goods and services produced with the licensed technology. This is the case both where the licensed technology is used in the production process and where it is incorporated into the product itself. In these guidelines the term '*products incorporating the licensed technology*' covers both situations. The TTBER applies in all cases where technology is licensed for the purposes of producing goods and services. It is sufficient in this respect that the licensor undertakes not to exercise his intellectual property rights against the licensee. Indeed, the essence of a pure patent licence is the right to operate inside the scope of the exclusive right of the patent. It follows that the TTBER also covers so-called non-assertion agreements and settlement agreements whereby the licensor permits the licensee to produce within the scope of the patent.

Subcontracting

44. The TTBER covers 'subcontracting' whereby the licensor licenses technology to the licensee who undertakes to produce certain products on the basis thereof exclusively for the licensor. Subcontracting may also involve the supply of equipment by the licensor to be used in the production of the goods and services covered by the agreement. For the latter type of subcontracting *to be covered by the TTBER, the licensed technology and not the supplied equipment must constitute the primary object of the agreement*. Subcontracting is also covered by the Commission's Notice concerning the assessment of certain subcontracting agreements in relation to Article 81(1) of the Treaty[(27)]. According to this notice, which remains applicable, subcontracting agreements whereby the subcontractor undertakes to produce certain products exclusively for the contractor generally fall outside Article 81(1). However, other restrictions imposed on the subcontractor such as the obligation not to conduct or exploit his own research and development may be caught by Article 81[(28)].

Licensee may be required to develop technology if contract product has been identified

45. The TTBER also applies to agreements whereby the licensee must carry out development work before obtaining a product or a process that is ready for commercial exploitation, *provided that a contract product has been identified*. Even if such further work and investment is required, the object of the agreement is the production of an identified contract product. On the other hand, the TTBER and the guidelines do not cover agreements whereby a technology is licensed for the purpose of enabling the licensee to carry out further research and development in various fields. For instance, the TTBER and the guidelines do not cover the licensing of a technological research tool used in the process of further research activity. The framework of the TTBER and the guidelines is based on the premise that there is a direct link between the licensed technology and an identified contract product. In cases where no such link exists the main object of the agreement is research and development as opposed to bringing a particular product to the market; in that case the analytical framework of the TTBER and the guidelines may not be appropriate. For the same reasons the TTBER and the guidelines do not cover research and development sub-contracting whereby the licensee undertakes to carry out research and development in the field of the licensed technology and to hand back the improved technology package to the licensor. The main object of such agreements is the provision of research and development services aimed at improving the technology as opposed to the production of goods and services on the basis of the licensed technology.

2.3. The concept of technology transfer agreements

'Agreements for the transfer of technology' defined [A 1(1)(a) and (b)]

46. The TTBER and these guidelines cover agreements for the transfer of technology. According to Article 1(1)(b) and (h) of the TTBER the concept of '*technology*' covers patents and patent applications, utility models and applications for utility models, *design rights*, plant breeders rights, topographies of semiconductor products, supplementary protection certificates for medicinal products or other products for which such supplementary protection certificates may be obtained, *software copyright*, and know-how. The licensed technology should allow the licensee with or without other inputs to produce the contract products.

'Know-how' defined

47. Know-how is defined in Article 1(1)(i) as a package of non-patented practical information, resulting from experience and testing, which is secret, substantial and identified. 'Secret' means that the know-how is not generally known or easily accessible. 'Substantial' means that the know-how includes information which is significant and useful for the production of the products covered by the licence agreement or the application of the process covered by the licence agreement. In other words, the information must significantly contribute to or facilitate the production of the contract products. In cases where the licensed know-how relates to a product as opposed to a process, this condition implies that the know-how is

useful for the production the contract product. This condition is not satisfied where the contract product can be produced on the basis of freely available technology. However, the condition does not require that the contract product is of higher value than products produced with freely available technology. In the case of process technologies, this condition implies that the know-how is useful in the sense that it can reasonably be expected at the date of conclusion of the agreement to be capable of significantly improving the competitive position of the licensee, for instance by reducing his production costs. 'Identified' means that it is possible to verify that the licensed know-how fulfils the criteria of secrecy and substantiality. This condition is satisfied where the licensed know-how is described in manuals or other written form. However, in some cases this may not be reasonably possible. The licensed know-how may consist of practical knowledge possessed by the licensor's employees. For instance, the licensor's employees may possess secret and substantial knowledge about a certain production process which is passed on to the licensee in the form of training of the licensee's employees. In such cases it is sufficient to describe in the agreement the general nature of the know-how and to list the employees that will be or have been involved in passing it on to the licensee.

'Transfer' defined

48. The concept of '*transfer*' implies that technology must flow from one undertaking to another. Such transfers *normally take the form of licensing* whereby the licensor grants the licensee the right to use his technology against payment of royalties. It can also take the form of sub-licensing, whereby a licensee, having been authorised to do so by the licensor, grants licenses to third parties (sub-licensees) for the exploitation of the technology.

Ancillary restraints – not the primary object and directly related

49. The TTBER only applies to agreements that have as *their primary object the transfer of technology* as defined in that Regulation as opposed to the purchase of goods and services or the licensing of other types of intellectual property. Agreements containing provisions relating to the purchase and sale of products are only covered by the TTBER to the extent that those provisions do *not constitute the primary object* of the agreement and are *directly related* to the application of the licensed technology. This is likely to be the case where the tied products take the form of equipment or process input which is specifically tailored to efficiently exploit the licensed technology. If, on the other hand, the product is simply another input into the final product, it must be carefully examined whether the licensed technology constitutes the primary object of the agreement. For instance, in cases where the licensee is already manufacturing a final product on the basis of another technology, the licence must lead to *a significant improvement of the licensee's production process*, exceeding the value of the product purchased from the licensor. The requirement that the tied products must be related to the licensing of technology implies that the TTBER does not cover the purchase of products that have no relation with the products incorporating the licensed technology. This is for example the case where the tied product is not intended to be used with the licensed product, but relates to an activity on a separate product market.

Other iprs covered only if ancillary

50. The TTBER only covers the *licensing of other types of intellectual property* such as *trademarks and copyright, other than software copyright*, to the extent that they are *directly related* to the exploitation of the licensed technology and *do not constitute the primary object of the agreement*. This condition ensures that agreements covering other types of intellectual property rights are only block exempted to the extent that these other intellectual property rights *serve to enable the licensee to better exploit the licensed technology*. The licensor may for instance authorise the licensee to *use his trademark* on the products incorporating the licensed technology. The trademark licence may allow the licensee to better exploit the licensed technology by allowing consumers *to make an immediate link between the product and the characteristics imputed to it by the licensed technology*. An obligation on the licensee to use the licensor's trademark may also promote the dissemination of technology by allowing the licensor to identify himself as the source of the underlying technology. However, where the value of the licensed technology to the licensee is limited because he already employs an identical or very similar technology and the main object of the agreement is the trademark, the TTBER does not apply(29).

Traditional copyright

51. The licensing of copyright for the purpose of reproduction and distribution of the protected work, ie the production of copies for resale, is considered to be similar to technology licensing. Since such licence agreements relate to the production and sale of products on the basis of an intellectual property right, they are considered to be of a similar nature as technology transfer agreements and normally raise comparable issues. Although the TTBER does not cover copyright other than software copyright, the Commission will *as a general rule apply the principles set out in the TTBER and these guidelines when assessing such licensing of copyright under Article 81*.

Performing rights

52. On the other hand, the licensing of *rights in performances and other rights related to copyright* is considered to raise particular issues and it may not be warranted to assess such licensing on the basis of the principles developed in these guidelines. In the case of the various rights related to performances value is created not by the reproduction and sale of copies of a product but by each individual performance of the protected work. Such exploitation can take various forms including the performance, showing or the renting of protected material such as films, music or sporting events. In the application of Article 81 the specificities of the work and the way in which it is exploited must be taken into account(30). For instance, resale restrictions may give rise to less competition concerns whereas particular concerns may arise where licensors impose on their licensees to extend to each of the licensors more favourable conditions obtained by one of them. The Commission will therefore *not apply the TTBER and the present guidelines by way of analogy to the licensing of these other rights*.

Ancillary trademarks

53. The Commission will also not extend the principles developed in the TTBER and these guidelines to trademark licensing. Trademark licensing often occurs in the

context of distribution and resale of goods and services and is generally more akin to distribution agreements than technology licensing. Where a trademark licence is directly related to the use, sale or resale of goods and services and does not constitute the primary object of the agreement, the licence agreement is covered by Commission Regulation (EC) No 2790/1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices[(31)].

2.4. Duration

54. Subject to the duration of the TTBER, the block *exemption applies for as long as the licensed property right has not lapsed, expired or been declared invalid*. In the case of *know-how the block exemption applies as long as the licensed know-how remains secret*, except where the know-how *becomes publicly known as a result of action by the licensee*, in which case the exemption shall apply for the duration of the agreement (cf Article 2 of the TTBER).

55. The block exemption applies to each licensed property right covered by the agreement and *ceases to apply on the date of expiry, invalidity or the coming into the public domain of the last intellectual property right which constitutes 'technology'* within the meaning of the TTBER (cf paragraph above).

2.5. Relationship with other block exemption regulations

Technology is element of other types of agreement

56. The TTBER covers agreements *between two undertakings* concerning the *licensing of technology for the purpose of the production of contract products*. However, *technology can also be an element of other types of agreements*. In addition, the products incorporating the licensed technology are subsequently sold on the market. It is therefore necessary to address the interface between the TTBER and Commission Regulation (EC) No 2658/2000 on the application of Article 81(3) of the Treaty to categories of *specialisation agreements*[(32)], Commission Regulation 2659/2000 on the application of Article 81(3) to categories of *research and development agreements*[(33)] and Commission Regulation (EC) No 2790/1999 on the application of Article 81(3) of the Treaty to categories of *vertical agreements* and concerted practices[(34)].

2.5.1. The Block Exemption Regulations on specialisation and R&D agreements

Relationship with specialisation agreements

57. According to Article 1(1)(c) of *Regulation 2658/2000 on specialisation agreements,* that Regulation covers, *inter alia, joint production agreements by virtue of which two or more undertakings agree to produce certain products jointly*. The Regulation extends to provisions concerning the assignment or use of *intellectual property rights, provided that they do not constitute the primary object of the agreement*, but are directly related to and necessary for its implementation.

58. Where undertakings establish a production joint venture and license the joint venture to exploit technology, which is used in the production of the products

produced by the joint venture, *such licensing is subject to Regulation 2658/2000 and not the TTBER*. Accordingly, licensing in the context of a production joint venture normally falls to be considered under Regulation 2658/2000. However, *where the joint venture engages in licensing of the technology to third parties*, the activity is not linked to production by the joint venture and therefore not covered by that Regulation. Such licensing arrangements, which bring together the technologies of the parties, constitute technology pools, which are dealt with in *section IV.4 below*.

Relationship with R & D agreements

59. *Regulation 2659/2000 on research and development agreements* covers agreements whereby two or more undertakings agree to jointly carry out research and development and to jointly exploit the results thereof. According to Article 2(11), research and development and the exploitation of the results are carried out jointly where the work involved is carried out by a joint team, organisation or undertakings, jointly entrusted to a third party or allocated between the parties by way of specialisation in research, development, production and distribution, including licensing.

60. It follows that *Regulation 2659/2000 covers licensing between the parties and by the parties to a joint entity in the context of a research and development agreement*. In the context of such agreements the parties can also determine the conditions for licensing the fruits of the research and development agreement to third parties. However, since third party licensees are not party to the research and development agreement, *the individual licence agreement concluded with third parties is not covered by Regulation 2659/2000*. Such licence agreements are block exempted by the TTBER where they fulfil the conditions of that Regulation.

2.5.2. The Block Exemption Regulation on vertical agreements

Relationship with vertical distribution agreements

61. *Commission Regulation (EC) No 2790/1999 on vertical agreements* covers agreements entered into between two or more undertakings each operating, for the purposes of the agreement, at different levels of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services. It thus covers supply and distribution agreements[35].

Which transaction governed by which regulation?

62. Given that the TTBER only covers agreements between two parties and that a licensee, selling products incorporating the licensed technology, is a supplier for the purposes of Regulation 2790/1999, *these two block exemption regulations are closely related*. The *agreement between licensor and licensee is subject to the TTBER* whereas *agreements concluded between a licensee and buyers are subject to Regulation 2790/1999 and the Guidelines on Vertical Restraints*[36].

TTBER A 4(2)

63. The *TTBER also block exempts agreements between the licensor and the licensee where the agreement imposes obligations on the licensee as to the way in which*

he must sell the products incorporating the licensed technology. In particular, the licensee can be obliged to establish a certain type of distribution system such as exclusive distribution or selective distribution. However, the distribution agreements concluded for the purposes of implementing such obligations must, in order to be block exempted, comply with Regulation 2790/1999. For instance, the licensor can oblige the licensee to establish a system based on exclusive distribution in accordance with specified rules. However, it follows from Article 4(b) of Regulation 2790/1999 that *distributors must be free to make passive sales into the territories of other exclusive distributors*.

No territorial protection of distributors from each other – unless licensor's common brand

64. Furthermore, distributors must in principle be free to sell both actively and passively into territories covered by the distribution systems of other licensees producing their own products on the basis of the licensed technology. This is because for the purposes of Regulation 2790/1999 each licensee is a separate supplier. However, the reasons underlying the block exemption contained in that Regulation may also apply where the products incorporating the licensed technology are sold by the licensees under a common brand belonging to the licensor. When the products incorporating the licensed technology are *sold under a common brand* identity there may be the same efficiency reasons for applying the same types of restraints between licensees' distribution systems as within a single vertical distribution system. In such cases the Commission would be unlikely to challenge restraints where *by analogy* the requirements of Regulation 2790/1999 are fulfilled. For a common brand identity to exist the products must be sold and marketed under a common brand, which is predominant in terms of conveying quality and other relevant information to the consumer. It does not suffice that in addition to the licensees' brands the product carries the licensor's brand, which identifies him as the source of the licensed technology.

3. The safe harbour established by the Block Exemption Regulation

No presumption over the thresholds of market share

65. According to Article 3 of the TTBER the block exemption of restrictive agreements is subject to market share thresholds, confining the scope of the block exemption to agreements that although they may be restrictive of competition can generally be presumed to fulfil the conditions of Article 81(3). Outside the safe harbour created by the market share thresholds individual assessment is required. The fact that *market shares exceed the thresholds does not give rise to any presumption either that the agreement is caught by Article 81(1) or that the agreement does not fulfil the conditions of Article 81(3). In the absence of hardcore restrictions, market analysis is required*.

Competitors on the relevant technology market

66. The market share threshold to be applied for the purpose of the safe harbour of the TTBER depends on whether the agreement is concluded between competitors or

non-competitors. For the purposes of the TTBER undertakings are competitors on the relevant technology market *when they license competing technologies. Potential competition on the technology market is not taken into account for the application of the market share threshold or the hardcore list.* Outside the safe harbour of the TTBER potential competition on the technology market is taken into account but does not lead to the application of the hardcore list relating to agreements between competitors (see also paragraph 31 above).

Actual or potential competitors on the relevant product and geographic market

67. Undertakings are competitors on the relevant product market where both undertakings are active on the same product and geographic market(s) on which the products incorporating the licensed technology are sold (*actual competitors*). They are also considered competitors where they would be likely, on realistic grounds, to undertake the necessary additional investments or other necessary switching costs to enter the relevant product and geographic market(s) within a reasonably short period of time[37] in response to a small and permanent increase in relative prices (*potential competitors*).

May become competitors

68. It follows from paragraphs 66 and 67 that two undertakings are not competitors for the purposes of the TTBER where the licensor is neither an actual nor a potential supplier of products on the relevant market and the licensee, already present on the product market, is not licensing out a competing technology even if he owns a competing technology and produces on the basis of that technology. However, *the parties become competitors* if at a later point in time the licensee starts licensing out his technology or the licensor becomes an actual or potential supplier of products on the relevant market. In that case the *hardcore list relevant for agreements between non-competitors will continue to apply* to the agreement *unless* the agreement is *subsequently amended in any material respect*, see Article 4(3) of the TTBER and paragraph 31 above.

Ceilings of market share – A 3; R 10–12

69. In the case of agreements between competitors the market share threshold is 20% and in the case of agreements between non-competitors it is 30% (cf Article 3(1) and (2) of the TTBER). *Where the undertakings party to the licensing agreement are not competitors* the agreement is covered if the *market share of neither party exceeds 30% on the affected relevant technology and product markets*. Where the undertakings party to the licensing agreement are *competitors the agreement is covered if the combined market shares of the parties do not exceed 20% on the relevant technology and product markets*. The market share thresholds apply both to technology markets and markets for products incorporating the licensed technology. If the applicable market share threshold is exceeded on an affected relevant market, the block exemption does not apply to the agreement for that relevant market. For instance, if the licence agreement concerns two separate product markets or two separate geographic markets, the block *exemption may apply to one of the markets and not to the other.*

Technology markets

70. In the case of technology markets, it follows from Article 3(3) of the TTBER that the licensor's market share is to be calculated on the basis of the sales of the licensor and all his licensees of products incorporating the licensed technology and this for each relevant market separately[(38)]. Where the parties are competitors on the technology market, sales of products incorporating the licensee's own technology must be combined with the sales of the products incorporating the licensed technology. In the case of *new technologies* that have not yet generated any sales, *a zero market share* is assigned. When sales commence the technology will start accumulating market share.

Product markets

71. In the case of product markets, the *licensee's market share* is to be calculated on the basis of the licensee's sales of products incorporating the licensor's technology and competing products, ie the total sales of the licensee on the product market in question. Where the licensor is also a supplier of products on the relevant market, *the licensor's sales on the product market* in question must also be taken into account. In the calculation of market shares for product markets, however, sales made by other licensees are not taken into account when calculating the licensee's and/or licensor's market share.

Market shares

72. Market shares should be calculated on the basis of *sales value data* where such data are available. Such data normally provide a more accurate indication of the strength of a technology than volume data. However, where value based data are not available, estimates based on other reliable market information may be used, including market sales volume data.

Examples

73. The principles set out above can be illustrated by the following examples:

Licensing between non-competitors

Example 1

Company A is specialised in developing bio-technological products and techniques and has developed a new product Xeran. It is not active as a producer of Xeran, for which it has neither the production nor the distribution facilities. Company B is one of the producers of competing products, produced with freely available non-proprietary technologies. In year 1, B was selling EUR 25 million worth of products produced with the freely available technologies. In year 2, A gives a licence to B to produce Xeran. In that year B sells EUR 15 million produced with the help of the freely available technologies and EUR 15 million of Xeran. In year 3 and the following years B produces and sells only Xeran worth EUR 40 million annually. In addition in year 2, A is also licensing to C. C was not active on that product market before. C produces and sells only Xeran, EUR 10 million in year 2 and EUR 15 million in year 3 and thereafter. It is established that the total market of Xeran and its substitutes where B and C are active is worth EUR 200 million in each year.

In year 2, the year the licence agreement is concluded, A's market share on the technology market is 0% as its market share has to be calculated on the basis of the total sales of Xeran in the preceding year. In year 3 A's market share on the technology market is 12,5%, reflecting the value of Xeran produced by B and C in the preceding year 2. In year 4 and thereafter A's market share on the technology market is 27.5%, reflecting the value of Xeran produced by B and C in the preceding year.

In year 2 B's market share on the product market is 12.5%, reflecting B's EUR 25 million sales in year 1. In year 3 B's market share is 15% because its sales have increased to EUR 30 million in year 2. In year 4 and thereafter B's market share is 20% as its sales are EUR 40 million annually. C's market share on the product market is 0% in year 1 and 2.5% in year 3 and 7.5% thereafter.

As the licence agreements are between non-competitors and the individual market shares of A, B and C are below 30% each year, the agreements fall within the safe harbour of the TTBER.

Example 2

The situation is the same as in example 1, however now B and C are operating in different geographic markets. It is established that the total market of Xeran and its substitutes is worth EUR 100 million annually in each geographic market.

In this case, A's market share on the technology market has to be calculated for each of the two geographic markets. In the market where B is active A's market share depends on the sale of Xeran by B. As in this example the total market is assumed to be EUR 100 million, ie half the size of the market in example 1, the market share of A is 0% in year 2, 15% in year 3 and 40% thereafter. B's market share is 25% in year 2, 30% in year 3 and 40% thereafter. In year 2 and 3 both A's and B's market share does not exceed the 30% threshold. The threshold is however exceeded from year 4 and this means that, in line with Article 8(2) of the TTBER, after year 6 the licence agreement between A and B can no longer benefit from the safe harbour but has to be assessed on an individual basis.

In the market where C is active A's market share depends on the sale of Xeran by C. A's market share on the technology market, based on C's sales in the previous year, is therefore 0% in year 2, 10% in year 3 and 15% thereafter. The market share of C on the product market is the same: 0% in year 2, 10% in year 3 and 15% thereafter. The licence agreement between A and C therefore falls within the safe harbour for the whole period.

Licensing between competitors

Example 3

Companies A and B are active on the same relevant product and geographic market for a certain chemical product. They also each own a patent on different technologies used to produce this product. In year 1 A and B sign a cross licence agreement licensing each other to use their respective technologies. In year 1 A and B produce only with their own technology and A sells EUR 15 million of the product and B sells EUR 20 million of the product. From year 2 they both use their own and the other's technology. From that year onward A sells EUR 10 million of the product produced with its own technology and EUR 10 million of the product produced with B's technology. B sells from year 2 EUR 15 million of the product produced with its own technology and EUR 10 million of the product produced with A's technology. It is established that the total market of the product and its substitutes is worth EUR 100 million in each year.

To assess the licence agreement under the TTBER, the market shares of A and B have to be calculated both on the technology market and the product market. The market share of A on the technology market depends on the amount of the product sold in the preceding year that was produced, by both A and B, with A's technology. In year 2 the market share of A on the technology market is therefore 15%, reflecting its own production and sales of EUR 15 million in year 1. From year 3 A's market share on the technology market is 20%, reflecting the EUR 20 million sale of the product produced with A's technology and produced and sold by A and B (EUR 10 million each). Similarly, in year 2 B's market share on the technology market is 20% and thereafter 25%.

The market shares of A and B on the product market depend on their respective sales of the product in the previous year, irrespective of the technology used. The market share of A on the product market is 15% in year 2 and 20% thereafter. The market share of B on the product market is 20% in year 2 and 25% thereafter.

As the agreement is between competitors, their combined market share, both on the technology and on the product market, has to be below the 20% market share threshold in order to benefit from the safe harbour. It is clear that this is not the case here. The combined market share on the technology market and on the product market is 35% in year 2 and 45% thereafter. This agreement between competitors will therefore have to be assessed on an individual basis.

4. Hardcore restrictions of competition under the Block Exemption Regulation

4.1. General principles

Hardcore restrictions of competition

74. Article 4 of the TTBER contains a *list of hardcore restrictions of competition*. The classification of a restraint as a hardcore restriction of competition is based on the nature of the restriction and experience showing that such restrictions are *almost always anti-competitive*. In line with the case law of the Community Courts[(39)] such a restriction may result from the clear objective of the agreement or from the circumstances of the individual case (cf paragraph 14 above).

Prevent application of regulation even to other provisions

75. When a technology transfer agreement contains a hardcore restriction of competition, it follows from Article 4(1) and 4(2) of the TTBER that the agreement as a whole falls outside the scope of the block exemption. For the purposes of the TTBER *hardcore restrictions cannot be severed* from the rest of the agreement. Moreover, the Commission considers that in the context of individual assessment hardcore restrictions of competition will *only in exceptional circumstances fulfil the four conditions of Article 81(3)* (cf paragraph 18 above).

Distinguish licences between competitors and between non-competitors

76. Article 4 of the TTBER distinguishes between agreements between competitors and agreements between non-competitors.

4.2. Agreements between competitors

A 4(1)

77. Article 4(1) lists the hardcore restrictions for licensing between competitors. According to Article 4(1), the TTBER does not cover agreements which, *directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object*:

Price fixing

(a) The restriction of a party's *ability to determine its prices* when selling products to third parties;

Output limitations

(b) The *limitation of output*, except limitations on the output of contract products imposed on the licensee in a *non-reciprocal agreement or imposed on only one of the licensees in a reciprocal agreement*;

Market allocation

(c) The *allocation of markets or customers except*

Field of use or product restriction on licensee

(i) the obligation on the licensee(s) to produce with the licensed technology only within *one or more technical fields of use or one or more product markets*;

Similar restriction on either party if licence not reciprocal

(ii) the obligation on the licensor and/or the licensee, in a *non-reciprocal agreement*, not to produce with the licensed technology within one or more technical fields of use or *one or more product markets or one or more exclusive territories reserved for the other party*;

Sole licence

(iii) the obligation on the licensor *not to license the technology to another licensee in a particular territory*;

No poaching by either party on other's exclusive territory or customer grouping non-reciprocal licence

(iv) the restriction, in a *non-reciprocal agreement, of active and/or passive sales by the licensee and/or the licensor into the exclusive territory or to the exclusive customer group reserved for the other party*;

Active sales ban to protect licensor or another licensee in non-reciprocal licence

(v) the restriction, in a *non-reciprocal* agreement, of *active sales by the licensee into the exclusive territory or to the exclusive customer group* *allocated by the licensor to another licensee provided that the latter was not a competing undertaking of the licensor at the time of the conclusion of its own licence*;

Captive use restriction

(vi) the *obligation on the licensee to produce the contract products only for its own use* provided that the licensee is not restricted in selling the contract products actively and passively as *spare parts* for its own products;

Second source

(vii) the obligation on the licensee in a *non-reciprocal* agreement to *produce* the contract products only for a particular customer, where the licence was granted in order *to create an alternative source* of supply for that customer;

Restriction on licensee using or developing own technology

(d) The restriction of the *licensee's ability to exploit its own technology* or the restriction of the ability of any of the parties to the agreement to *carry out research and development*, unless such latter restriction is indispensable to prevent the disclosure of the licensed know-how to third parties.

Distinguish reciprocal from non-reciprocal agreements

78. For a number of hardcore restrictions the TTBER makes a distinction between reciprocal and non-reciprocal agreements. The hardcore list is stricter for reciprocal agreements than for non-reciprocal agreements between competitors. Reciprocal agreements are cross-licensing agreements where the licensed technologies are competing technologies or can be used for the production of competing products. A *non-reciprocal agreement is an agreement where only one of the parties is licensing its technology to the other party or where in case of cross-licensing the licensed technologies are not competing technologies and cannot be used for the production of competing products*. An agreement is *not reciprocal merely because the agreement contains a grant back obligation or because the licensee licenses back own improvements of the licensed technology*. In case *at a later point in time* a non-reciprocal agreement becomes a reciprocal agreement due to the conclusion of a second licence between the same parties, they may have to revise the first licence in order to avoid that the agreement contains a hardcore restriction. In the assessment of the individual case the Commission will take into account the time lapsed between the conclusion of the first and the second licence.

A 4(1)(a) – Price fixing

79. The hardcore restriction of competition contained in Article 4(1)(a) concerns agreements between competitors that have as their object the fixing of prices for products sold to third parties, including the products incorporating the licensed technology. Price fixing between competitors constitutes a restriction of competition *by its very object*. Price fixing can for instance take the form of a direct agreement

on the exact price to be charged or on a price list with certain allowed maximum rebates. It is immaterial whether the agreement concerns fixed, minimum, maximum or recommended prices. Price fixing can also be implemented indirectly by applying disincentives to deviate from an agreed price level, for example, by providing that the royalty rate will increase if product prices are reduced below a certain level. However, an obligation on the licensee to pay a certain minimum royalty does not in itself amount to price fixing.

Running royalties

80. When royalties are calculated on the basis of individual product sales, the amount of the *royalty has a direct impact on the marginal cost* of the product and *thus a direct impact on product prices*[(40)]. Competitors can therefore use cross licensing with reciprocal running royalties as a means of co-ordinating prices on downstream product markets[(41)]. However, the Commission *will only treat cross licences with reciprocal running royalties as price fixing where* the agreement is devoid of any pro-competitive purpose and therefore does not constitute a bona fide licensing arrangement. In such cases where the agreement does not create any value and therefore has no valid business justification, the arrangement is a sham and amounts to a cartel.

Royalties on turnover even if licensed technology not used

81. The hardcore restriction contained in Article 4(1)(a) also covers agreements whereby *royalties are calculated on the basis of all product sales irrespective of whether the licensed technology is being used*. Such agreements are also caught by Article 4(1)(d) according to which the licensee must not be restricted in his ability to use his own technology (see paragraph 95 below). In general such agreements restrict competition since the agreement *raises the cost of using the licensee's own competing technology and restricts competition that existed in the absence of the agreement*[(42)]. This is so both in the case of reciprocal and non-reciprocal arrangements. Exceptionally, however, an agreement whereby royalties are calculated on the basis of all product sales *may fulfil the conditions of Article 81(3) in an individual case* where on the basis of objective factors it can be concluded that the restriction is indispensable for pro-competitive licensing to occur. This may be the case where in the absence of the restraint it would be *impossible or unduly difficult to calculate and monitor the royalty payable by the licensee*, for instance because the licensor's technology leaves no visible trace on the final product and practicable alternative monitoring methods are unavailable.

Reciprocal output limitation – A 4(1)(b)

82. The hardcore restriction of competition set out in Article 4(1)(b) concerns reciprocal output restrictions on the parties. An output restriction is a limitation on how much a party may produce and sell. Article 4(1)(b) does not cover output limitations on the licensee in a non-reciprocal agreement or output limitations on one of the licensees in a reciprocal agreement provided that the output limitation only concerns products produced with the licensed technology. Article 4(1)(b) thus identifies as hardcore restrictions reciprocal output restrictions on the parties and output restrictions

on the licensor in respect of his own technology. When competitors agree to impose reciprocal output limitations, the object and likely effect of the agreement is to reduce output in the market. The same is true of agreements that reduce the incentive of the parties to expand output, for example by obliging each other to make payments if a certain level of output is exceeded.

Reason for favouring non-reciprocal agreements

83. The more favourable treatment of non-reciprocal quantity limitations is based on the consideration that *a one-way restriction does not necessarily lead to a lower output* on the market while also *the risk that the agreement is not a bona fide licensing arrangement is less when the restriction is non-reciprocal*. When a licensee is willing to accept a one-way restriction, it is *likely that the agreement leads to a real integration of complementary technologies or an efficiency enhancing integration of the licensor's superior technology with the licensee's productive assets*. In a reciprocal agreement an output restriction on one of the licensees is likely to reflect the higher value of the technology licensed by one of the parties and may serve to promote pro-competitive licensing.

A 4(1)(c) – Allocation of markets or customers

84. The hardcore restriction of competition set out in Article 4(1)(c) concerns the allocation of markets and customers. Agreements whereby competitors share markets and customers have *as their object* the restriction of competition. It is a hardcore restriction where competitors in a reciprocal agreement agree not to produce in certain territories or not to sell actively and/or passively into certain territories or to certain customers reserved for the other party.

(c) applies even if licensee free to use its own technology

85. Article 4(1)(c) applies irrespective of whether the licensee remains free to use his own technology. Once the licensee has tooled up to use the licensor's technology to produce a given product, it may be costly to maintain a separate production line using another technology in order to serve customers covered by the restrictions. Moreover, given the anti-competitive potential of the restraint the licensee may have little incentive to produce under his own technology. Such restrictions are also highly unlikely to be indispensable for pro-competitive licensing to occur.

(ii) – Field of use, product restriction or exclusive territory to protect the other party in a non-reciprocal licence

86. Under Article 4(1)(c)(ii) it is not a hardcore restriction for the licensor in a *non-reciprocal agreement* to grant the licensee an *exclusive licence* to produce on the basis of the licensed technology *in a particular territory* and thus agree not to produce himself the contract products in or provide the contract products from that territory. Such exclusive licences are block *exempted irrespective of the scope of the territory*. *If the licence is world-wide*, the exclusivity implies that the licensor abstains from entering or remaining on the market. The block exemption also applies where the licence is *limited to one or more technical fields of use or one or*

more product markets. The purpose of agreements covered by Article 4(1)(c)(ii) may be to *give the licensee an incentive to invest in and develop the licensed technology*. The object of the agreement is therefore not necessarily to share markets.

(iv) – Non-reciprocal licence with restraints on active or passive sales

87. According to Article 4(1)(c)(iv) and for the same reason, the block exemption also applies to non-reciprocal agreements whereby the parties agree not to sell actively or passively[(43)] into an exclusive territory or to an exclusive customer group reserved for the other party.

Sole licence

88. According to Article 4(1)(c)(iii) it is also not a hardcore restriction if the licensor appoints the licensee as his sole licensee in a particular territory, implying that third parties will not be licensed to produce on the basis of the licensor's technology in the territory in question. In the case of such sole licences the block exemption applies irrespective of *whether the agreement is reciprocal or not* given that the agreement does not affect the ability of the parties to fully exploit their own technology in the respective territories.

(v) – Restriction on active sales by licensee to protect another licensee in a non-reciprocal licence

89. Article 4(1)(c)(v) excludes from the hardcore list and thus block exempts up to the market share threshold restrictions in a non-reciprocal agreement on active sales by a licensee into the territory or to the customer group allocated by the licensor to another licensee. It is a *condition, however, that the protected licensee was not a competitor of the licensor when the agreement was concluded*. It is not warranted to hardcore such restrictions. By allowing the licensor to grant a licensee, who was not already on the market, protection against active sales by licensees which are competitors of the licensor and which for that reason are already established on the market, such restrictions are likely to induce the licensee to exploit the licensed technology more efficiently. On the other hand, *if the licensees agree between themselves not to sell actively or passively into certain territories or to certain customer groups, the agreement amounts to a cartel amongst the licensees*. Given that such agreements do not involve any transfer of technology they fall outside the scope of the TTBER.

(i) – Field of use or product restriction on licensee provided each can use its own technology freely

90. According to Article 4(1)(c)(i) restrictions in agreements between competitors that limit the licence to one or more product markets or technical fields of use[(44)] are not hardcore restrictions. Such restrictions are *block exempted up to the market share threshold of 20%* irrespective of whether the agreement is reciprocal or not. It is a condition for the application of the block exemption, however, that the field of use restrictions do *not go beyond the scope of the licensed technologies*. It is also a condition that *licensees are not limited in the use of their own technology* (see

Article 4(1)(d)). Where licensees are limited in the use of their own technology the agreement amounts to market sharing.

91. The block *exemption applies irrespective of whether the field of use restriction is symmetrical or asymmetrical*. An asymmetrical field of use restriction in a reciprocal licence agreement implies that both parties are allowed to use the respective technologies that they license in only within different fields of use. As long as the parties are unrestricted in the use of their own technologies, it is not assumed that the agreement leads the parties to abandon or refrain from entering the field(s) covered by the licence to the other party. Even if the licensees tool up to use the licensed technology within the licensed field of use, there may be no impact on assets used to produce outside the scope of the licence. It is important in this regard that the *restriction relates to distinct product markets or fields of use* and not to customers, allocated by territory or by group, who purchase products falling within the same product market or technical field of use. The risk of market sharing is considered substantially greater in the latter case (see paragraph 85 above). In addition, field of use restrictions may be necessary to promote pro-competitive licensing (see paragraph 182 below).

(vi) – Captive use restrictions

92. Article 4(1)(c)(vi) contains a further exception, namely captive use restrictions, ie a *requirement whereby the licensee may produce the products incorporating the licensed technology only for his own use*. Where the contract product is a component the licensee can thus be obliged to produce that component only for incorporation into his own products and can be obliged not to sell the components to other producers. *The licensee must be able, however, to sell the components as spare parts for his own products and must thus be able to supply third parties that perform after sale services on these products*. Captive use restrictions as defined may be necessary to encourage the dissemination of technology, particularly between competitors, and are covered by the block exemption. Such restrictions are also dealt with in section IV.2.5 below.

(vii) – Non-reciprocal agreement limited to providing an alternative source for a particular customer

93. Finally, Article 4(1)(c)(vii) excludes from the hardcore list an obligation on the licensee in a non-reciprocal agreement to produce the contract products only for a particular customer with a view to creating an alternative source of supply for that customer. It is thus a condition for the application of Article 4(1)(c)(vii) that the licence is limited to creating an alternative source of supply for that particular customer. It is not a condition, however, that only one such licence is granted. Article 4(1)(c)(vii) also covers situations where more than one undertaking is licensed to supply the same specified customer. The potential of such agreements to share markets is limited where the licence is granted only for the purpose of supplying a particular customer. In particular, in such circumstances it cannot be assumed that the agreement will cause the licensee to cease exploiting his own technology.

A 4(1)(d) – Restriction on licensee exploiting other technology

94. The hardcore restriction of competition set out in Article 4(1)(d) *covers firstly restrictions on any of the parties' ability to carry out research and development.*

Both parties must be free to carry out independent research and development. This rule applies irrespective of whether the restriction applies to a field covered by the licence or to other fields. However, the mere *fact that the parties agree to provide each other with future improvements of their respective technologies does not amount to a restriction on independent research and development*. The effect on competition of such agreements must be assessed in light of the circumstances of the individual case. Article 4(1)(d) also *does not extend to restrictions* on a party to carry out research and development with third parties, *where such restriction is necessary to protect the licensor's know-how against disclosure*. In order to be covered by the exception, the restrictions imposed to protect the licensor's know-how against disclosure must be necessary and *proportionate* to ensure such protection. For instance, where the agreement designates particular employees of the licensee to be trained in and responsible for the use of the licensed know-how, it may be sufficient to oblige the licensee not to allow those employees to be involved in research and development with third parties. Other safeguards may be equally appropriate.

95. According to Article 4(1)(d) the *licensee must also be unrestricted in the use of his own competing technology* provided that in so doing he does *not make use of the technology licensed from the licensor*. In relation to his own technology the licensee must not be subject to limitations in terms of where he produces or sells, how much he produces or sells and at what price he sells. He must also not be obliged to pay royalties on products produced on the basis of his own technology (cf paragraph 81 above). Moreover, the licensee must not be restricted in licensing his own technology to third parties. When restrictions are imposed on the licensee's use of his own technology or to carry out research and development, the competitiveness of the licensee's technology is reduced. The effect of this is to reduce competition on existing product and technology markets and to reduce the licensee's incentive to invest in the development and improvement of his technology.

4.3. Agreements between non-competitors

96. Article 4(2) lists the hardcore restrictions for licensing between non-competitors. According to this provision, the TTBER does not cover agreements which, *directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object*:

Price fixing

(a) the restriction of a party's ability to determine its prices when selling products to third parties, without prejudice to the possibility to impose a maximum sale price or recommend a sale price, provided that it does not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties;

Territorial or customer restriction on passive sales by licensee

(b) the restriction of the territory into which, or of the customers to whom, the licensee may passively sell the contract products, except:

To protect exclusive territory or customer group of licensor

(i) the restriction of passive sales into an exclusive territory or to an exclusive customer group reserved for the licensor;

To protect exclusive territory or customer group of another licensee

(ii) the restriction of passive sales into an exclusive territory or to an exclusive customer group allocated by the licensor to another licensee during the first two years that this other licensee is selling the contract products in that territory or to that customer group;

Captive sales

(iii) the obligation to produce the contract products only for its own use provided that the licensee is not restricted in selling the contract products actively and passively as spare parts for its own products;

Alternative source

(iv) the obligation to produce the contract products only for a particular customer, where the licence was granted in order to create an alternative source of supply for that customer;

Separate wholesale and retail trade

(v) the restriction of sales to end users by a licensee operating at the wholesale level of trade;

Selective distribution

(vi) the restriction of sales to unauthorised distributors by the members of a selective distribution system;

Selective distribution

(c) the restriction of active or passive sales to end users by a licensee which is a member of a selective distribution system and which operates at the retail level, without prejudice to the possibility of prohibiting a member of the system from operating out of an unauthorised place of establishment.

A 4(2)(a) – Price fixing

97. The hardcore restriction of competition set out in Article 4(2)(a) concerns the fixing of prices charged when selling products to third parties. More specifically, this provision covers restrictions which have as their direct or indirect object the establishment of a fixed or a minimum selling price or a *fixed or minimum price level to be observed by the licensor or the licensee when selling products to third parties*. In the case of agreements that directly establish the selling price, the restriction is clear-cut. However, the fixing of selling prices can also be achieved *through indirect means*. Examples of the latter are agreements fixing the margin, fixing the maximum

level of discounts, linking the sales price to the sales prices of competitors, threats, intimidation, warnings, penalties, or contract terminations in relation to observance of a given price level. Direct or indirect means of achieving price fixing can be made more effective when combined with measures to identify price-cutting, such as the implementation of a price monitoring system, or the obligation on licensees to report price deviations. Similarly, direct or indirect price fixing can be made more effective when combined with measures that reduce the licensee's incentive to lower his selling price, such as the licensor obliging the licensee to apply a most-favoured-customer clause, ie an obligation to grant to a customer any more favourable terms granted to any other customer. The same means can be used to make maximum or recommended prices work as fixed or minimum selling prices. However, the provision of a list of recommended prices to or the imposition of a maximum price on the licensee by the licensor is not considered in itself as leading to fixed or minimum selling prices.

A 4(2)(b) – Territorial or customer restraint on passive sales by licensee

98. Article 4(2)(b) identifies as hardcore restrictions of competition *agreements or concerted practices that have as their direct or indirect object the restriction of passive sales by licensees of products incorporating the licensed technology*(45). Passive sales restrictions on the licensee may be the result of direct obligations, such as the obligation not to sell to certain customers or to customers in certain territories or the obligation to refer orders from these customers to other licensees. It may also result from indirect measures aimed at inducing the licensee to refrain from making such sales, such as financial incentives and the implementation of a monitoring system aimed at verifying the effective destination of the licensed products. *Quantity limitations* may be an indirect means to restrict passive sales. The Commission will not assume that quantity limitations as such serve this purpose. However, it will be otherwise where quantity limitations are used to implement an underlying market partitioning agreement. Indications thereof *include the adjustment of quantities over time to cover only local demand, the combination of quantity limitations and an obligation to sell minimum quantities in the territory, minimum royalty obligations linked to sales in the territory, differentiated royalty rates depending on the destination of the products and the monitoring of the destination of products sold by individual licensees*. The general hardcore restriction covering passive sales by licensees is subject to a number of exceptions, which are dealt with below.

A 4(2)(b) excludes restrictions on licensor and restraints on active sales by licensee

99. *Article 4(2)(b) does not cover sales restrictions on the licensor*. All sales restrictions on the licensor are block exempted up to the market share threshold of 30%. The same applies to *all restrictions on active sales by the licensee*, with the exception of what is said on active selling in paragraphs 105 and 106 below. The block exemption of restrictions on active selling is based on the assumption that such restrictions promote investments, non-price competition and improvements in the quality of services provided by the licensees *by solving free rider problems and hold-up problems*. In the case of restrictions of active sales between licensees' territories or customer groups, it is not a condition that the protected licensee has been granted an

exclusive territory or an exclusive customer group. The block exemption also applies to active sales restrictions where more than one licensee has been appointed for a particular territory or customer group. Efficiency enhancing investment is likely to be promoted where a licensee can be ensured that he will only face active sales competition from a limited number of licensees inside the territory and not also from licensees outside the territory.

A 4(2)(b)(i) – Exclusive territory or customer group reserved for licensor

100. *Restrictions on active and passive sales by licensees into an exclusive territory or to an exclusive customer group reserved for the licensor do not constitute hardcore restrictions of competition* (cf Article 4(2)(b)(i)). Indeed, they are block exempted. It is presumed that up to the market share threshold such restraints, where restrictive of competition, promote pro-competitive dissemination of technology and integration of such technology into the production assets of the licensee. For a territory or customer group to be reserved for the licensor, it is not required that the licensor is actually producing with the licensed technology in the territory or for the customer group in question. A territory or customer group can also be reserved by the licensor for later exploitation.

A 4(2)(b)(ii) – Exclusive territory or customer group of other licensee

101. *Restrictions on passive sales by licensees into an exclusive territory or customer group allocated to another licensee are block exempted for two years calculated from the date on which the protected licensee first markets the products incorporating the licensed technology inside his exclusive territory or to his exclusive customer group* (cf Article 4(2)(b)(ii)). Licensees often have to commit substantial investments in production assets and promotional activities in order to start up and develop a new territory. The risks facing the new licensee are therefore likely to be substantial, in particular since promotional expenses and investment in assets required to produce on the basis of a particular technology are often sunk, ie they cannot be recovered if the licensee exits the market. In such circumstances, it is often the case that licensees would not enter into the licence agreement without protection for a certain period of time against (active and) passive sales into their territory by other licensees. Restrictions on passive sales into the exclusive territory of a licensee by other licensees therefore often fall outside Article 81(1) for a period of up to two years from the date on which the product incorporating the licensed technology was first put on the market in the exclusive territory by the licensee in question. However, to the extent that in individual cases such restrictions are caught by Article 81(1) they are block exempted. *After the expiry of this two-year period restrictions on passive sales between licensees constitute hardcore restrictions*. Such restrictions are generally caught by Article 81(1) and are unlikely to fulfil the conditions of Article 81(3). In particular, passive sales restrictions are unlikely to be indispensable for the attainment of efficiencies[46].

A 4(2)(b)(iii) – Captive sales

102. Article 4(2)(b)(iii) brings under the block exemption a restriction whereby the licensee is *obliged to produce products incorporating the licensed technology only*

for his own (captive) use. Where the contract product is a component the licensee can thus be obliged to use that product only for incorporation into his own products and can be obliged not to sell the product to other producers. The *licensee must however be able to actively and passively sell the products as spare parts for his own products* and must thus be able to supply third parties that perform after sale services on these products. Captive use restrictions are also dealt with in section IV.2.5 below.

A 4(2)(b)(iv) – Alternative source

103. As in the case of agreements between competitors (cf paragraph 93 above) the block exemption also applies to agreements whereby the licensee is *obliged to produce the contract products only for a particular customer in order to provide that customer with an alternative source of supply* (cf Article 4(2)(b)(iv)). In the case of agreements between non-competitors, such restrictions are unliely to be caught by Article 81(1).

A 4(2)(b)(v) – Separate wholesale and retail trade

104. Article 4(2)(b)(v) brings under the block exemption an obligation on the licensee *not to sell to end users* and thus only to sell to retailers. Such an obligation allows the licensor to assign the wholesale distribution function to the licensee and normally falls outside Article 81(1)[(47)].

A 4(2)(b)(vi) – Selective distribution

105. Finally Article 4(2)(b)(vi) brings under the block exemption a restriction on the licensee *not to sell to unauthorised distributors*. This exception allows the licensor to impose on the licensees an obligation to form part of a selective distribution system. In that case, however, the licensees must according to Article 4(2)(c) be permitted to sell both actively and passively to end users, without prejudice to the possibility to restrict the licensee to a wholesale function as foreseen in Article 4(2)(b)(v) (cf the previous paragraph).

106. It is recalled (cf paragraph 39 above) that the block exemption covers licence agreements whereby the licensor imposes obligations which the licensee must or may impose on his buyers, including distributors. However, these obligations must comply with the competition rules applicable to supply and distribution agreements. Since the TTBER is limited to agreements between two parties the agreements concluded between the licensee and his buyers implementing such obligations are not covered by the TTBER. Such agreements are only block exempted when they comply with Regulation 2790/1999 (cf section 2.5.2 above).

5. Excluded restrictions

A 5 – Severable restrictions

107. Article 5 of the TTBER lists four types of restrictions that are *not block exempted and which thus require individual assessment of their anti-competitive and pro-competitive effects*. It follows from Article 5 that the inclusion in a licence

agreement of any of the restrictions contained in these provisions does not prevent the application of the block exemption to the rest of the agreement. It is only the individual restriction in question that is not block exempted, implying that individual assessment is required. Accordingly, the rule of severability applies to the restrictions set out in Article 5.

108. Article 5(1) provides that the block exemption shall not apply to the following three obligations:

Exclusive grant back

(a) Any direct or indirect obligation on the licensee to grant an exclusive licence to the licensor or to a third party designated by the licensor in respect of its own severable improvements to or its new applications of the licensed technology.

Exclusive assignment back

(b) Any direct or indirect obligation on the licensee to assign to the licensor or to a third party designated by the licensor rights to severable improvements to or new applications of the licensed technology.

No challenge

(c) Any direct or indirect obligation on the licensee not to challenge the validity of intellectual property rights held by the licensor in the common market. However, the *TTBER does cover the possibility for the licensor to terminate the licence agreement in the event that the licensee challenges the validity of the licensed technology*.

The purpose of Article 5(1)(a), (b) and (c) is to avoid block exemption of agreements that may reduce the incentive of licensees to innovate.

A 5(1)(a) – Exclusive grant back and assignments

109. Article 5(1)(a) and 5(1)(b) concerns exclusive grant backs or assignments to the licensor of severable improvements of the licensed technology. An improvement is severable if it can be exploited without infringing upon the licensed technology. An obligation to grant the licensor an exclusive licence to severable improvements of the licensed technology or to assign such improvements to the licensor is likely to reduce the licensee's incentive to innovate since it hinders the licensee in exploiting his improvements, including by way of licensing to third parties. This is the case both where the severable improvement concerns the same application as the licensed technology and where the licensee develops new applications of the licensed technology. According to Article 5(1)(a) and (b) such obligations are not block exempted. However, the *block exemption does cover non-exclusive grant back obligations in respect of severable improvements*. This is so *even where the grant back obligation is non-reciprocal*, ie only imposed on the licensee, and *where under the agreement the licensor is entitled to feed-on the severable improvements to other licensees*. A non-reciprocal grant back obligation may promote innovation and the dissemination of new technology by permitting the licensor to freely determine whether and to what extent to pass on his own improvements to his licensees. A

feed-on clause may also promote the dissemination of technology because each licensee knows at the time of contracting that he will be on an equal footing with other licensees in terms of the technology on the basis of which he is producing. Exclusive grant backs and obligations to assign non-severable improvements are not restrictive of competition within the meaning of Article 81(1) since non-severable improvements cannot be exploited by the licensee without the licensor's permission.

Exclusive grant and assignment back

110. The application of Article 5(1)(a) and (b) does *not depend on whether or not the licensor pays consideration in return for acquiring the improvement or for obtaining an exclusive licence*. However, the *existence and level of such consideration may be a relevant factor in the context of an individual assessment under Article 81*. When grant backs are made against consideration it is less likely that the obligation creates a disincentive for the licensee to innovate. In the assessment of exclusive grant backs outside the scope of the block exemption the market position of the licensor on the technology market is also a relevant factor. *The stronger the position of the licensor, the more likely it is that exclusive grant back obligations will have restrictive effects on competition in innovation*. The stronger the position of the licensor's technology the more likely it is that the licensee will be an important source of innovation and future competition. The *negative impact of grant back obligations can also be increased in case of parallel networks of licence agreements containing such obligations*. When available technologies are controlled by a limited number of licensors that impose exclusive grant back obligations on licensees, the risk of anti-competitive effects is greater than where there are a number of technologies only some of which are licensed on exclusive grant back terms.

111. The *risk of negative effects on innovation is higher in the case of cross licensing between competitors where a grant back obligation on both parties is combined with an obligation on both parties to share with the other party improvements of his own technology*. The sharing of all improvements between competitors may prevent each competitor from gaining a competitive lead over the other (see also paragraph 208 below). However, the parties are unlikely to be prevented from gaining a competitive lead over each other where the purpose of the licence is to permit them to develop their respective technologies and where the licence does not lead them to use the same technological base in the design of their products. This is the case where the purpose of the licence is to create design freedom rather than to improve the technological base of the licensee.

A 5(1)(c) – No challenge

112. The excluded restriction set out in Article 5(1)(c) concerns non-challenge clauses, ie obligations not to challenge the validity of the licensor's intellectual property. *The reason for excluding non-challenge clauses* from the scope of the block exemption is the fact that licensees are normally in the best position to determine whether or not an intellectual property right is invalid. In the interest of undistorted competition and in conformity with the principles underlying the protection of intellectual property, invalid intellectual property rights should be eliminated. Invalid intellectual property stifles innovation rather than promoting it. *Article 81(1) is likely to apply to non-challenge clauses where the licensed technology is valuable and therefore*

creates a competitive disadvantage for undertakings that are prevented from using it or are only able to use it against payment of royalties[(48)]. In such cases the conditions of Article 81(3) are unlikely to be fulfilled[(49)]. However, the Commission takes a *favourable view of non-challenge clauses relating to know-how where once disclosed it is likely to be impossible or very difficult to recover the licensed know-how*. In such cases, an obligation on the licensee not to challenge the licensed know-how promotes dissemination of new technology, in particular by allowing weaker licensors to license stronger licensees without fear of a challenge once the know-how has been absorbed by the licensee.

May provide for termination in event of challenge

113. *The TTBER covers the possibility for the licensor to terminate the licence agreement in the event of a challenge of the licensed technology*. Accordingly, the licensor is not forced to continue dealing with a licensee that challenges the very subject matter of the licence agreement, implying that upon termination any further use by the licensee of the challenged technology is at the challenger's own risk. Article 5(1)(c) ensures, however, that the TTBER does not cover contractual obligations obliging the licensee not to challenge the licensed technology, which would permit the licensor to sue the licensee for breach of contract and thereby create a further disincentive for the licensee to challenge the validity of the licensor's technology. The provision thereby ensures that the licensee is in the same position as third parties.

A 5(2) – Limitations on licensee using its own technology between non-competitors

114. Article 5(2) excludes from the scope of the block exemption, in the case of agreements between non-competitors, *any direct or indirect obligation limiting the licensee's ability to exploit his own technology or limiting the ability of the parties to the agreement to carry out research and development*, unless such latter restriction is indispensable to prevent the disclosure of licensed know-how to third parties. The content of this condition is the same as that of Article 4(1)(d) of the hardcore list concerning agreements between competitors, which is dealt with in paragraphs 94 and 95 above. However, in the case of agreements between non-competitors it cannot be considered that such restrictions generally have negative effects on competition or that the conditions of Article 81(3) are generally not satisfied[(50)]. Individual assessment is required.

115. In the case of *agreements between non-competitors, the licensee normally does not own a competing technology*. However, there may be cases where for the purposes of the block exemption the parties are considered non-competitors in spite of the fact that the licensee does own a competing technology. This is the case where the licensee owns a technology but does not license it and the licensor is not an actual or potential supplier on the product market. For the purposes of the block exemption the parties are in such circumstances neither competitors on the technology market nor competitors on the product market[(51)]. In such cases it is important to ensure that the licensee is not restricted in his ability to exploit his own technology and further develop it. *This technology constitutes a competitive constraint in the market, which should be preserved*. In such a situation restrictions on the licensee's

use of his own technology or on research and development are normally considered to be restrictive of competition and not to satisfy the conditions of Article 81(3). For instance, an obligation on the licensee to pay royalties not only on the basis of products it produces with the licensed technology but also on the basis of products it produces with its own technology will generally limit the ability of the licensee to exploit its own technology and thus be excluded from the scope of the block exemption.

116. In cases *where the licensee does not own a competing technology or is not already developing such a technology, a restriction on the ability of the parties to carry out independent research and development may be restrictive of competition where only a few technologies are available*. In that case the parties may be an important (potential) source of innovation in the market. This is *particularly so where the parties possess the necessary assets and skills to carry out further research and development*. In that case the conditions of Article 81(3) are unlikely to be fulfilled. In other cases *where several technologies are available and where the parties do not possess special assets or skills, the restriction on research and development is likely to either fall outside Article 81(1) for lack of an appreciable restrictive effect or satisfy the conditions of Article 81(3)*. The restraint may promote the dissemination of new technology by assuring the licensor that the licence does not create a new competitor and by inducing the licensee to focus on the exploitation and development of the licensed technology. Moreover, Article 81(1) only applies where the agreement reduces the licensee's incentive to improve and exploit his own technology. This is for instance not likely to be the case where the licensor is entitled to terminate the licence agreement once the licensee commences to produce on the basis of his own competing technology. Such a right does not reduce the licensee's incentive to innovate, since the agreement can only be terminated when a commercially viable technology has been developed and products produced on the basis thereof are ready to be put on the market.

6. Withdrawal and disapplication of the Block Exemption Regulation

6.1. Withdrawal procedure

Commission and NCA may withdraw benefit of block exemption

117. According to Article 6 of the TTBER, the *Commission and the competition authorities of the Member States may withdraw* the benefit of the block exemption in respect of individual agreements that do not fulfil the conditions of Article 81(3). The power of the competition authorities of the Member States to withdraw the benefit of the block exemption is limited to cases *where the relevant geographic market is no wider than the territory of the Member State in question*.

Conditions of A 81(3) cumulative

118. The four conditions of Article 81(3) are cumulative and must all be fulfilled for the exception rule to be applicable(52). The block exemption can therefore be withdrawn where a particular agreement fails one or more of the four conditions.

Burden of proof on authority

119. Where the withdrawal procedure is applied, the withdrawing authority bears the burden of proving that the agreement falls within the scope of Article 81(1) and that the agreement does not satisfy all four conditions of Article 81(3). Given that withdrawal implies that the agreement in question restricts competition within the meaning of Article 81(1) and does not fulfil the conditions of Article 81(3), withdrawal is necessarily accompanied by a negative decision based on Articles 5, 7 or 9 of Regulation 1/2003.

Examples

120. According to Article 6, withdrawal may in particular be warranted in the following circumstances:

Cumulative effect of parallel networks of similar agreements foreclosing other technology

1. access of third parties' technologies to the market is restricted, for instance by the cumulative effect of parallel networks of similar restrictive agreements prohibiting licensees from using third party technology;

Cumulative effect of parallel networks of similar agreements foreclosing other licensees

2. access of potential licensees to the market is restricted, for instance by the cumulative effect of parallel networks of similar restrictive agreements preventing licensors from licensing to other licensees;

Parties do not exploit without valid reason

3. without any objectively valid reason the parties refrain from exploiting the licensed technology.

Cumulative effects

121. Articles 4 and 5 of the TTBER, containing the list of hardcore restrictions of competition and excluded restrictions, aim at ensuring that block exempted agreements do not reduce the incentive to innovate, do not delay the dissemination of technology, and do not unduly restrict competition between the licensor and licensee or between licensees. *However, the list of hardcore restrictions and the list of excluded restrictions do not take into account all the possible impacts of licence agreements*. In particular, the block exemption does *not take account of any cumulative effect of similar restrictions contained in networks of licence agreements*. Licence agreements may lead to foreclosure of third parties both at the level of the licensor and at the level of the licensee. *Foreclosure of other licensors* may stem from the cumulative effect of networks of licence agreements prohibiting the licensees from exploiting competing technologies, leading to the exclusion of other (potential) licensors. *Foreclosure of licensors* is likely to arise in cases where most of the undertakings on the market that could (efficiently) take a competing licence are prevented from doing so as a consequence of restrictive

agreements and where potential licensees face relatively high barriers to entry. *Foreclosure of other licensees* may stem from the cumulative effect of licence agreements prohibiting licensors from licensing other licensees and thereby preventing potential licensees from gaining access to the necessary technology. The issue of foreclosure is examined in more detail in section IV.2.7 below. In addition, the Commission is likely to withdraw the benefit of the block exemption where a significant number of licensors of competing technologies in individual agreements impose on their licensees to extend to them more favourable conditions agreed with other licensors.

Parties do not exploit without valid reason

122. The Commission is also likely to withdraw the benefit of the block exemption *where the parties refrain from exploiting the licensed technology, unless they have an objective justification for doing s*o. Indeed, when the parties do not exploit the licensed technology, no efficiency enhancing activity takes place, in which case the very rationale of the block exemption disappears. However, exploitation does not need to take the form of an integration of assets. *Exploitation also occurs where the licence creates design freedom for the licensee by allowing him to exploit his own technology without facing the risk of infringement claims by the licensor*. In the case of licensing *between competitors*, the fact that the parties do not exploit the licensed technology may be an indication that the arrangement is *a disguised cartel*. For these reasons the Commission will examine very closely cases of non-exploitation.

6.2. Disapplication of the Block Exemption Regulation

Commission may exclude by regulation

123. Article 7 of the TTBER enables the Commission to exclude from the scope of the TTBER, by means of regulation, parallel networks of similar agreements where these cover more than 50% of a relevant market. Such a measure is not addressed to individual undertakings but concerns all undertakings whose agreements are defined in the regulation disapplying the TTBER.

124. Whereas withdrawal of the benefit of the TTBER by the Commission under Article 6 implies the adoption of a decision under Articles 7 or 9 of Regulation 1/2003, the *effect of a Commission disapplication regulation under Article 7 of the TTBER* is merely to remove, in respect of the restraints and the markets concerned, the benefit of the TTBER and to restore the full application of Article 81(1) and (3). Following the adoption of a regulation declaring the TTBER inapplicable for a particular market in respect of agreements containing certain restraints, the criteria developed by the relevant case law of the Community Courts and by notices and previous decisions adopted by the Commission will give guidance on the application of Article 81 to individual agreements. Where appropriate, the Commission will take a decision in an individual case, which can provide guidance to all the undertakings operating on the market concerned.

Calculating 50%

125. For the purpose of calculating the 50% market coverage ratio, account must be taken of each individual network of licence agreements containing restraints, or combinations of restraints, producing similar effects on the market.

Commission not bound to act

126. Article 7 does not entail an obligation on the part of the Commission to act where the 50% market-coverage ratio is exceeded. In general, disapplication is appropriate when it is likely that access to the relevant market or competition therein is appreciably restricted. In assessing the need to apply Article 7, the Commission will consider whether individual withdrawal would be a more appropriate remedy. This may depend, in particular, on the number of competing undertakings contributing to a cumulative effect on a market or the number of affected geographic markets within the Community.

Clarify scope of regulation

127. *Any regulation adopted under Article 7 must clearly set out its scope*. This means, first, that the Commission must *define the relevant product and geographic market(s)* and, secondly, that it *must identify the type of licensing restraint* in respect of which the TTBER will no longer apply. As regards the latter aspect, the Commission may modulate the scope of its regulation according to the competition concern which it intends to address. For instance, while all parallel networks of non-compete arrangements will be taken into account for the purpose of establishing the 50% market coverage ratio, the Commission may nevertheless restrict the scope of the disapplication regulation only to non-compete obligations exceeding a certain duration. Thus, agreements of a shorter duration or of a less restrictive nature might be left unaffected, due to the lesser degree of foreclosure attributable to such restraints. Where appropriate, the Commission may also provide guidance by specifying the market share level which, in the specific market context, may be regarded as insufficient to bring about a significant contribution by an individual undertaking to the cumulative effect. In general, when the market share of the products incorporating a technology licensed by an individual licensor does not exceed 5%, the agreement or network of agreements covering that technology is not considered to contribute significantly to a cumulative foreclosure effect(53).

Transitional period of six months

128. The transitional period of not less than six months that the Commission will have to set under Article 7(2) should allow the undertakings concerned to adapt their agreements to take account of the regulation disapplying the TTBER.

Disapplication not retrospective

129. A regulation disapplying the TTBER will not affect the block exempted status of the agreements concerned for the period preceding its entry into force.

IV. APPLICATION OF ARTICLE 81(1) AND 81(3) OUTSIDE THE SCOPE OF THE BLOCK EXEMPTION REGULATION

1. The general framework for analysis

No presumption

130. Agreements that fall outside the block exemption, for example because the market share thresholds are exceeded or the agreement involves more than two

parties, are *subject to individual assessment*. Agreements that either do not restrict competition within the meaning of Article 81(1) or which fulfil the conditions of Article 81(3) are valid and enforceable. It is recalled that there is *no presumption of illegality of agreements that fall outside the scope of the block exemption provided that they do not contain hardcore restrictions of competition*. In particular, there is no presumption that Article 81(1) applies merely because the market share thresholds are exceeded. Individual assessment based on the principles described in these guidelines is required.

Four or more poles of R & D

131. In order to promote predictability beyond the application of the TTBER and to confine detailed analysis to cases that are likely to present real competition concerns, the Commission takes the view that *outside the area of hardcore restrictions Article 81 is unlikely to be infringed where there are four or more independently controlled technologies* in addition to the technologies controlled by the parties to the agreement that may be substitutable for the licensed technology at a comparable cost to the user. In assessing *whether the technologies are sufficiently substitutable the relative commercial strength of the technologies in question must be taken into account*. The competitive constraint imposed by a technology is limited if it does not constitute a commercially viable alternative to the licensed technology. *For instance, if due to network effects in the market consumers have a strong preference for products incorporating the licensed technology*, other technologies already on the market or likely to come to market within a reasonable period of time may not constitute a real alternative and may therefore impose only a limited competitive constraint. The fact that an agreement falls outside the safe harbour described in this paragraph does not imply that the agreement is caught by Article 81(1) and, if so, that the conditions of Article 81(3) are not satisfied. As for the market share safe harbour of the TTBER, this additional safe harbour *merely creates a negative presumption* that the agreement is not prohibited by Article 81. Outside the safe harbour individual assessment of the agreement based on the principles developed in these guidelines is required.

1.1. The relevant factors

How competition operates on the market

132. In the application of Article 81 to individual cases it is *necessary to take due account of the way in which competition operates on the market in question*. The following factors are particularly relevant in this respect:

(a) the *nature of the agreement*;
(b) the *market position of the parties*;
(c) the *market position of competitors*;
(d) the *market position of buyers* of the licensed products;
(e) *entry barriers*;
(f) *maturity of the market*; and
(g) *other factors*.

No formalistic firm rules

The *importance of individual factors may vary* from case to case and depends on all other factors. For instance, *a high market share of the parties is usually a good indicator of market power*, but in the case of low entry barriers it may not be indicative of market power. It is therefore *not possible to provide firm rules on the importance of the individual factors*.

May be implicit restraints

133. Technology transfer agreements can take many shapes and forms. It is therefore important to analyse *the nature of the agreement* in terms of the competitive relationship between the parties and the restraints that it contains. In the latter regard it is necessary to go beyond the express terms of the agreement. *The existence of implicit restraints may be derived from the way in which the agreement has been implemented by the parties and the incentives that they face.*

Market share

134. The *market position of the parties* provides an indication of the degree of market power, if any, possessed by the licensor, the licensee or both. The higher their market share the greater their market power is likely to be. This is particularly so *where the market share reflects cost advantages or other competitive advantages vis-à-vis competitors*. These competitive advantages may for instance result from being a *first mover in the market, from holding essential patents or from having superior technology*.

Agreement between non-competitors

135. In analysing the competitive relationship between the parties it is *sometimes necessary to go beyond the analysis set out in the above sections II.3 on market definition and II.4 on the distinction between competitors and non-competitors*. Even where the licensor is not an actual or potential supplier on the product market and the licensee is not an actual or potential competitor on the technology market, it is relevant to the analysis *whether the licensee owns a competing technology, which is not being licensed. If the licensee has a strong position on the product market*, an agreement granting him an exclusive *licence to a competing technology* can restrict competition significantly compared to the situation where the licensor does not grant an exclusive licence or licences other undertakings.

Market position of competitors

136. *Market shares and possible competitive advantages and disadvantages* are also used to assess the *market position of competitors*. The stronger the actual competitors and the greater their number the less risk there is that the parties will be able to individually exercise market power. However, if the number of competitors is rather small and their market position (size, costs, R&D potential, etc.) is rather similar, this market structure may increase the risk of collusion.

Market position of buyers

137. The *market position of buyers* provides an indication of whether or not one or more buyers possess buyer power. The *first indicator of buying power is the market*

share of the buyer on the purchase market. This share reflects the importance of his demand for possible suppliers. Other indicators focus on *the position of the buyer on his resale market*, including characteristics such as a wide geographic spread of his outlets, and his brand image amongst final consumers. In some circumstances *buyer power may prevent the licensor and/or the licensee from exercising market power on the market and thereby solve a competition problem that would otherwise have existed. This is particularly so when strong buyers have the capacity and the incentive to bring new sources of supply on to the market in the case of a small but permanent increase in relative prices*. Where the strong buyers merely extract favourable terms from the supplier or simply pass on any price increase to their customers, the position of the buyers is not such as to prevent the exercise of market power by the licensee on the product market and therefore not such as to solve the competition problem on that market(54).

Entry barriers

138. *Entry barriers are measured by the extent to which incumbent companies can increase their price above the competitive level without attracting new entry*. In the absence of entry barriers, easy and quick entry would render price increases unprofitable. When effective entry, preventing or eroding the exercise of market power, is *likely to occur within one or two years*, entry barriers can, as a general rule, be said to be low. Entry barriers *may result from a wide variety of factors* such as economies of scale and scope, government regulations, especially where they establish exclusive rights, state aid, import tariffs, intellectual property rights, ownership of resources where the supply is limited due to for instance natural limitations, essential facilities, a first mover advantage or brand loyalty of consumers created by strong advertising over a period of time. Restrictive agreements entered into by undertakings may also work as an entry barrier by making access more difficult and foreclosing (potential) competitors. Entry barriers may be present at all stages of the research and development, production and distribution process. The question *whether certain of these factors should be described as entry barriers depends particularly on whether they entail sunk costs*. Sunk costs are those costs which have to be incurred to enter or be active on a market but which are lost when the market is exited. The more costs are sunk, the more potential entrants have to weigh the risks of entering the market and the more credibly incumbents can threaten that they will match new competition, as sunk costs make it costly for incumbents to leave the market. In general, entry requires sunk costs, sometimes minor and sometimes major. Therefore, actual competition is in general more effective and will weigh more heavily in the assessment of a case than potential competition.

Mature market

139. A mature market is a market that has existed for some time, where the technology used is well known and widespread and not changing very much and in which demand is relatively stable or declining. In such a market restrictions of competition are more likely to have negative effects than in more dynamic markets.

Other factors

140. In the assessment of particular restraints *other factors* may have to be taken into account. *Such factors include cumulative effects*, ie the coverage of the market by similar agreements, the duration of the agreements, the *regulatory environment* and *behaviour that may indicate or facilitate collusion* like price leadership, pre-announced price changes and discussions on the 'right' price, price rigidity in response to excess capacity, price discrimination and past collusive behaviour.

1.2. Negative effects of restrictive licence agreements

141. The negative effects on competition on the market that may result from restrictive technology transfer agreements include the following:

Competition between technologies

1. reduction of inter-technology competition between the companies operating on a technology market or on a market for products incorporating the technologies in question, including facilitation of collusion, both explicit and tacit;

Raising rivals' costs

2. foreclosure of competitors by raising their costs, restricting their access to essential inputs or otherwise raising barriers to entry; and

Competition from same technology

3. reduction of intra-technology competition between undertakings that produce products on the basis of the same technology.

Reciprocal obligations and competition between technologies

142. Technology transfer agreements may *reduce inter-technology competition*, ie competition between undertakings that license or produce on the basis of substitutable technologies. This is *particularly so where reciprocal obligations* are imposed. For instance, where competitors transfer competing technologies to each other and impose a reciprocal obligation *to provide each other with future improvements* of their respective technologies and where this agreement prevents either competitor from gaining a technological lead over the other, *competition in innovation between the parties is restricted* (see also paragraph 208 below).

Facilitate collusion

143. Licensing between competitors may also facilitate collusion. The *risk of collusion is particularly high in concentrated markets*. Collusion requires that the undertakings concerned have *similar views on what is in their common interest and on how the co-ordination mechanisms function*. For collusion to work the undertakings must also *be able to monitor each other's market behaviour* and there must be *adequate deterrents* to ensure that there is an incentive not to depart from the common policy on the market, while *entry barriers must be high enough* to limit entry

or expansion by outsiders. *Agreements can facilitate collusion by increasing transparency in the market, by controlling certain behaviour and by raising barriers to entry*. Collusion can also exceptionally be *facilitated by* licensing agreements that *lead to a high degree of commonality of costs*, because undertakings that have similar costs are more likely to have similar views on the terms of coordination[(55)].

Non-compete and tying may foreclose new technology

144. Licence agreements may also *affect inter-technology competition by creating barriers to entry* for and expansion by competitors. Such foreclosure effects may stem from restraints that prevent licensees from licensing from third parties or create disincentives for them to do so. For instance, third parties may be foreclosed where incumbent licensors impose non-compete obligations on licensees to such an extent that an insufficient number of licensees are available to third parties and where entry at the level of licensees is difficult. Suppliers of substitutable technologies may also be foreclosed where a licensor with a sufficient degree of market power ties together various parts of a technology and licenses them together as a package while only part of the package is essential to produce a certain product.

Territorial restraints may reduce competition between licensees

145. Licence agreements may also reduce intra-technology competition, ie competition between undertakings that produce on the basis of the same technology. An agreement imposing territorial restraints on licensees, preventing them from selling into each other's territory reduces competition between them. Licence agreements may also reduce intra-technology competition by facilitating collusion between licensees. Moreover, licence agreements that reduce intra-technology competition may facilitate collusion between owners of competing technologies or reduce inter-technology competition by raising barriers to entry.

1.3. Positive effects of restrictive licence agreements and the framework for analysing such effects

Balance efficiencies under A 81(3)

146. Even restrictive licence agreements mostly also produce pro-competitive effects in the form of efficiencies, which may outweigh their anti-competitive effects. This assessment takes place within the framework of Article 81(3), which contains an exception from the prohibition rule of Article 81(1). For this exception to be applicable the licence agreement must produce objective economic benefits, the restrictions on competition must be indispensable to attain the efficiencies, consumers must receive a fair share of the efficiency gains, and the agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of the products concerned.

Context – change of facts – appraise ex ante

147. The assessment of restrictive agreements under Article 81(3) is made within the *actual context in which they occur*[(56)] and on the basis of the facts existing at any

given point in time. The assessment is sensitive to material changes in the facts. The *exception rule of Article 81(3) applies as long as the four conditions are fulfilled* and ceases to apply when that is no longer the case[(57)]. However, when applying Article 81(3) in accordance with these principles it is necessary to *take into account the initial sunk investments made by any of the parties and the time needed and the restraints required to commit and recoup an efficiency enhancing investment*. Article 81 cannot be applied without considering the *ex ante* investment and the risks relating thereto. The *risk facing the parties and the sunk investment that must be committed to implement the agreement can thus lead to the agreement falling outside Article 81(1) or fulfilling the conditions of Article 81(3), as the case may be, for the period of time required to recoup the investment.*

Benefits must be objective

148. The first condition of Article 81(3) requires an assessment of what are the *objective benefits in terms of efficiencies produced by the agreement*. In this respect, licence agreements have the potential of bringing together complementary technologies and other assets allowing new or improved products to be put on the market or existing products to be produced at lower cost. *Outside the context of hardcore cartels, licensing often occurs because it is more efficient for the licensor to licence the technology than to exploit it himself*. This may particularly be the case where the licensee already has access to the necessary production assets. The agreement allows the licensee to gain access to a technology that can be combined with these assets, allowing him to exploit new or improved technologies. Another example of potentially efficiency enhancing licensing is where the licensee already has a technology and where the combination of this technology and the licensor's technology gives rise to synergies. When the two technologies are combined the licensee may be able to attain a cost/output configuration that would not otherwise be possible. Licence agreements may also give rise to efficiencies at the distribution stage in the same way as vertical distribution agreements. Such efficiencies can take the form of cost savings or the provision of valuable services to consumers. *The positive effects of vertical agreements are described in the Guidelines on Vertical Restraints*[(58)]. A *further example* of possible efficiency gains is agreements whereby technology owners assemble a technology package for licensing to third parties. *Such pooling arrangements may in particular reduce transaction costs, as licensees do not have to conclude separate licence agreements with each licensor*. Pro-competitive licensing may also occur to *ensure design freedom*. In sectors where large numbers of intellectual property rights exist and where individual products may infringe upon a number of existing and future property rights, licence agreements whereby the parties agree not to assert their property rights against each other are often pro-competitive because they allow the parties to develop their respective technologies without the risk of subsequent infringement claims.

Indispensable

149. In the application of the *indispensability test contained in Article 81(3)* the Commission will in particular examine whether individual restrictions make it possible to perform the activity in question more efficiently than would have been the case in the absence of the restriction concerned. In making this assessment the *market conditions and the realities facing the parties* must be taken into account.

Undertakings invoking the benefit of Article 81(3) are not required to consider *hypothetical and theoretical alternatives*. They *must*, however, *explain and demonstrate why seemingly realistic and significantly less restrictive alternatives would be significantly less efficient*. If the application of what appears to be a commercially realistic and less restrictive alternative would lead to a significant loss of efficiencies, the restriction in question is treated as indispensable. In some cases, it may also be necessary to examine whether the agreement as such is indispensable to achieve the efficiencies. This may for example be so in the case of technology pools that include complementary but non-essential technologies(59), in which case it *must be examined to what extent such inclusion gives rise to particular efficiencies or whether, without a significant loss of efficiencies, the pool could be limited to technologies for which there are no substitutes*. In the case of simple licensing between two parties it is generally not necessary to go beyond an examination of the indispensability of individual restraints. Normally there is no less restrictive alternative to the licence agreement as such.

Fair share to consumers

150. The condition that *consumers must receive a fair share of the benefits* implies that *consumers of the products produced under the licence must at least be compensated for the negative effects of the agreement*(60). This means that the efficiency gains must fully off-set the likely negative impact on prices, output and other relevant factors caused by the agreement. They may do so by changing the cost structure of the undertakings concerned, giving them an incentive to reduce price, or by allowing consumers to gain access to new or improved products, compensating for any likely price increase(61).

Not eliminate competition nor override A 82

151. The last condition of Article 81(3), according to which the agreement must *not afford the parties the possibility of eliminating competition in respect of a substantial part of the products concerned*, presupposes an *analysis of remaining competitive pressures on the market and the impact of the agreement on such sources of competition*. In the application of the last condition of Article 81(3) the relationship between Article 81(3) and *Article 82* must be taken into account. According to settled case law, the application of Article 81(3) cannot prevent the application of Article 82 of the Treaty(62). Moreover, since Articles 81 and 82 both pursue the aim of maintaining effective competition on the market, consistency requires that Article 81(3) be interpreted as precluding any application of the exception rule to restrictive agreements that constitute an abuse of a dominant position(63).

Network effects – industry standard

152. The fact that the agreement *substantially reduces one dimension of competition does not necessarily mean that competition is eliminated* within the meaning of Article 81(3). A *technology pool, for instance, can result in an industry standard*, leading to a situation in which there is little competition in terms of the technological format. Once the main players in the market adopt a certain format, *network effects may make it very difficult for alternative formats to survive*. This does not imply, howev-

er, that the creation of a *de facto* industry standard always eliminates competition within the meaning of the last condition of Article 81(3). *Within the standard, suppliers may compete on price, quality and product features*. However, in order for the agreement to comply with Article 81(3), it must be ensured that the agreement does not unduly restrict competition and does not unduly restrict future innovation.

2. The application of Article 81 to various types of licensing restraints

153. This section deals with various types of restraints that are commonly included in licence agreements. Given their prevalence it is useful to provide guidance as to how they are assessed outside the safe harbour of the TTBER. Restraints that have already been dealt with in the preceding parts of these guidelines, in particular sections III.4 and III.5, are only dealt with briefly in the present section.

Reciprocal or non-reciprocal licences between competitors and between non-competitors

154. This section covers both agreements between non-competitors and agreements *between competitors*. In respect of the latter *a distinction* is made - where appropriate - *between reciprocal and non-reciprocal agreements*. No such distinction is required in the case of agreements between non-competitors. *When* undertakings are *neither actual nor potential competitors* on a relevant technology market or on a market for products incorporating the licensed technology, *a reciprocal licence is for all practical purposes no different from two separate licences. Arrangements whereby the parties assemble a technology package, which is then licensed to third parties, are technology pools*, which are dealt with in section 4 below.

Outside A 81(1)

155. This section does not deal with obligations in licence agreements that are generally not restrictive of competition within the meaning of Article 81(1). These obligations include but are not limited to:

(a) confidentiality obligations;
(b) obligations on licensees not to sub-license;
(c) obligations not to use the licensed technology after the expiry of the agreement, provided that the licensed technology remains valid and in force;
(d) obligations to assist the licensor in enforcing the licensed intellectual property rights;
(e) obligations to pay minimum royalties or to produce a minimum quantity of products incorporating the licensed technology; and
(f) obligations to use the licensor's trade mark or indicate the name of the licensor on the product.

2.1. Royalty obligations

156. The parties to a licence agreement are *normally free to determine the royalty payable* by the licensee and its mode of payment without being caught by Article 81(1).

This principle applies both to agreements between competitors and agreements between non-competitors. Royalty obligations may for instance take the *form of lump sum payments, a percentage of the selling price or a fixed amount for each product incorporating the licensed technology*. In cases where the licensed technology relates to an input which is incorporated into a final product it is as a general rule not restrictive of competition that royalties are calculated on the basis of the price of the final product, provided that it incorporates the licensed technology. In the case of software licensing royalties based on the number of users and royalties calculated on a per machine basis are generally compatible with Article 81(1).

Between competitors, running royalties may amount to price fixing

157. In the case of licence *agreements between competitors* it is recalled, see paragraphs and above, that in a limited number of circumstances *royalty obligations may amount to price fixing*, which is a *hardcore restriction* (cf Article 4(1)(a)). It is a hardcore restriction under Article 4(1)(a) if competitors provide for *reciprocal running royalties in circumstances where the licence is a sham*, in that its purpose is not to allow an integration of complementary technologies or to achieve another pro-competitive aim. It is *also a hardcore* restriction under Article 4(1)(a) and 4(1)(d) *if royalties extend to products produced solely with the licensee's own technology*.

Other royalty arrangements block exempted

158. *Other types of royalty arrangements between competitors are block exempted up to the market share threshold of 20% even if they restrict competition*. Outside the safe harbour of the block exemption *Article 81(1) may be applicable where competitors cross license and impose running royalties that are clearly disproportionate compared to the market value of the licence and where such royalties have a significant impact on market prices*. In assessing whether the royalties are disproportionate it is relevant to have regard to the royalties paid by other licensees on the product market for the same or substitute technologies. In such cases it is *unlikely that the conditions of Article 81(3) are satisfied*. Article 81(1) may also apply where reciprocal running royalties per unit increase as output increases. If the parties have a significant degree of market power, such royalties may have the effect of limiting output.

Duration

159. Notwithstanding the fact that the block exemption only applies as long as the technology is valid and in force, the parties can normally agree to extend royalty obligations beyond the period of validity of the licensed intellectual property rights without falling foul of Article 81(1). Once these rights expire, third parties can legally exploit the technology in question and compete with the parties to the agreement. Such actual and potential competition will normally suffice to ensure that the obligation in question does not have appreciable anti-competitive effects.

Royalties on products not licensed

160. In the case of *agreements between non-competitors* the block exemption covers agreements whereby *royalties are calculated on the basis of both products produced*

with the licensed technology and products produced with technologies licensed from third parties. Such arrangements *may facilitate the metering of royalties*. However, they *may also lead to foreclosure by increasing the cost of using third party inputs* and may thus have *similar effects as a non-compete obligation*. If royalties are paid not just on products produced with the licensed technology but also on products produced with third party technology, then the royalties will increase the cost of the latter products and reduce demand for third party technology. *Outside the scope of the block exemption it must therefore be examined whether the restriction has foreclosure effects*. For that purpose it is appropriate to use the analytical framework set out in section 2.7 below. In the case of appreciable foreclosure effects such agreements are caught by Article 81(1) and unlikely to fulfil the conditions of Article 81(3), unless there is no other practical way of calculating and monitoring royalty payments.

2.2. Exclusive licensing and sales restrictions

161. For the present purposes it is useful to distinguish between restrictions as to production within a given territory (exclusive or sole licences) and restrictions on the sale of products incorporating the licensed technology into a given territory and to a given customer group (sales restrictions).

2.2.1. Exclusive and sole licences

Distinguish sole and exclusive licences from sales restrictions

162. A licence is deemed to be exclusive if the licensee is the only one who is permitted to produce on the basis of the licensed technology within a given territory. The licensor thus undertakes not to produce itself or license others to produce within a given territory. This territory may cover the whole world. Where the licensor undertakes only not to licence third parties to produce within a given territory, the licence is a sole licence. Often exclusive or sole licensing is accompanied by sales restrictions that limit the parties in where they may sell products incorporating the licensed technology.

Reciprocal exclusive licensing between competitors hardcore

163. *Reciprocal exclusive licensing between competitors falls under Article 4(1)(c)*, which identifies market sharing between competitors as a hardcore restriction. Reciprocal sole licensing between competitors is block exempted up to the market share threshold of 20%. Under such an agreement the parties mutually commit not to license their competing technologies to third parties. In cases *where the parties have a significant degree of market power such agreements may facilitate collusion* by ensuring that the parties are the only sources of output in the market based on the licensed technologies.

Non-reciprocal licences between competitors block exempted up to 20%

164. Non-reciprocal exclusive licensing between competitors is block exempted up to the market share threshold of 20%. Above the market share threshold it is necessary to *analyse what are the likely anti-competitive effects of such exclusive licensing*.

Where the exclusive licence is world-wide it implies that the licensor leaves the market. In cases where exclusivity is limited to a particular territory such as a Member State the agreement implies that the licensor abstains from producing goods and services inside the territory in question. In the context of Article 81(1) it must in particular be assessed what is the competitive significance of the licensor. If the licensor has a limited market position on the product market or lacks the capacity to effectively exploit the technology in the licensee's territory, the agreement is unlikely to be caught by Article 81(1). A special case is where the licensor and the licensee only compete on the technology market and the licensor, for instance being a research institute or a small research based undertaking, lacks the production and distribution assets to effectively bring to market products incorporating the licensed technology. In such cases Article 81(1) is unlikely to be infringed.

Exclusive licence between non-competitors usually outside A 81

165. *Exclusive licensing between non-competitors* – to the extent that it is caught by Article 81(1)[(64)] – *is likely to fulfil the conditions of Article 81(3)*. The right to grant an exclusive licence is generally necessary in order to induce the licensee to invest in the licensed technology and to bring the products to market in a timely manner. This is in particular the case where the licensee must make large investments in further developing the licensed technology. To intervene against the exclusivity once the licensee has made a commercial success of the licensed technology would deprive the licensee of the fruits of his success and would be detrimental to competition, the dissemination of technology and innovation. The Commission will therefore *only exceptionally intervene against exclusive licensing in agreements between non-competitors, irrespective of the territorial scope of the licence*.

... unless to dominant licence

166. The main situation in which intervention may be warranted is *where a dominant licensee obtains an exclusive licence to one or more competing technologies*. Such agreements are likely to be caught by Article 81(1) and unlikely to fulfil the conditions of Article 81(3). It is *a condition however that entry into the technology market is difficult and the licensed technology constitutes a real source of competition on the market*. In such circumstances an exclusive licence may foreclose third party licensees and allow the licensee to preserve his market power.

... exclusive cross licences of industry standard

167. Arrangements whereby two or more parties cross licence each other and undertake not to licence third parties give rise to particular concerns when the *package of technologies resulting from the cross licences creates a de facto industry standard* to which third parties must have access in order to compete effectively on the market. In such cases the agreement creates a closed standard reserved for the parties. The Commission will assess such arrangements according to the *same principles as those applied to technology pools* (see section 4 below). It will normally be required that the *technologies which support such a standard be licensed to third parties on fair, reasonable and non-discriminatory terms*[(65)]. Where the parties to the arrangement compete with third parties on an existing product market and the arrangement

relates to that product market a closed standard is likely to have substantial exclusionary effects. This negative impact on competition can only be avoided by licensing also to third parties.

2.2.2. Sales restrictions

Distinguish licences between competitors and between non-competitors

168. Also as regards sales restrictions there is an important distinction to be made between licensing between competitors and between non-competitors.

Reciprocal sales restrictions between competitors, hardcore because share markets

169. Restrictions on active and passive sales by one or both parties in a reciprocal agreement between competitors are hardcore restrictions of competition under Article 4(1)(c). Sales restrictions on either party in a reciprocal agreement between competitors are caught by Article 81(1) and are unlikely to fulfil the conditions of Article 81(3). *Such restrictions are generally considered market sharing*, since they prevent the affected party from selling actively and passively into territories and to customer groups which he actually served or could realistically have served in the absence of the agreement.

Non-reciprocal sales restrictions between competitors to protect parties' exclusive territory or customer group within exemption up to 20%

170. In the case of non-reciprocal agreements between competitors the block exemption applies to restrictions on active and passive sales by the licensee or the licensor into the exclusive territory or to the exclusive customer group reserved for the other party (cf Article 4(1)(c)(iv)). Above the market share threshold of 20% sales restrictions between licensor and licensee are caught by Article 81(1) when one or both of the parties have a significant degree of market power. Such restrictions, however, may be indispensable for the dissemination of valuable technologies and therefore fulfil the conditions of Article 81(3). This may be the case where the licensor has a relatively weak market position in the territory where he exploits himself the technology. In such circumstances restrictions on active sales in particular may be indispensable to induce the licensor to grant the licence. In the absence thereof the licensor would risk facing active competition in his main area of activity. Similarly, restrictions on active sales by the licensor may be indispensable, in particular, where the licensee has a relatively weak market position in the territory allocated to him and has to make significant investments in order to efficiently exploit the licensed technology.

... to protect other licensees

171. *The block exemption also covers restrictions on active sales into the territory or to the customer group allocated to another licensee, who was not a competitor of the licensor at the time when he concluded the licence agreement with the licensor. It is a condition, however, that the agreement between the parties in question is non-reciprocal*. Above the market share threshold such *active sales restrictions are*

likely to be caught by Article 81(1) when the parties have a significant degree of market power. However, the restraint is *likely to be indispensable within the meaning of Article 81(3) for the period of time required for the protected licensee to penetrate a new market* and establish a market presence in the allocated territory or vis-à-vis the allocated customer group. This protection against active sales allows the licensee to overcome the asymmetry, which he faces due to the fact that some of the licensees are competing undertakings of the licensor and thus already established on the market. Restrictions on passive sales by licensees into a territory or to a customer group allocated to another licensee are hardcore restrictions under Article 4(1)(c) of the TTBER.

Sales restriction between non-competitors block exempted up to 30%

172. In the case of *agreements between non-competitors sales restrictions between the licensor and a licensee are block exempted* up to the market share threshold of 30%. Above the market share threshold restrictions on active and passive sales by licensees to territories or customer groups reserved for the licensor *may fall outside Article 81(1) where on the basis of objective factors it can be concluded that in the absence of the sales restrictions licensing would not occur*. A technology owner cannot normally be expected to create direct competition with himself on the basis of his own technology. In other cases sales restrictions on the licensee *may be caught by Article 81(1) both where the licensor individually has a significant degree of market power and in the case of a cumulative effect of similar agreements concluded by licensors which together hold a strong position on the market.*

Sales restrictions on licensor

173. Sales restrictions on the licensor, when caught by Article 81(1), are likely to fulfil the conditions of Article 81(3) unless there are no real alternatives to the licensor's technology on the market or such alternatives are licensed by the licensee from third parties. Such restrictions and in particular restrictions on active sales are likely to be indispensable within the meaning of Article 81(3) in order to induce the licensee to invest in the production, marketing and sale of the products incorporating the licensed technology. It is likely that the licensee's incentive to invest would be significantly reduced if he would face direct competition from the licensor whose production costs are not burdened by royalty payments, possibly leading to sub-optimal levels of investment.

Restrictions on active sales between non-competitors to protect licensees from each other block exempted

174. As regards restrictions on sales between licensees in agreements between non-competitors, the TTBER block exempts restrictions on active selling between territories or customer groups. *Above the market share threshold restrictions on active sales between licensees' territories and customer groups limit intra-technology competition and are likely to be caught by Article 81(1) when the individual licensee has a significant degree of market power*. Such restrictions, however, *may fulfil the conditions of Article 81(3) where they are necessary to prevent free riding and to induce the licensee to make the investment necessary for efficient exploitation of the*

licensed technology inside his territory and to promote sales of the licensed product. Restrictions on passive sales are covered by the hardcore list of Article 4(2)(b), cf paragraph 101 above, when they exceed two years from the date on which the licensee benefiting from the restrictions first put the product incorporating the licensed technology on the market inside his exclusive territory. Passive sales restrictions exceeding this two-year period are unlikely to fulfil the conditions of Article 81(3).

2.3. Output restrictions

Reciprocal output restriction between competitors hardcore – A 4(1)(b)

175. Reciprocal output restrictions in licence agreements between competitors constitute a hardcore restriction covered by Article 4(1)(b) of the TTBER (cf point 82 above). *Article 4(1)(b) does not cover output restrictions imposed on the licensee in a non-reciprocal agreement or on one of the licensees in a reciprocal agreement.* Such restrictions are block exempted up to the market share threshold of 20%. *Above the market share threshold, output restrictions on the licensee may restrict competition where the parties have a significant degree of market power.* However, *Article 81(3) is likely to apply in cases where the licensor's technology is substantially better than the licensee's technology and the output limitation substantially exceeds the output of the licensee prior to the conclusion of the agreement.* In that case the effect of the output limitation is limited even in markets where demand is growing. In the application of Article 81(3) it must also be taken into account that *such restrictions may be necessary in order to induce the licensor to disseminate his technology as widely as possible.* For instance, a licensor may be reluctant to license his competitors if he cannot limit the licence to a particular production site with a specific capacity (*a site licence*). Where the licence agreement leads to a real integration of complementary assets, output restrictions on the licensee may therefore fulfil the conditions of Article 81(3). However, this is unlikely to be the case where the parties have substantial market power.

... between non-competitors block exempted up to 30%

176. Output restrictions in licence agreements between non-competitors are block exempted up to the market share threshold of 30%. *The main anti-competitive risk* flowing from output restrictions on licensees in agreements between non-competitors *is reduced intra-technology competition between licensees.* The *significance* of such anti-competitive effects *depends on the market position of the licensor and the licensees* and the extent to which the output limitation prevents the licensee from satisfying demand for the products incorporating the licensed technology.

When output restriction combined with exclusive territories or customer groups

177. When output restrictions are combined with exclusive territories or exclusive customer groups, *the restrictive effects are increased.* The combination of the two types of restraints makes it *more likely that the agreement serves to partition markets.*

Between non-competitors output limitations on licensee may be pro-competitive

178. Output limitations imposed on the licensee in agreements between non-competitors may also have pro-competitive effects by promoting the dissemination of technology. As a supplier of technology, the *licensor should normally be free to determine the output produced with the licensed technology by the licensee*. If the licensor were not free to determine the output of the licensee, a number of licence agreements might not come into existence in the first place, which would have a negative impact on the dissemination of new technology. This is particularly likely to be the case where the licensor is also a producer, since in that case the output of the licensees may find their way back into the licensor's main area of operation and thus have a direct impact on these activities. On the other hand, it is less likely that output restrictions are necessary in order to ensure dissemination of the licensor's technology when combined with sales restrictions on the licensee prohibiting him from selling into a territory or customer group reserved for the licensor.

2.4. Field of use restrictions

Definition

179. Under a field of use restriction the licence is either limited to one or more technical fields of application or one or more product markets. There are many cases in which the same technology can be used to make different products or can be incorporated into products belonging to different product markets. A new moulding technology may for instance be used to make plastic bottles and plastic glasses, each product belonging to separate product markets. However, a single product market may encompass several technical fields of use. For instance a new engine technology may be employed in four cylinder engines and six cylinder engines. Similarly, a technology to make chipsets may be used to produce chipsets with up to four CPUs and more than four CPUs. A licence limiting the use of the licensed technology to produce say four cylinder engines and chipsets with up to four CPUs constitutes a technical field of use restriction.

Distinguish customer restraints

180. Given that *field of use restrictions are block exempted* and that *certain customer restrictions are hardcore restrictions under Articles 4(1)(c) and 4(2)(b)* of the TTBER, it is important to distinguish the two categories of restraints. *A customer restriction presupposes that specific customer groups are identified and that the parties are restricted in selling to such identified groups*. The fact that a technical field of use restriction may correspond to certain groups of customers within a product market does not imply that the restraint is to be classified as a customer restriction. For instance, the fact that certain customers buy predominantly or exclusively chipsets with more than four CPUs does not imply that a licence which is limited to chipsets with up to four CPUs constitutes a customer restriction. However, *the field of use must be defined objectively by reference to identified and meaningful technical characteristics of the licensed product*.

Field of use with sole or exclusive licence

181. A field of use restriction limits the exploitation of the licensed technology by the licensee to one or more particular fields of use without limiting the licensor's ability to exploit the licensed technology. In addition, as with territories, these fields of use can be allocated to the licensee under an exclusive or sole licence. *Field of use restrictions combined with an exclusive or sole licence* also restrict the licensor's ability to exploit his own technology, by preventing him from exploiting it himself, including by way of licensing to others. In the case of a sole license only licensing to third parties is restricted. Field of use restrictions combined with exclusive and sole licences are treated in the same way as the exclusive and sole licenses dealt with in section 2.2.1 above *[G 162–167]*. In particular, for licensing between competitors, this means that reciprocal exclusive licensing is hardcore under Article 4(1)(c).

Encourages licensing

182. *Field of use restrictions may have pro-competitive effects by encouraging the licensor to license his technology for applications that fall outside his main area of focus*. If the licensor could not prevent licensees from operating in fields where he exploits the technology himself or in fields where the value of the technology is not yet well established, it would be likely to create a disincentive for the licensor to license or would lead him to charge a higher royalty. It must also be taken into account that in certain sectors licensing often occurs to ensure design freedom by preventing infringement claims. Within the scope of the licence the licensee is able to develop his own technology without fearing infringement claims by the licensor.

Between actual or potential competitors, block exempted up to 20%

183. Field of use restrictions on licensees in agreements between actual or potential competitors are block exempted up to the market share threshold of 20%. *The main competitive concern in the case of such restrictions is the risk that the licensee ceases to be a competitive force outside the licensed field of use*. This *risk is greater in the case of cross licensing between competitors where the agreement provides for asymmetrical field of use restrictions*. A field of use restriction is asymmetrical where one party is permitted to use the licensed technology within one product market or technical field of use and the other party is permitted to use the other licensed technology within another product market or technical field of use. *Competition concerns may in particular arise where the licensee's production facility, which is tooled up to use the licensed technology, is also used to produce with his own technology products outside the licensed field of use*. If the agreement is likely to lead the licensee to reduce output outside the licensed field of use, the agreement is likely to be caught by Article 81(1). *Symmetrical field of use restrictions, ie agreements whereby the parties are licensed to use each other's technologies within the same field(s) of use, are unlikely to be caught by Article 81(1)*. Such agreements are unlikely to restrict competition that existed in the absence of the agreement. *Article 81(1) is also unlikely to apply in the case of agreements that merely enable the licensee to develop and exploit his own technology within the scope of the licence without fearing infringement claims by the licensor*. In such circumstances field of use restrictions do not in themselves restrict competition that existed in the absence

of the agreement. In the absence of the agreement the licensee also risked infringement claims outside the scope of the licensed field of use. However, *if the licensee without business justification terminates or scales back his activities in the area outside the licensed field of use this may be an indication of an underlying market sharing arrangement amounting to a hardcore restriction under Article 4(1)(c) of the TTBER*.

Between non-competitors block exempted

184. Field of use restrictions on licensee and licensor in agreements between non-competitors are block exempted up to the market share threshold of 30%. Field of use restrictions in agreements between non-competitors whereby the licensor reserves one or more product markets or technical fields of use for himself are *generally either non-restrictive of competition or efficiency enhancing*. They promote dissemination of new technology by giving the licensor an incentive to license for exploitation in fields in which he does not want to exploit the technology himself. If the licensor could not prevent licensees from operating in fields where the licensor exploits the technology himself, it would be likely to create a disincentive for the licensor to licence.

With sole or exclusive licences between non-competitors

185. In agreements between non-competitors the licensor is normally also entitled to grant sole or exclusive licences to different licensees limited to one or more fields of use. Such restrictions limit intra-technology competition between licensees in the same way as exclusive licensing and are analysed in the same way (cf section 2.2.1 above).

2.5. Captive use restrictions

Definition – block exempted

186. A captive use restriction can be defined as an *obligation on the licensee to limit his production of the licensed product to the quantities required for the production of his own products and for the maintenance and repair of his own products*. In other words, this type of use restriction takes the form of an obligation on the licensee to use the products incorporating the licensed technology only as an input for incorporation into his own production; it does *not cover the sale of the licensed product for incorporation into the products of other producers*. Captive use restrictions are block exempted up to the respective market share thresholds of 20% and 30%. Outside the scope of the block exemption it is necessary to examine what are the pro-competitive and anti-competitive effects of the restraint. In this respect it is necessary to distinguish agreements between competitors from agreements between non-competitors.

Between competitors

187. In the case of licence agreements between competitors a restriction that imposes on the licensee to produce under the licence only for incorporation into his own products *prevents him from being a supplier of components to third party producers*. If prior to the conclusion of the agreement, the licensee was not an actual or likely potential supplier of components to other producers, the captive use

restriction does not change anything compared to the pre-existing situation. In those circumstances the restriction is assessed in the same way as in the case of agreements between non-competitors. *If*, on the other hand, *the licensee is an actual or likely component supplier*, it is necessary to examine what is the impact of the agreement on this activity. If by tooling up to use the licensor's technology the licensee ceases to use his own technology on a stand alone basis and thus to be a component supplier, the agreement restricts competition that existed prior to the agreement. It may result in serious negative market effects when the licensor has a significant degree of market power on the component market.

Between non-competitors

188. In the case of licence agreements between non-competitors there are *two main competitive risks* stemming from captive use restrictions: (a) *a restriction of intra-technology competition on the market for the supply of inputs and (b) an exclusion of arbitrage between licensees enhancing the possibility for the licensor to impose discriminatory royalties on licensees*.

... to provide an alternative source

189. Captive use restrictions, however, *may also promote pro-competitive licensing*. If the licensor is a supplier of components, the restraint may be necessary in order for the dissemination of technology between non-competitors to occur. In the absence of the restraint the licensor may not grant the licence or may do so only against higher royalties, because otherwise he would create direct competition to himself on the component market. In such cases a captive use restriction is normally either not restrictive of competition or covered by Article 81(3). It is *a condition, however, that the licensee is not restricted in selling the licensed product as replacement parts for his own products*. The licensee must be able to serve the after market for his own products, including independent service organisations that service and repair the products produced by him.

If licensor not a component maker

190. Where the licensor is not a component supplier on the relevant market, the above reason for imposing captive use restrictions does not apply. In such cases a captive use restriction may in principle promote the dissemination of technology by ensuring that licensees do not sell to producers that compete with the licensor on other markets. However, a restriction on the licensee not to sell into certain customer groups reserved for the licensor normally constitutes a less restrictive alternative. Consequently, in such cases a captive use restriction is normally not necessary for the dissemination of technology to take place.

2.6. Tying and bundling

Definition

191. In the context of technology licensing ***tying*** occurs *when the licensor makes the licensing of one technology (the tying product) conditional upon the licensee taking a licence for another technology or purchasing a product from the licensor*

or someone designated by him (the tied product). ***Bundling*** occurs where two technologies or a technology and a product are only sold together as a bundle. In both cases, however, it is *a condition that the products and technologies involved are distinct in the sense that there is distinct demand for each of the products and technologies forming part of the tie or the bundle*. This is normally not the case where the technologies or products are by necessity linked in such a way that the licensed technology cannot be exploited without the tied product or both parts of the bundle cannot be exploited without the other. In the following the term 'tying' refers to both tying and bundling.

Block exempted up to 20% or 30%

192. Article 3 of the TTBER, which limits the application of the block exemption by market share thresholds, ensures that tying and bundling are not block exempted above the market share thresholds of 20% in the case of agreements between competitors and 30% in the case of agreements between non-competitors. The market share thresholds apply to any relevant technology or product market affected by the licence agreement, including the market for the tied product. Above the market share thresholds it is necessary to balance the anti-competitive and pro-competitive effects of tying.

Foreclosure of competing suppliers of tied product – raising rivals' costs – raising royalties

193. The main restrictive effect of tying is *foreclosure* of competing suppliers of the tied product. Tying may also allow the licensor to maintain market power in the market for the tying product by *raising barriers to entry* since it may force new entrants to enter several markets at the same time. Moreover, *tying may allow the licensor to increase royalties, in particular when the tying product and the tied product are partly substitutable and the two products are not used in fixed proportion*. Tying prevents the licensee from switching to substitute inputs in the face of increased royalties for the tying product. These competition concerns are *independent of whether the parties to the agreement are competitors or not*. For tying to produce likely anti-competitive effects the licensor must have a significant degree of market power in the tying product so as to restrict competition in the tied product. In the absence of market power in the tying product the licensor cannot use his technology for the anti-competitive purpose of foreclosing suppliers of the tied product. Furthermore, as in the case of non-compete obligations, the tie must cover a certain proportion of the market for the tied product for appreciable foreclosure effects to occur. In cases where the licensor has market power on the market for the tied product rather than on the market for the tying product, the restraint is analysed as non-compete or quantity forcing, reflecting the fact that any competition problem has its origin on the market for the 'tied' product and not on the market for the 'tying' product(66).

... efficiencies – ensuring quality

194. Tying can also give rise to efficiency gains. This is for instance the case *where the tied product is necessary for a technically satisfactory exploitation of the*

licensed technology or for ensuring that production under the licence conforms to quality standards respected by the licensor and other licensees. In such cases tying is normally either not restrictive of competition or covered by Article 81(3). Where the licensees use the licensor's trademark or brand name or where it is otherwise obvious to consumers that there is a link between the product incorporating the licensed technology and the licensor, the licensor has a legitimate interest in ensuring that the quality of the products are such that it does not undermine the value of his technology or his reputation as an economic operator. Moreover, where it is known to consumers that the licensees (and the licensor) produce on the basis of the same technology it is unlikely that licensees would be willing to take a licence unless the technology is exploited by all in a technically satisfactory way.

Efficiencies – helping licensee to exploit efficiently

195. Tying is also likely to be pro-competitive where the tied product allows the licensee to exploit the licensed technology significantly more efficiently. For instance, where the licensor licenses a particular process technology the parties can also agree that the licensee buys a catalyst from the licensor which is developed for use with the licensed technology and which allows the technology to be exploited more efficiently than in the case of other catalysts. Where in such cases the restriction is caught by Article 81(1), the conditions of Article 81(3) are likely to be fulfilled even above the market share thresholds.

2.7. Non-compete obligations

Definition

196. Non-compete obligations in the context of technology licensing take the form of an obligation on the licensee not to use third party technologies which compete with the licensed technology. To the extent that a non-compete obligation covers a product or additional technology supplied by the licensor the obligation is dealt with in the preceding section on tying.

Block exempted up to 20% or 30%

197. The TTBER exempts non-compete obligations both in the case of agreements between competitors and in the case of agreements between non-competitors up to the market share thresholds of 20% and 30% respectively.

Foreclosure – facilitate collusion

198. The *main competitive risk* presented by non-compete obligations is *foreclosure of third party technologies*. Non-compete obligations may also facilitate collusion between licensors in the case of cumulative use. Foreclosure of competing technologies reduces competitive pressure on royalties charged by the licensor and reduces competition between the incumbent technologies by limiting the possibilities for licensees to substitute between competing technologies. As in both cases the main problem is foreclosure, the *analysis can in general be the same in the case of agreements between competitors and agreements between non-competitors*. However, in

the case of *cross licensing between competitors* where both agree not to use third party technologies the agreement *may facilitate collusion between them on the product market*, thereby justifying the lower market share threshold of 20%.

Cumulative foreclosure

199. Foreclosure may arise where a substantial part of potential licensees are already tied to one or, in the case of cumulative effects, more sources of technology and are prevented from exploiting competing technologies. Foreclosure effects may result from agreements concluded by a single licensor with a significant degree of market power or by a cumulative effect of agreements concluded by several licensors, even where each individual agreement or network of agreements is covered by the TTBER. In the latter case, however, *a serious cumulative effect is unlikely to arise as long as less than 50% of the market is tied. Above this threshold significant foreclosure is likely to occur when there are relatively high barriers to entry for new licensees*. If barriers to entry are low, new licensees are able to enter the market and exploit commercially attractive technologies held by third parties and thus represent a real alternative to incumbent licensees. In order to determine the real possibility for entry and expansion by third parties it is also necessary to take account of the extent to which distributors are tied to licensees by non-compete obligations. Third party technologies only have a real possibility of entry if they have access to the necessary production and distribution assets. In other words, the ease of entry depends not only on the availability of licensees but also the extent to which they have access to distribution. In assessing foreclosure effects at the distribution level the Commission will apply the analytical framework set out in section IV.2.1 of the Guidelines on Vertical Restraints(67).

Depends on market power of licensor

200. *When the licensor has a significant degree of market power*, obligations on licensees to obtain the technology only from the licensor *can lead to significant foreclosure effects*. The stronger the market position of the licensor the higher the risk of foreclosing competing technologies. For appreciable foreclosure effects to occur the non-compete obligations do not necessarily have to cover a substantial part of the market. Even in the absence thereof, *appreciable foreclosure effects may occur where non-compete obligations are targeted at undertakings that are the most likely to license competing technologies*. The risk of foreclosure is particularly high where there is only a limited number of potential licensees and the licence agreement concerns a technology which is used by the licensees to make an input for their own use. In such cases the entry barriers for a new licensor are likely to be high. Foreclosure may be less likely in cases where the technology is used to make a product that is sold to third parties; although in this case the restriction also ties production capacity for the input in question, it does not tie demand for the product incorporating the input produced with the licensed technology. To enter the market in the latter case licensors only need access to one or more licensee(s) that have suitable production capacity and unless only few undertakings possess or are able to obtain the assets required to take a licence, it is unlikely that by imposing non-compete obligations on its licensees the licensor is able to deny competitors access to efficient licensees.

Benefits

201. Non-compete obligations may also produce pro-competitive effects. First, such obligations may promote dissemination of technology by reducing the risk of misappropriation of the licensed technology, in particular know-how. If a licensee is entitled to license competing technologies from third parties, there is a risk that particularly licensed know-how would be used in the exploitation of competing technologies and thus benefit competitors. When a licensee also exploits competing technologies, it normally also makes monitoring of royalty payments more difficult, which may act as a disincentive to licensing.

Less restrictive alternatives

202. Second, non-compete obligations possibly in combination with an exclusive territory may be necessary to ensure that the licensee has an incentive to invest in and exploit the licensed technology effectively. In cases where the agreement is caught by Article 81(1) because of an appreciable foreclosure effect, it may be necessary in order to benefit from Article 81(3) to choose a less restrictive alternative, *for instance to impose minimum output or royalty obligations, which normally have less potential to foreclose competing technologies*.

Sunk client specific costs

203. Third, in cases where the licensor undertakes to make significant client specific investments for instance in training and tailoring of the licensed technology to the licensee's needs, non-compete obligations or alternatively minimum output or minimum royalty obligations may be necessary to induce the licensor to make the investment and to avoid hold-up problems. However, normally the licensor will be able to charge directly for such investments by way of a lump sum payment, implying that less restrictive alternatives are available.

3. Settlement and non-assertion agreements

Blocking positions

204. Licensing may serve as a means of settling disputes or avoiding that one party exercises his intellectual property rights to prevent the other party from exploiting his own technology. Licensing including cross licensing in the context of settlement agreements and non-assertion agreements is not as such restrictive of competition since it allows the parties to exploit their technologies post agreement. However, the individual terms and conditions of such agreements may be caught by Article 81(1). Licensing in the context of settlement agreements is treated like other licence agreements. In the case of technologies that from a technical point of view are substitutes, it is therefore necessary to assess to what extent it is likely that the technologies in question are in a one-way or two-way blocking position (cf paragraph 32 above). If so, the parties are not deemed to be competitors.

Block exempted unless hardcore restraints

205. The block exemption applies provided that the agreement does not contain any hardcore restrictions of competition as set out in Article 4 of the TTBER. The

hardcore list of Article 4(1) may in particular apply where it was clear to the parties that no blocking position exists and that consequently they are competitors. In such cases the settlement is merely a means to restrict competition that existed in the absence of the agreement.

'in the absence of the licence'

206. In cases where it is likely that *in the absence of the licence the licensee could be excluded from the market*, the agreement is generally pro-competitive. Restrictions that limit intra-technology competition between the licensor and the licensee are often compatible with Article 81, see section 2 above.

Cross licences

207. Agreements whereby the *parties cross license each other and impose restrictions on the use of their technologies, including restrictions on the licensing to third parties, may be caught by Article 81(1). Where the parties have a significant degree of market power and the agreement imposes restrictions that clearly go beyond what is required in order to unblock*, the agreement is likely to be caught by Article 81(1) even if it is likely that a mutual blocking position exists. Article 81(1) is particularly likely to apply where the parties share markets or fix reciprocal running royalties that have a significant impact on market prices.

Incentive to innovate depends on market power

208. Where under the agreement the parties are entitled to use each other's technology and the agreement extends to future developments, it is necessary to assess what is the impact of the agreement on the parties' incentive to innovate. In cases where the parties have a significant degree of market power the agreement is likely to be caught by Article 81(1) where the agreement prevents the parties from gaining a competitive lead over each other. *Agreements that eliminate or substantially reduce the possibilities of one party to gain a competitive lead over the other reduce the incentive to innovate and thus adversely affect an essential part of the competitive process*. Such agreements are also unlikely to satisfy the conditions of Article 81(3). It is particularly unlikely that the restriction can be considered indispensable within the meaning of the third condition of Article 81(3). The achievement of the objective of the agreement, *namely to ensure that the parties can continue to exploit their own technology without being blocked by the other party, does not require that the parties agree to share future innovations*. However, the parties are unlikely to be prevented from gaining a competitive lead over each other where the purpose of the licence is to allow the parties to develop their respective technologies and where the licence does not lead them to use the same technological solutions. *Such agreements merely create design freedom* by preventing future infringement claims by the other party.

No challenge clauses

209. In the context of a settlement and non-assertion agreement, non-challenge clauses are generally considered to fall outside Article 81(1). It is inherent in such

agreements that the parties agree not to challenge *ex post* the intellectual property rights covered by the agreement. Indeed, the very purpose of the agreement is to settle existing disputes and/or to avoid future disputes.

4. Technology pools

Definition

210. Technology pools are defined as arrangements *whereby two or more parties assemble a package of technology which is licensed not only to contributors to the pool but also to third parties. In terms of their structure technology pools can take the form of simple arrangements between a limited number of parties or elaborate organisational arrangements whereby the organisation of the licensing of the pooled technologies is entrusted to a separate entity*. In both cases the pool may allow licensees to operate on the market on the basis of a single licence.

May cover industry standard

211. There is no inherent link between technology pools and standards, but in some cases the technologies in the pool support (wholly or partly) a *de facto* or *de jure* industry standard. *When technology pools do support an industry standard they do not necessarily support a single standard. Different technology pools may support competing standards*(68).

Only sub-licences by pool may be block exempted

212. Agreements establishing technology pools and setting out the terms and conditions for their operation are *not* – irrespective of the number of parties – *covered by the block exemption* (cf section III.2.2 above). Such agreements are addressed only by these guidelines. *Pooling arrangements give rise to a number of particular issues regarding the selection of the included technologies and the operation of the pool*, which do not arise in the context of other types of licensing. The *individual licences granted by the pool to third party licensees, however, are treated like other licence agreements*, which are block exempted when the conditions set out in the TTBER are fulfilled, including the requirements of Article 4 of the TTBER containing the list of hardcore restrictions.

Anti-competitive effects – cartel – industry standard

213. Technology pools may be restrictive of competition. The creation of a technology pool necessarily implies joint selling of the pooled technologies, which in the case of pools composed solely or predominantly of substitute technologies amounts to a price fixing cartel. Moreover, in addition to reducing competition between the parties, technology pools may also, in particular when they support an industry standard or establish a de facto industry standard, result in a reduction of innovation by foreclosing alternative technologies. The existence of the standard and the related technology pool may make it more difficult for new and improved technologies to enter the market.

Benefits – reduce transaction costs, avoid double marginalisation, one stop licensing

214. Technology pools can also produce pro-competitive effects, in particular by reducing transaction costs and by setting a limit on cumulative royalties to avoid double marginalisation. The creation of a pool allows for one-stop licensing of the technologies covered by the pool. This is particularly important in sectors where intellectual property rights are prevalent and where in order to operate on the market licences need to be obtained from a significant number of licensors. In cases where licensees receive on-going services concerning the application of the licensed technology, joint licensing and servicing can lead to further cost reductions.

4.1. The nature of the pooled technologies

Distinguish technological complements from substitutes and essential from non-essential technologies

215. The competitive risks and the efficiency enhancing potential of technology pools depend to a large extent on the relationship between the pooled technologies and their relationship with technologies outside the pool. Two basic distinctions must be made, namely (a) between technological complements and technological substitutes and (b) between essential and non-essential technologies.

Definitions

216. Two technologies[(69)] are *complements* as opposed to *substitutes* when they are both required to produce the product or carry out the process to which the technologies relate. Conversely, two technologies are substitutes when either technology allows the holder to produce the product or carry out the process to which the technologies relate. A technology is *essential* as opposed to *non-essential* if there are no substitutes for that technology inside or outside the pool and the technology in question constitutes a necessary part of the package of technologies for the purposes of producing the product(s) or carrying out the process(es) to which the pool relates. A technology for which there are no substitutes, remains essential as long as the technology is covered by at least one valid intellectual property right. Technologies that are essential are by necessity also complements.

If substitutes royalties will be increased – if complements, reduced

217. *When technologies in a pool are substitutes, royalties are likely to be higher than they would otherwise be*, because licensees do not benefit from rivalry between the technologies in question. *When the technologies in the pool are complements the arrangement reduces transaction costs and may lead to lower overall royalties* because the parties are in a position to fix a common royalty for the package as opposed to each fixing a royalty which does not take account of the royalty fixed by others.

Technologies may be partly complements and partly substitutes

218. The distinction between complementary and substitute technologies is not clear-cut in all cases, since technologies may be substitutes in part and complements

in part. When due to efficiencies stemming from the integration of two technologies licensees are likely to demand both technologies the technologies are treated as complements even if they are partly substitutable. In such cases it is likely that in the absence of the pool licensees would want to licence both technologies due to the additional economic benefit of employing both technologies as opposed to employing only one of them.

If substitutes, restricts inter-technology competition – collective bundling

219. The inclusion in the pool of substitute technologies restricts inter-technology competition and amounts to collective bundling. Moreover, where the pool is substantially composed of substitute technologies, the arrangement amounts to price fixing between competitors. As a general rule the Commission considers that the inclusion of substitute technologies in the pool constitutes a violation of Article 81(1). The Commission also considers that it is unlikely that the conditions of Article 81(3) will be fulfilled in the case of pools comprising to a significant extent substitute technologies. Given that the technologies in question are alternatives, no transaction cost savings accrue from including both technologies in the pool. In the absence of the pool licensees would not have demanded both technologies. It is not sufficient that the parties remain free to license independently. In order not to undermine the pool, which allows them to jointly exercise market power, the parties are likely to have little incentive to do so.

If all technologies are essential, outside A 81

220. When a pool is composed only of technologies that are essential and therefore by necessity also complements, the creation of the pool as such generally falls outside Article 81(1) irrespective of the market position of the parties. However, the conditions on which licences are granted may be caught by Article 81(1).

Risk of foreclosure if non-essential complements included

221. Where non-essential but complementary patents are included in the pool there is a risk of foreclosure of third party technologies. Once a technology is included in the pool and is licensed as part of the package, licensees are likely to have little incentive to license a competing technology when the royalty paid for the package already covers a substitute technology. Moreover, the inclusion of technologies which are not necessary for the purposes of producing the product(s) or carrying out the process(es) to which the technology pool relates also forces licensees to pay for technology that they may not need. The inclusion of complementary patents thus amounts to collective bundling. When a pool encompasses non-essential technologies, the agreement is likely to be caught by Article 81(1) where the pool has a significant position on any relevant market.

More technologies may be developed

222. Given that substitute and complementary technologies may be developed after the creation of the pool, *the assessment of essentiality is an on-going process*. A technology may therefore become non-essential after the creation of the pool due to

the emergence of new third party technologies. One way to ensure that such third party technologies are not foreclosed is to exclude from the pool technologies that have become non-essential. However, there may be other ways to ensure that third party technologies are not foreclosed. In the assessment of technology pools comprising non-essential technologies, ie technologies for which substitutes exist outside the pool or which are not necessary in order to produce one or more products to which the pool relates, the Commission will in its overall assessment, *inter alia, take account of the following factors*:

(a) whether there are *any pro-competitive reasons for including* the non-essential technologies in the pool;
(b) *whether the licensors remain free to license their respective technologies independently*. Where the pool is composed of a limited number of technologies and there are substitute technologies outside the pool, licensees may want to put together their own technological package composed partly of technology forming part of the pool and partly of technology owned by third parties;
(c) whether, in cases *where the pooled technologies have different applications* some of which do not require use of all of the pooled technologies, the pool offers the technologies only as a single package or whether it offers separate packages for distinct applications. In the latter case it is avoided that technologies which are not essential to a particular product or process are tied to essential technologies;
(d) *whether the pooled technologies are available only as a single package* or whether licensees have the possibility of obtaining a licence for only part of the package with a corresponding reduction of royalties. The possibility to obtain a licence for only part of the package may reduce the risk of foreclosure of third party technologies outside the pool, in particular where the licensee obtains a corresponding reduction in royalties. This requires that a share of the overall royalty has been assigned to each technology in the pool. Where the licence agreements concluded between the pool and individual licensees are of relatively long duration and the pooled technology supports a *de facto* industry standard, it must also be taken into account that the pool may foreclose access to the market of new substitute technologies. In assessing the risk of foreclosure in such cases it is relevant to take into account whether or not licensees can terminate at reasonable notice part of the licence and obtain a corresponding reduction of royalties.

4.2. Assessment of individual restraints

Licensing to create the pool

223. The purpose of this section is to address a certain number of restraints that in one form or another are commonly found in technology pools and which need to be assessed in the overall context of the pool. It is recalled, cf paragraph 212 above, that the TTBER applies to licence agreements concluded between the pool and third party licensees. This section is therefore limited to addressing the creation of the pool and licensing issues that are particular to licensing in the context of technology pools.

Main principles

224. In making its assessment the Commission will be guided by the following main principles:

1. The stronger the market position of the pool the greater the risk of anti-competitive effects.
2. Pools that hold a strong position on the market should be open and non-discriminatory.
3. Pools should not unduly foreclose third party technologies or limit the creation of alternative pools.

Free to fix and negotiate royalties, but not the price of protected products

225. Undertakings setting up a technology pool that is compatible with Article 81, and any industry standard that it may support, are normally free to negotiate and fix royalties for the technology package and each technology's share of the royalties either before or after the standard is set. Such agreement is inherent in the establishment of the standard or pool and cannot in itself be considered restrictive of competition and may in certain circumstances lead to more efficient outcomes. In certain circumstances it may be more efficient if the royalties are agreed before the standard is chosen and not after the standard is decided upon, to avoid that the choice of the standard confers a significant degree of market power on one or more essential technologies. On the other hand, licensees must remain free to determine the price of products produced under the licence. Where the selection of technologies to be included in the pool is carried out by an independent expert this may further competition between available technological solutions.

If pool dominant, royalties should be fair and not discriminatory – licences non-exclusive

226. Where the pool has a dominant position on the market, royalties and other licensing terms should be fair and non-discriminatory and licences should be non-exclusive. These requirements are necessary to ensure that the pool is open and does not lead to foreclosure and other anti-competitive effects on down stream markets. These requirements, however, do not preclude different royalties for different uses. It is in general not considered restrictive of competition to apply different royalty rates to different product markets, whereas there should be no discrimination within product markets. In particular, the treatment of licensees should not depend on whether they are licensors or not. The Commission will therefore take into account whether licensors are also subject to royalty obligations.

All free to develop competing products and grant or obtain licences outside pool to limit risk of foreclosure of other technologies – beware of industry standard and non-compete obligations

227. *Licensors and licensees must be free to develop competing products and standards and must also be free to grant and obtain licences outside the pool*. These requirements are necessary in order to *limit the risk of foreclosure of third party technologies* and ensure that the pool does not limit innovation and preclude the

creation of competing technological solutions. Where a pool supports a (*de facto*) industry standard and where the parties are subject to non-compete obligations, the pool creates a particular risk of preventing the development of new and improved technologies and standards.

Grant back not exclusive nor limited to developments important to pooled technology

228. Grant back obligations should be non-exclusive and be limited to developments that are essential or important to the use of the pooled technology. This allows the pool to feed on and benefit from improvements to the pooled technology. It is legitimate for the parties to ensure that the exploitation of the pooled technology cannot be held up by licensees that hold or obtain essential patents.

Risk of shielding invalid patents

229. One of the problems identified with regard to patent pools is the risk that they shield invalid patents. Pooling raises the costs/risks for a successful challenge, because the challenge fails if only one patent in the pool is valid. The shielding of invalid patents in the pool may oblige licensees to pay higher royalties and may also prevent innovation in the field covered by an invalid patent. In order to limit this risk any right to terminate a licence in the case of a challenge must be limited to the technologies owned by the licensor who is the addressee of the challenge and must not extend to the technologies owned by the other licensors in the pool.

4.3. The institutional framework governing the pool

Way in which pool is created and operated

230. The way in which a technology pool is created, organised and operated can reduce the risk of it having the object or effect of restricting competition and provide assurances to the effect that the arrangement is pro-competitive.

Better if open to all

231. When participation in a standard and pool creation process is open to all interested parties representing different interests it is more likely that technologies for inclusion into the pool are selected on the basis of price/quality considerations than when the pool is set up by a limited group of technology owners. Similarly, when the relevant bodies of the pool are composed of persons representing different interests, it is more likely that licensing terms and conditions, including royalties, will be open and non-discriminatory and reflect the value of the licensed technology than when the pool is controlled by licensor representatives.

Better if independent experts

232. Another relevant factor is the extent to which independent experts are involved in the creation and operation of the pool. For instance, the assessment of whether or not a technology is essential to a standard supported by a pool is often a complex matter that requires special expertise. The involvement in the selection process

of independent experts can go a long way in ensuring that a commitment to include only essential technologies is implemented in practice.

Selection of experts

233. The Commission will take into account how experts are selected and what are the exact functions that they are to perform. *Experts should be independent* from the undertakings that have formed the pool. If experts are connected to the licensors or otherwise depend on them, the involvement of the expert will be given less weight. Experts must also have the *necessary technical expertise* to perform the various functions with which they have been entrusted. The functions of independent experts may include, in particular, an *assessment of whether or not technologies put forward for inclusion into the pool are valid and whether or not they are essential*.

Arrangements for exchanging sensitive information that may facilitate collusion

234. It is also relevant to consider the arrangements for exchanging sensitive information among the parties. In oligopolistic markets exchanges of sensitive information such as pricing and output data may facilitate collusion[(70)]. In such cases the Commission will take into account to what extent safeguards have been put in place, which ensure that sensitive information is not exchanged. An independent expert or licensing body may play an important role in this respect by ensuring that output and sales data, which may be necessary for the purposes of calculating and verifying royalties is not disclosed to undertakings that compete on affected markets.

Dispute resolution mechanisms

235. Finally, it is relevant to take account of the dispute resolution mechanism foreseen in the instruments setting up the pool. The more dispute resolution is entrusted to bodies or persons that are independent of the pool and the members thereof, the more likely it is that the dispute resolution will operate in a neutral way.

(1) OJ L 123, 27.4.2004. The TTBER replaces Commission Regulation (EC) No 240/96 of 31 January 1996 on the application of Article 85(3) of the Treaty to certain categories of technology transfer agreements (OJ L 31, 9.2.1996, p. 2).
(2) See Joined Cases C-395/96 P and C-396/96 P, *Compagnie Maritime Belge*, [2000] ECR I-1365, paragraph 130, and paragraph 106 of the Commission Guidelines on the application of Article 81(3) of the Treaty, not yet published.
(3) Council Regulation (EC) No 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (OJ L 1, 4.1.2003, p. 1).
(4) In the following the term 'agreement' includes concerted practices and decisions of associations of undertakings.
(5) See Commission Notice on the concept of effect on trade between Member States contained in Articles 81 and 82 of the Treaty, not yet published.
(6) In the following the term 'restriction' includes the prevention and distortion of competition.

(7) This principle of Community exhaustion is for example enshrined in Article 7(1) of Directive 104/89/EEC to approximate the laws of the Member States relating to trade marks (OJ L 40, 11.2.1989, p. 1), which provides that the trade mark shall not entitle the proprietor to prohibit its use in relation to goods which have been put on the market in the Community under that trade mark by the proprietor or with his consent.
(8) On the other hand, the sale of copies of a protected work does not lead to the exhaustion of performance rights, including rental rights, in the work, see in this respect Case 158/86, *Warner Brothers and Metronome Video*, [1988] ECR 2605, and Case C-61/97, *Foreningen af danske videogramdistributører*, [1998] ECR I-5171.
(9) See eg Joined Cases 56/64 and 58/64, *Consten and Grundig*, [1966] ECR 429.
(10) The methodology for the application of Article 81(3) is set out in the Commission Guidelines on the application of Article 81(3) of the Treaty cited in note 2.
(11) See Case 56/65, *Société Technique Minière*, [1966] ECR 337, and Case C-7/95 P, John Deere, [1998] ECR I-3111, paragraph 76.
(12) See in this respect eg judgment in *Consten and Grundig* cited in note 9.
(13) See in this respect the judgment in *Société Technique Minière* cited in note 11 and Case 258/78, *Nungesser*, [1982] ECR 2015.
(14) See in this respect eg Case C-49/92 P, *Anic Partecipazioni,* [1999] ECR I-4125, paragraph 99.
(15) See Joined Cases 29/83 and 30/83, *CRAM and Rheinzink*, [1984] ECR 1679, paragraph 26, and Joined Cases 96/82 and others, *ANSEAU-NAVEWA*, [1983] ECR 3369, paragraphs 23–25.
(16) See the judgment in *John Deere*, [1998] cited in note 11.
(17) Guidance on the issue of appreciability can be found in Commission notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty (OJ C 368, 22.12.2001, p. 13). The notice defines appreciability in a negative way. Agreements, which fall outside the scope of the de minimis notice, do not necessarily have appreciable restrictive effects. An individual assessment is required.
(18) See Article 1(2) of Council Regulation No 1/2003 cited in note 3.
(19) Commission notice on the definition of the relevant market for the purposes of Community competition law (OJ C 372, 9.12.1997, p. 5).
(20) As to these distinctions see also Commission Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements (OJ C 3, 6.1.2001, p. 2, paragraphs 44 to 52).
(21) See to that effect paragraphs 50 to 52 of the Guidelines on horizontal cooperation agreements, cited in the previous note.
(22) Idem, paragraph 51.
(23) See in this respect the Notice on agreements of minor importance cited in note 17.
(24) According to Article 3(2) of Regulation 1/2003, agreements which may affect trade between Member States but which are not prohibited by Article 81 cannot be prohibited by national competition law.
(25) Under Council Regulation 19/65, OJ Special Edition Series I 1965–1966, p. 35, the Commission is not empowered to block exempt technology transfer agreements concluded between more than two undertakings.
(26) See recital 19 of the TTBER and further section 2.5 below.

(27) OJ C 1, 3.1.1979, p. 2.
(28) See paragraph 3 of the subcontracting notice.
(29) See in this respect Commission Decision in *Moosehead/Whitbread* (OJ L 100, 20.4.1990, p. 32).
(30) See in this respect Case 262/81, *Coditel (II)*, [1982] ECR 3381.
(31) OJ L 336, 29.12.1999, p. 21.
(32) OJ L 304, 5.12.2000, p. 3.
(33) OJ L 304, 5.12.2000, p. 7.
(34) See note 31.
(35) See the guide 'Competition policy in Europe – The competition rules for supply and distribution agreements', 2002.
(36) OJ C 291, 13.10.2000, p. 1, and note 31.
(37) See paragraph 29 above.
(38) The reasons for this calculation rule are explained in paragraph 23 above.
(39) See eg the case law cited in note 15.
(40) See in this respect paragraph 98 of the Guidelines on the application of Article 81(3) of the Treaty cited in note 2.
(41) This is also the case where one party grants a licence to the other party and accepts to buy a physical input from the licensee. The purchase price can serve the same function as the royalty.
(42) See in this respect Case 193/83, *Windsurfing International*, [1986] ECR 611, paragraph 67.
(43) For a general definition of active and passive sales, reference is made to paragraph 50 of the Guidelines on vertical restraints cited in note 36.
(44) Field of use restrictions are further dealt with in section IV.2.4 below.
(45) This hardcore restriction applies to licence agreements concerning trade within the Community. As regards agreements concerning exports outside the Community or imports/re-imports from outside the Community see Case C-306/96, *Javico*, [1998] ECR I-1983.
(46) See in this respect paragraph 77 of the judgment in *Nungesser* cited in note 13.
(47) See in this respect Case 26/76, *Metro (I)*, [1977] ECR 1875.
(48) If the licensed technology is outdated no restriction of competition arises, see in this respect Case 65/86, *Bayer v Süllhofer*, [1988] ECR 5249.
(49) As to non-challenge clauses in the context of settlement agreements see point 209 below.
(50) See paragraph 14 above.
(51) See paragraphs 66 and 67 above.
(52) See in this respect paragraph 42 of the Guidelines on the application of Article 81(3) of the Treaty, cited in note 2.
(53) See in this respect paragraph 8 of the Commission Notice on agreements of minor importance, cited in note 17.
(54) See in this respect Case T-228/97, *Irish Sugar*, [1999] ECR II-2969, paragraph 101.
(55) See in this respect paragraph 23 of the Guidelines on horizontal cooperation agreements, cited in note 20.
(56) See Joined Cases 25/84 and 26/84, *Ford*, [1985] ECR 2725.
(57) See in this respect for example Commission Decision in TPS (OJ L 90, 2.4.1999, p. 6). Similarly, the prohibition of Article 81(1) also only applies as long as the agreement has a restrictive object or restrictive effects.

(58) Cited in note 36. See in particular paragraphs 115 et seq.
(59) As to these concepts see section IV.4.1 below.
(60) See paragraph 85 of the Guidelines on the application of Article 81(3) of the Treaty, cited in note 2.
(61) Idem, paragraphs 98 and 102.
(62) See paragraph 130 of the judgment cited in note 2. Similarly, the application of Article 81(3) does not prevent the application of the Treaty rules on the free movement of goods, services, persons and capital. These provisions are in certain circumstances applicable to agreements, decisions and concerted practices within the meaning of Article 81(1), see to that effect Case C-309/99, *Wouters*, [2002] ECR I-1577, paragraph 120.
(63) See in this respect Case T-51/89, *Tetra Pak (I)*, [1990] ECR II-309. See also paragraph 106 of the Guidelines on the application of Article 81(3) of the Treaty cited in note 2 above.
(64) See the judgment in *Nungesser* cited in note 13.
(65) See in this respect the Commission's Notice in the *Canon/Kodak* Case (OJ C 330, 1.11.1997, p. 10) and the *IGR Stereo Television* Case mentioned in the XI Report on Competition Policy, paragraph 94.
(66) For the applicable analytical framework see section 2.7 below and paragraphs 138 et seq. of the Guidelines on Vertical Restraints cited in note 36.
(67) See note 36.
(68) See in this respect the Commission's press release IP/02/1651 concerning the licensing of patents for third generation (3G) mobile services. This case involved five technology pools creating five different technologies, each of which could be used to produce 3G equipment.
(69) The term 'technology' is not limited to patents. It covers also patent applications and intellectual property rights other than patents.
(70) See in this respect the judgment in *John Deere* cited in note 11.

Appendix 5

Guidelines on the Application of Article 81(3) of the Treaty, 2004/C 101/08

Headings to most of the individual guidelines have been added by Valentine Korah (centered and in italics) and key words within the guidelines have been italicised to make it easier for the reader to navigate through the text.

1. INTRODUCTION

A 81(3) excepts from A 81(1) – direct effect

1. Article 81(3) of the Treaty sets out an exception rule, which provides a defence to undertakings against a finding of an infringement of Article 81(1) of the Treaty. Agreements, decisions of associations of undertakings and concerted practices[1] caught by Article 81(1) which satisfy the conditions of Article 81(3) are valid and enforceable, no prior decision to that effect being required.

Individual or group exemptions

2. Article 81(3) can be applied in *individual cases* or to *categories of agreements* and concerted practices by way of block exemption regulation. Regulation 1/2003 on the implementation of the competition rules laid down in Articles 81 and 82[2] does not affect the validity and legal nature of block exemption regulations. All existing block exemption regulations remain in force and agreements covered by block exemption regulations are *legally valid and enforceable even if they are restrictive* of competition within the meaning of Article 81(1)[3]. Such agreements can only be prohibited for the future and only upon formal withdrawal of the block exemption by the Commission or a national competition authority[4]. Block

[1] In the following the term '*agreement*' includes concerted practices and decisions of associations of undertakings.

[2] OJ 2003 L 1, p. 1.

[3] All existing block exemption regulations and Commission notices are available on the DG Competition web site: http://www.europa.eu.int/comm/dgs/competition.

[4] See paragraph 36 below.

exempted agreements cannot be held invalid by national courts in the context of private litigation.

Other guidelines

3. The existing guidelines on *vertical restraints*, *horizontal cooperation* agreements and *technology transfer agreements*[5] deal with the application of Article 81 to various types of agreements and concerted practices. The purpose of those guidelines is to set out the Commission's view of the substantive assessment criteria applied to the various types of agreements and practices.

Do not bind NCAs or courts

4. The present guidelines set out the Commission's interpretation of the conditions for exception contained in Article 81(3). It thereby provides guidance on how it will apply Article 81 in individual cases. Although not binding on them, these guidelines also intend to give guidance to the courts and authorities of the Member States in their application of Article 81(1) and (3) of the Treaty.

Analytical framework

5. The guidelines establish an analytical framework for the application of Article 81(3). The purpose is to develop a methodology for the application of this Treaty provision. This methodology is based on the economic approach already introduced and developed in the guidelines on vertical restraints, horizontal co-operation agreements and technology transfer agreements. The Commission will follow the present guidelines, which provide *more detailed guidance on the application of the four conditions of Article 81(3)* than the guidelines on vertical restraints, horizontal co-operation agreements and technology transfer agreements, also with regard to agreements covered by those guidelines.

No mechanical application

6. The standards set forth in the present guidelines must be applied in light of the circumstances specific to each case. This excludes a mechanical application. Each case must be assessed on its own facts and the guidelines must be applied reasonably and flexibly.

Current case law and Commission policy

7. With regard to a number of issues, the present guidelines outline the current state of the case law of the Court of Justice. However, the Commission also intends to explain its policy with regard to issues that have not been dealt with in the case law,

[5] See Commission Notice on Guidelines on vertical restraints, OJ 2000 C 291, page 1, Commission Notice on Guidelines on the application of Article 81 of the Treaty to horizontal cooperation agreements, OJ 2001 C 3, page 2, and Commission Notice on Guidelines on the application of Article 81 of the Treaty to technology transfer agreements, not yet published.

or that are subject to interpretation. The Commission's position, however, is *without prejudice to the case law of the Court of Justice and the Court of First Instance* concerning the interpretation of Article 81(1) and (3), and to the interpretation that the Community Courts may give to those provisions in the future.

2. THE GENERAL FRAMEWORK OF ARTICLE 81 EC

2.1 The Treaty provisions

A 81(1)

8. Article 81(1) *prohibits* all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States[6] and which have as their object or effect the prevention, restriction or distortion of competition[7].

A 81(3)

9. As an *exception* to this rule Article 81(3) provides that the prohibition contained in Article 81(1) may be declared inapplicable in case of agreements which contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefits, and which do not impose restrictions which are not indispensable to the attainment of these objectives, and do not afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products concerned.

Direct effect of A 81

10. According to Article 1(1) of Regulation 1/2003 agreements which are caught by Article 81(1) and which do not satisfy the conditions of Article 81(3) are prohibited, no prior decision to that effect being required[8]. According to Article 1(2) of the same Regulation agreements which are caught by Article 81(1) but which satisfy the conditions of Article 81(3) are not prohibited, no prior decision to that effect being required. Such agreements are valid and enforceable from the moment that the conditions of Article 81(3) are satisfied and for as long as that remains the case.

Balancing performed only under A 81(3)

11. The assessment under Article 81 thus *consists of two parts*. The first step is to assess whether an agreement between undertakings, which is capable of affecting

[6] The concept of effect on trade between Member States is dealt with in separate guidelines.
[7] In the following the term 'restriction' includes the prevention and distortion of competition.
[8] According to Article 81(2) such agreements are automatically void.

trade between Member States, has an anti-competitive object or actual or potential[9] anti-competitive effects. The second step, which only becomes relevant when an agreement is found to be restrictive of competition, is to determine the pro-competitive benefits produced by that agreement and to assess whether these pro-competitive effects outweigh the anti-competitive effects. The balancing of anti-competitive and pro-competitive effects is conducted exclusively within the framework laid down by Article 81(3)[10].

See whether agreement infringes A 81(1) before applying A 81(3)
Other guidelines

12. The assessment of any countervailing benefits under Article 81(3) necessarily requires *prior determination of the restrictive nature and impact of the agreement*. To place Article 81(3) in its proper context it is appropriate to briefly outline the objective and principal content of the prohibition rule of Article 81(1). The Commission guidelines on vertical restraints, horizontal co-operation agreements and technology transfer agreements[11] contain substantial guidance on the application of Article 81(1) to various types of agreements. The present guidelines are therefore limited to recalling the basic analytical framework for applying Article 81(1).

2.2 The prohibition rule of Article 81(1)

2.2.1 General remarks

Consumer welfare and efficient allocation

13. The objective of Article 81 is to protect competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources. Competition and market integration serve these ends since the creation and preservation of an open single market promotes an efficient allocation of resources throughout the Community for the benefit of consumers.

Collusion – R 1/2003, A 3 – primacy of Community law
(citations are to cartel cases)

14. The prohibition rule of Article 81(1) applies to restrictive agreements and concerted practices between undertakings and decisions by associations of undertakings in so far as they are capable of affecting trade between Member States. A general

[9] Article 81(1) prohibits both actual and potential anti-competitive effects, see e.g. Case C-7/95 P, John Deere, [1998] ECR I-3111, paragraph 77.

[10] See Case T-65/98, *Van den Bergh* Foods, [2003] ECR II-, paragraph 107 and Case T-112/99, *Métropole télévision (M6) and others*, [2001] ECR II-2459, paragraph 74, where the Court of First Instance held that it is only in the precise framework of Article 81(3) that the pro- and anti-competitive aspects of a restriction may be weighed.

[11] See note 5 above.

principle underlying Article 81(1) which is expressed in the case law of the Community Courts is that *each economic operator must determine independently the policy, which he intends to adopt on the market*[12]. In view of this the Community Courts have defined *'agreements', 'decisions' and 'concerted practices' as Community law concepts* which allow a *distinction to be made between the unilateral conduct of an undertaking and co-ordination of behaviour or collusion between undertakings*[13]. Unilateral conduct is subject only to Article 82 of the Treaty as far as Community competition law is concerned. Moreover, the convergence rule set out in Article 3(2) of Regulation 1/2003 does not apply to unilateral conduct. This provision applies only to agreements, decisions and concerted practices, which are *capable of affecting trade between Member States*. Article 3(2) provides that when such agreements, decisions and concerted practices are not prohibited by Article 81, they cannot be prohibited by national competition law. Article 3 is without prejudice to the fundamental principle of *primacy of Community law w*hich entails in particular that agreements and abusive practices that are prohibited Articles 81 and 82 cannot be upheld by national law.[14]

A 81(1) applies to coordination that substantially reduces uncertainty – actual or tacit collusion.

15. The type of co-ordination of behaviour or collusion between undertakings falling within the scope of Article 81(1) is that where at least one undertaking vis-à-vis another undertaking undertakes to adopt a certain conduct on the market or that as a result of contacts between them *uncertainty as to their conduct on the market is eliminated or at least substantially reduced*[15]. It follows that co-ordination can take the form of obligations that regulate the market conduct of at least one of the parties as well as of arrangements that influence the market conduct of at least one of the parties by causing a change in its incentives. It is not required that co-ordination is in the interest of all the undertakings concerned[16]. Co-ordination must also not necessarily be express. *It can also be tacit.* For an agreement to be capable of being regarded as having been concluded by tacit acceptance there must be an invitation from an undertaking to another undertaking, whether express or implied, to fulfil a goal jointly[17]. In certain circumstances an agreement may be inferred from and imputed to an ongoing commercial relationship between the parties[18]. However,

[12] See e.g. Case C-49/92 P, *Anic Partecipazioni*, [1999] ECR I-4125, paragraph 116; and Joined Cases 40/73 to 48/73 and others, *Suiker Unie*, [1975] ECR page 1663, paragraph 173.

[13] See in this respect paragraph 108 of the judgment in *Anic Partecipazioni* cited in the previous note and Case C-277/87, *Sandoz Prodotti*, [1990] ECR I-45.

[14] See in this respect e.g. Case 14/68 *Walt Wilhelm* [1969] ECR 1, and more recently Case T-203/01 *Michelin (II)* ..., paragraph 112.

[15] See Joined Cases T-25/95 and others, *Cimenteries CBR*, [2000] ECR II-491, paragraphs 1849 and 1852; and Joined Cases T-202/98 and others, *British Sugar*, [2001] ECR II-2035, paragraphs 58 to 60.

[16] See to that effect Case C-453/99, *Courage v Crehan*, [2001] ECR I-6297, and paragraph 3444 of the judgment in *Cimenteries CBR* cited in the previous note.

[17] See in this respect Joined Cases C-2/01 P and C-3/01 P, *Bundesverband der Arzneimittel-Importeure*, [2004] ECR I-, paragraph 102.

[18] See e.g. Joined Cases 25/84 and 26/84, *Ford*, [1985] ECR 2725.

the mere fact that a measure adopted by an undertaking falls within the context of on-going business relations is not sufficient[19].

Appreciable

16. Agreements between undertakings are caught by the prohibition rule of Article 81(1) when they are *likely to have an appreciable adverse impact* on the parameters of competition on the market, *such as price, output, product quality, product variety and innovation*. Agreements can have this effect by appreciably reducing rivalry between the parties to the agreement or between them and third parties.

2.2.2 The basic principles for assessing agreements under Article 81(1)

Appraisal ex ante – inter- and intra-brand competition

17. The assessment of whether an agreement is restrictive of competition must be made *within the actual context in which competition would occur in the absence of the agreement with its alleged restrictions*[20]. In making this assessment it is necessary to take account of the likely impact of the agreement on *inter-brand competition* (i.e. competition between suppliers of competing brands) and on *intra-brand competition* (i.e. competition between distributors of the same brand). Article 81(1) prohibits restrictions of both inter-brand competition and intra-brand competition[21].

Inter- or intra-brand competition

18. For the purpose of assessing whether an agreement or its individual parts may restrict inter-brand competition and/or intra-brand competition it needs to be considered how and to what extent the agreement affects or is likely to affect competition on the market. The following two questions provide a useful framework for making this assessment. The *first question* relates to the impact of the agreement on *inter-brand competition* while the *second question* relates to the impact of the agreement on *intra-brand competition*. As restraints may be capable of affecting both inter-brand competition and intra-brand competition at the same time, it may be necessary to analyse a restraint in light of both questions before it can be concluded whether or not competition is restricted within the meaning of Article 81(1):

Compare hypothetical competition in absence of agreement

(1) Does the agreement restrict actual or potential competition that would have existed without the agreement? If so, the agreement may be caught by Article 81(1). In making this assessment it is necessary to take into account competition

[19] See in this respect paragraph 141 of the judgment in *Bundesverband der Arzneimittel-Importeure* cited in note 17.

[20] See Case 56/65, *Société Technique Minière*, [1966] ECR 337, and paragraph 76 of the judgment in *John Deere*, cited in note 9.

[21] See in this respect e.g. Joined Cases 56/64 and 58/66, *Consten and Grundig*, [1966] ECR 429.

between the parties and competition from third parties. For instance, where two undertakings established in different Member States undertake not to sell products in each other's home markets, (potential) competition that existed prior to the agreement is restricted. Similarly, where a supplier imposes obligations on his distributors not to sell competing products and these obligations foreclose third party access to the market, actual or potential competition that would have existed in the absence of the agreement is restricted. In assessing whether the parties to an agreement are actual or potential competitors the economic and legal context must be taken into account. For instance, if due to the financial risks involved and the technical capabilities of the parties it is unlikely on the basis of objective factors that each party would be able to carry out on its own the activities covered by the agreement the parties are deemed to be non-competitors in respect of that activity[22]. It is for the parties to bring forward evidence to that effect.

Ancillary restraints

(2) Does the agreement restrict actual or potential competition that would have existed in the absence of the contractual restraint(s)? If so, the agreement may be caught by Article 81(1). For instance, where a supplier restricts its distributors from competing with each other, (potential) competition that could have existed between the distributors absent the restraints is restricted. Such restrictions include resale price maintenance and territorial or customer sales restrictions between distributors. However, certain restraints may in certain cases not be caught by Article 81(1) when the restraint is objectively necessary for the existence of an agreement of that type or that nature[23]. Such exclusion of the application of Article 81(1) can only be made on the basis of objective factors external to the parties themselves and not the subjective views and characteristics of the parties. The question is not whether the parties in their particular situation would not have accepted to conclude a less restrictive agreement, but whether given the nature of the agreement and the characteristics of the market a less restrictive agreement would not have been concluded by undertakings in a similar setting. For instance, territorial restraints in an agreement between a supplier and a distributor may for a certain period of time fall outside Article 81(1), if the restraints are objectively necessary in order for the distributor to penetrate a new market[24]. Similarly, a prohibition imposed on all distributors not to sell to certain categories of end users may not be restrictive of competition if such restraint is objectively necessary for reasons of safety or health related to the dangerous nature of the product in question. Claims that in the

[22] See in this respect e.g. Commission Decision in *Elopak/Metal Box – Odin*, OJ 1990 L 209, p. 15, and in *TPS*, OJ 1999 L 90, p. 6.

[23] See in this respect the judgment in *Société Technique Minière* cited in note 20 and Case 258/78, *Nungesser*, [1982] ECR 2015.

[24] See rule 10 in paragraph 119 of the Guidelines on vertical restraints cited in note 5 above, according to which *inter alia* passive sales restrictions – a hardcore restraint – are held to fall outside Article 81(1) for a period of 2 years when the restraint is linked to opening up new product or geographic markets.

absence of a restraint the supplier would have resorted to vertical integration are not sufficient. Decisions on whether or not to vertically integrate depend on a broad range of complex economic factors, a number of which are internal to the undertaking concerned.

Restrictions by object or by effect

19. In the application of the analytical framework set out in the previous paragraph it must be taken into account that Article 81(1) distinguishes between those agreements that have a restriction of competition as their object and those agreements that have a restriction of competition as their effect. An agreement or contractual restraint is only prohibited by Article 81(1) if its object or effect is to restrict inter-brand competition and/or intra-brand competition.

Distinction does not apply to A 81(3)

20. *The distinction between restrictions by object and restrictions by effect is important. Once it has been established that an agreement has as its object the restriction of competition, there is no need to take account of its concrete effects*[25]. In other words, for the purpose of applying Article 81(1) no actual anti-competitive effects need to be demonstrated where the agreement has a restriction of competition as its object. *Article 81(3), on the other hand, does not distinguish between agreements that restrict competition by object and agreements that restrict competition by effect*. Article 81(3) applies to all agreements that fulfil the four conditions contained therein[26].

Restrictions by object

21. Restrictions of competition *by object* are those that *by their very nature* have the potential of restricting competition. These are restrictions which in light of the objectives pursued by the Community competition rules have *such a high potential of negative effects on competition* that it is unnecessary for the purposes of applying Article 81(1) to demonstrate any actual effects on the market. This presumption is based on the serious nature of the restriction and on experience showing that restrictions of competition by object are likely to produce negative effects on the market and to jeopardise the objectives pursued by the Community competition rules. Restrictions by object *such as price fixing and market sharing reduce output and raise prices, leading to a misallocation of resources, because goods and services demanded by customers are not produced. They also lead to a reduction in consumer welfare,* because consumers have to pay higher prices for the goods and services in question.

Criteria to determine whether object anti-competitive

22. The assessment of whether or not an agreement has as its object the restriction of competition is based on a number of factors. *These factors include*, in particular,

[25] See e.g. paragraph 99 of the judgment in *Anic Partecipazioni* cited in note 12.
[26] See paragraph 46 below.

the *content of the agreement and the objective aims* pursued by it. It may also be necessary to consider *the context* in which it is (to be) applied and the *actual conduct and behaviour of the parties on the market*[27]. In other words, an examination of the facts underlying the agreement and the specific circumstances in which it operates may be required before it can be concluded whether a particular restriction constitutes a restriction of competition by object. The way in which an agreement is actually implemented may reveal a restriction by object even where the formal agreement does not contain an express provision to that effect. Evidence of *subjective intent* on the part of the parties to restrict competition is a *relevant factor but not a necessary condition.*

Hardcore restraints in block exemptions and notices

23. Non-exhaustive guidance on what constitutes restrictions by object can be found in Commission block exemption regulations, guidelines and notices. Restrictions that are black listed in block exemptions or identified as hardcore restrictions in guidelines and notices are generally considered by the Commission to constitute restrictions by object. In the case of *horizontal agreements* restrictions of competition by object include price fixing, output limitation and sharing of markets and customers[28]. As regards *vertical agreements* the category of restrictions by object includes, in particular, fixed and minimum resale price maintenance and restrictions providing absolute territorial protection, including restrictions on passive sales[29].

Restrictions by effect – appreciable

24. If an agreement is not restrictive of competition by object it must be examined whether it has *restrictive effects* on competition. Account must be taken of both *actual and potential effects*[30]. In other words the agreement must have likely anti-competitive effects. In the case of restrictions of competition by effect there is no presumption of anti-competitive effects. For an agreement to be restrictive by effect it must affect actual or potential competition to such an extent that on the relevant market negative effects on prices, output, innovation or the variety or quality of goods and services can be expected with a reasonable degree of probability[31]. Such

[27] See Joined Cases 29/83 and 30/83, *CRAM and Rheinzink*, [1984] ECR 1679, paragraph 26, and Joined Cases 96/82 and others, *ANSEAU-NAVEWA*, [1983] ECR 3369, paragraphs 23–25.

[28] See the Guidelines on horizontal cooperation agreements, cited in note 5, paragraph 25, and Article 5 of Commission Regulation 2658/2000 on the application of Article 81(3) of the Treaty to categories of specialisation agreements, OJ 2000 L 304, p. 3.

[29] See Article 4 Commission Regulation 2790/1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ 1999 L 336, p. 21, and the Guidelines on Vertical Restraints, cited in note 5, paragraph 46 *et seq*. See also Case 279/87, *Tipp-Ex*, [1990] ECR I-261, and Case T-62/98, *Volkswagen v Commission*, [2000] ECR II-2707, paragraph 178.

[30] See paragraph 77 of the judgment in *John Deere* cited in note 9.

[31] It is not sufficient in itself that the agreement restricts the freedom of action of one or more of the parties, see paragraphs 76 and 77 of the judgment in *Métropole television (M6)* cited in note 10. This is in line with the fact that the object of Article 81 is to protect competition on the market for the benefit of consumers.

negative effects must be *appreciable*. The prohibition rule of Article 81(1) does not apply when the identified anti-competitive effects are insignificant[32]. This test reflects the economic approach which the Commission is applying. The prohibition of Article 81(1) only applies where on the basis of proper market analysis it can be concluded that the agreement has likely anti-competitive effects on the market[33]. It is insufficient for such a finding that the market shares of the parties exceed the thresholds set out in the Commission's *de minimis* notice[34]. Agreements falling within safe harbours of block exemption regulations may be caught by Article 81(1) but this is not necessarily so. Moreover, the fact that due to the market shares of the parties, an agreement falls outside the safe harbour of a block exemption is in itself an insufficient basis for finding that the agreement is caught by Article 81(1) or that it does not fulfil the conditions of Article 81(3). Individual assessment of the likely effects produced by the agreement is required.

Market power

25. Negative effects on competition within the relevant market are likely to occur when the parties individually or jointly have or obtain *some degree of market power and the agreement contributes to the creation, maintenance or strengthening of that market power or allows the parties to exploit such market power. Market power is the ability to maintain prices above competitive levels for a significant period of time or to maintain output in terms of product quantities, product quality and variety or innovation below competitive levels for a significant period of time. In markets with high fixed costs undertakings must price significantly above their marginal costs of production in order to ensure a competitive return on their investment.* The fact that undertakings price above their marginal costs is therefore not in itself a sign that competition in the market is not functioning well and that undertakings have market power that allows them to price above the competitive level. It is when competitive constraints are insufficient to maintain prices and output at competitive levels that undertakings have market power within the meaning of Article 81(1).

26. *The creation, maintenance or strengthening of market power can result from a restriction of competition between the parties to the agreement*. It can also result from a restriction of competition between any one of the parties and third parties, e.g. because the agreement leads to *foreclosure of competitors or because it raises competitors' costs,* limiting their capacity to compete effectively with the contracting parties. Market power is a *question of degree*. The degree of market power normally required for the finding of an infringement under Article 81(1) in the case of agreements that are restrictive of competition by effect is less than the degree of market power required for a finding of dominance under Article 82.

[32] See e.g. Case 5/69, Völk, [1969] ECR 295, paragraph 7. Guidance on the issue of appreciability can be found in the Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty, OJ 2001 C, 368, page 13. The notice defines appreciability in a negative way. Agreements, which fall outside the scope of the *de minimis* notice, do not necessarily have appreciable restrictive effects. An individual assessment is required.

[33] See in this respect Joined Cases T-374/94 and others, *European Night Services,* [1998] ECR II-3141.

[34] See note 32.

Appraise and define the market

27. For the purposes of analysing the restrictive effects of an agreement it is normally necessary to define the relevant market[35]. It is normally also necessary to examine and assess, *inter alia*, the nature of the products, the market position of the parties, the market position of competitors, the market position of buyers, the existence of potential competitors and the level of entry barriers. In some cases, however, it may be possible to show anti-competitive effects directly by analysing the conduct of the parties to the agreement on the market. It may for example be possible to ascertain that an agreement has led to price increases. The guidelines on horizontal cooperation agreements and on vertical restraints set out a detailed framework for analysing the competitive impact of various types of horizontal and vertical agreements under Article 81(1)[36].

2.2.3 Ancillary restraints

28. Paragraph 18 above sets out a framework for analysing the impact of an agreement and its individual restrictions on inter-brand competition and intra-brand competition. If on the basis of those principles it is concluded that the main transaction covered by the agreement is not restrictive of competition, it becomes relevant to examine whether individual restraints contained in the agreement are also compatible with Article 81(1) because they are ancillary to the main non-restrictive transaction.

Directly related and necessary to main non-restrictive transaction

29. In Community competition law the concept of *ancillary restraints covers any alleged restriction of competition which is directly related and necessary* to the implementation of a main non-restrictive transaction and proportionate to it[37]. If an agreement in its main parts, for instance a distribution agreement or a joint venture, does not have as its object or effect the restriction of competition, then restrictions, which are directly related to and necessary for the implementation of that transaction, also fall outside Article 81(1)[38]. These related restrictions are called ancillary restraints. *A restriction is directly related to the main transaction if it is subordinate to the implementation of that transaction and is inseparably linked to it.* The test of necessity implies that the restriction must be *objectively necessary* for the implementation of the main transaction and be *proportionate* to it. It follows that the ancillary restraints test is similar to the test set out in paragraph 18(2) above. However, the *ancillary restraints test applies in all cases where the main transaction is not restrictive of competition*[39]. It is not limited to determining the impact of the agreement on intra-brand competition.

[35] See in this respect Commission notice on the definition of the relevant market for the purposes of Community competition law, OJ 1997 C 372, page 1.

[36] For the reference in the OJ see note 5.

[37] See paragraph 104 of the judgment in *Métropole télévision (M6) and others*, cited in note 10.

[38] See e.g. Case C-399/93, *Luttikhuis*, [1995] ECR I-4515, paragraphs 12 to 14.

[39] see in this respect paragraphs 118 et seq. of the *Métropole television* judgment cited in note 10.

Distinguish A 81(3) from ancillary restraints

30. The application of the ancillary restraint concept must be distinguished from the application of the defence under Article 81(3) which relates to certain economic benefits produced by restrictive agreements and which are balanced against the restrictive effects of the agreements. The application of the ancillary restraint concept does not involve any weighing of pro-competitive and anti-competitive effects. Such balancing is reserved for Article 81(3)[40].

31. The assessment of ancillary restraints is limited to determining whether, in the specific context of the main non-restrictive transaction or activity, a particular restriction is necessary for the implementation of that transaction or activity and proportionate to it. If on the basis of objective factors it can be concluded that without the restriction the main non-restrictive transaction would be difficult or impossible to implement, the restriction may be regarded *as objectively necessary for its implementation and proportionate to it*[41]. If, for example, the main object of a franchise agreement does not restrict competition, then restrictions, which are necessary for the proper functioning of the agreement, such as obligations aimed at protecting the uniformity and reputation of the franchise system, also fall outside Article 81(1)[42]. Similarly, if a joint venture is not in itself restrictive of competition, then restrictions that are necessary for the functioning of the agreement are deemed to be ancillary to the main transaction and are therefore not caught by Article 81(1). For instance in *TPS*[43] the Commission concluded that an obligation on the parties not to be involved in companies engaged in distribution and marketing of television programmes by satellite was ancillary to the creation of the joint venture during the initial phase. The restriction was therefore deemed to fall outside Article 81(1) for a period of three years. In arriving at this conclusion the Commission took account of the heavy investments and commercial risks involved in entering the market for pay-television.

2.3 The exception rule of Article 81(3)

32. The assessment of restrictions by object and effect under Article 81(1) is only one side of the analysis. The other side, which is reflected in Article 81(3), is the assessment of the positive economic effects of restrictive agreements.

Aim of competition rules

33. The aim of the Community competition rules is to protect competition on the market as a means of *enhancing consumer welfare and of ensuring an efficient allocation of resources*. Agreements that restrict competition may at the same time have pro-competitive effects by way of efficiency gains[44]. *Efficiencies* may create

[40] See paragraph 107 of the judgment in Métropole télévision cited in note 10.
[41] See e.g. Commission Decision in *Elopak/Metal Box* – Odin cited in note 22.
[42] See Case 161/84, Pronuptia, [1986] ECR 353.
[43] See note 22. The decision was upheld by the Court of First Instance in the judgment in *Métropole télévision* (M6) cited in note 10.
[44] Cost savings and other gains to the parties that arise from the mere exercise of market power do not give rise to objective benefits and cannot be taken into account, cf. paragraph 49 below.

additional value by lowering the cost of producing an output, improving the quality of the product or creating a new product. When the pro-competitive effects of an agreement outweigh its anti-competitive effects the agreement is on balance pro-competitive and compatible with the objectives of the Community competition rules. The net effect of such agreements is to promote the very essence of the competitive process, namely to win customers by offering better products or better prices than those offered by rivals. This analytical framework is reflected in Article 81(1) and Article 81(3). The latter provision expressly acknowledges that restrictive agreements may generate objective economic benefits so as to outweigh the negative effects of the restriction of competition[45].

4 conditions

34. The application of the exception rule of Article 81(3) is subject to four cumulative conditions, two positive and two negative:

(a) The agreement must contribute to improving the production or distribution of goods or contribute to promoting technical or economic progress,
(b) Consumers must receive a fair share of the resulting benefits,
(c) The restrictions must be indispensable to the attainment of these objectives, and finally
(d) The agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of the products in question.

When these four conditions are fulfilled the agreement enhances competition within the relevant market, because it leads the undertakings concerned to offer cheaper or better products to consumers, compensating the latter for the adverse effects of the restrictions of competition.

Individual agreements or block exemptions

35. Article 81(3) can be applied either to individual agreements or to categories of agreements by way of a block exemption regulation. When an agreement is covered by a block exemption the parties to the restrictive agreement are relieved of their burden under Article 2 of Regulation 1/2003 of showing that their individual agreement satisfies each of the conditions of Article 81(3). They only have to prove that the restrictive agreement benefits from a block exemption. The application of Article 81(3) to categories of agreements by way of block exemption regulation is based on the presumption that restrictive agreements that fall within their scope[46] fulfil each of the four conditions laid down in Article 81(3).

Block exemption may be withdrawn by Commission or NCA

36. If *in an individual case* the agreement is caught by Article 81(1) and the conditions of Article 81(3) are not fulfilled the *block exemption may be withdrawn*. According to Article 29(1) of Regulation 1/2003 the Commission is empowered to withdraw the benefit of a block exemption when it finds that in a particular case an agreement

[45] See the judgment in *Consten and Grundig*, cited in note 21.

[46] The fact that an agreement is block exempted does not in itself indicate that the individual agreement is caught by Article 81(1).

covered by a block exemption regulation has certain effects which are incompatible with Article 81(3) of the Treaty. Pursuant to Article 29(2) of Regulation 1/2003 a competition authority of a Member State may also withdraw the benefit of a Commission block exemption regulation in respect of its territory (or part of its territory), if this territory has all the characteristics of a distinct geographic market. In the case of withdrawal it is for the competition authorities concerned to demonstrate that the agreement infringes Article 81(1) and that it does not fulfil the conditions of Article 81(3).

Not by a court

37. The courts of the Member States have no power to withdraw the benefit of block exemption regulations. Moreover, in their application of block exemption regulations Member State courts may not modify their scope by extending their sphere of application to agreements not covered by the block exemption regulation in question[47]. Outside the scope of block exemption regulations Member State courts have the power to apply Article 81 in full (cf. Article 6 of Regulation 1/2003).

3. THE APPLICATION OF THE FOUR CONDITIONS OF ARTICLE 81(3)

4 conditions cumulative

38. The remainder of these guidelines will consider each of the four conditions of Article 81(3)[48]. Given that these four conditions are cumulative[49] it is unnecessary to examine any remaining conditions once it is found that one of the conditions of Article 81(3) is not fulfilled. In individual cases it may therefore be appropriate to consider the four conditions in a different order.

39. For the purposes of these guidelines it is considered appropriate to invert the order of the second and the third condition and thus deal with the issue of indispensability before the issue of pass-on to consumers. The analysis of pass-on requires a balancing of the negative and positive effects of an agreement on consumers. This analysis should not include the effects of any restrictions, which already fail the indispensability test and which for that reason are prohibited by Article 81.

3.1 General principles

Relevant only if A 81(1) infringed

40. Article 81(3) of the Treaty only becomes relevant when an agreement between undertakings restricts competition within the meaning of Article 81(1). In the case of non-restrictive agreements there is no need to examine any benefits generated by the agreement.

[47] See e.g. Case C-234/89, *Delimitis*, [1991] ECR I-935, paragraph 46.

[48] Article 36(4) of Regulation 1/2003 has, inter alia, repealed Article 5 of Regulation 1017/68 applying rules of competition to transport by rail, road and inland waterway. However, the Commission's case practice adopted under Regulation 1017/68 remains relevant for the purposes of applying Article 81(3) in the inland transport sector

[49] See paragraph 42 below.

Burden of proof – nullity

41. Where in an individual case a restriction of competition within the meaning of Article 81(1) has been proven, Article 81(3) can be invoked as a defence. According to Article 2 of Regulation 1/2003 the *burden of proof under Article 81(3) rests on the undertaking(s) invoking the benefit* of the exception rule. Where the conditions of Article 81(3) are not satisfied the agreement is null and void, cf. Article 81(2). However, such *automatic nullity only applies* to those parts of the agreement that are incompatible with Article 81, provided that such parts are severable from the agreement as a whole[50]. If only part of the agreement is null and void, it is for the applicable national law to determine the consequences thereof for the remaining part of the agreement[51].

4 conditions cumulative and exhaustive

42. According to settled case law the four conditions of Article 81(3) are *cumulative*[52], i.e. they must all be fulfilled for the exception rule to be applicable. If they are not, the application of the exception rule of Article 81(3) must be refused[53]. The four conditions of Article 81(3) are also *exhaustive*. When they are met the exception is applicable and may not be made dependant on any other condition. Goals pursued by other Treaty provisions can be taken into account to the extent that they can be subsumed under the four conditions of Article 81(3)[54].

Balancing within the same market, unless . . .

43. The assessment under Article 81(3) of benefits flowing from restrictive agreements is in principle made within the confines of *each relevant market* to which the agreement relates. The Community competition rules have as their objective the protection of competition on the market and cannot be detached from this objective. Moreover, the condition that consumers[55] must receive a fair share of the benefits implies in general that *efficiencies* generated by the restrictive agreement within a relevant market *must be sufficient to outweigh the anti-competitive effects produced by the agreement within that same relevant market*[56]. Negative effects on consumers in

[50] See the judgment in Société Technique Miniere cited in note 20.

[51] See in this respect Case 319/82, *Kerpen & Kerpen*, [1983] ECR 4173, paragraphs 11 and 12.

[52] See e.g. Case T-185/00 and others, *Métropole télévision SA (M6)*, [2002] ECR II-3805, paragraph 86, Case T-17/93, *Matra*, ECR [1994] II-595, paragraph 85; and Joined Cases 43/82 and 63/82, *VBVB and VBBB*, [1984] ECR 19, paragraph 61.

[53] See Case T-213/00, *CMA CGM and others*, [2003] ECR II-, paragraph 226.

[54] See to that effect implicitly paragraph 139 of the Matra judgment cited in note 52, and Case 26/76, *Metro (I)*, [1977] ECR 1875, paragraph 43.

[55] As to the concept of consumers see paragraph 84 below where it is stated that consumers are the customers of the parties and subsequent buyers. The parties themselves are not 'consumers' for the purposes of Article 81(3).

[56] The test is market specific, see to that effect Case T-131/99, Shaw, [2002] ECR II-2023, paragraph 163, where the Court of First Instance held that the assessment under Article 81(3) had to be made within the same analytical framework as that used for assessing the restrictive effects, and Case C-360/92 P, *Publishers Association*, [1995] ECR I-23, paragraph 29, where in a case where the relevant market was wider than national the Court of Justice held that in the application of Article 81(3) it was not correct only to consider the effects on the national territory.

one geographic market or product market cannot normally be balanced against and compensated by positive effects for consumers in another unrelated geographic market or product market. However, *where two markets are related, efficiencies achieved on separate markets can be taken into account provided that the group of consumers affected by the restriction and benefiting from the efficiency gains are substantially the same*[57]. Indeed, in some cases only consumers in a downstream market are affected by the agreement in which case the impact of the agreement on such consumers must be assessed. This is for instance so in the case of purchasing agreements[58].

Economic context may change

44. The assessment of restrictive agreements under Article 81(3) is made within the a*ctual context in which they occur*[59] *and on the basis of the facts existing at any given point in time*. The assessment is sensitive to material changes in the facts. The exception rule of *Article 81(3) applies as long as the four conditions are fulfilled* and ceases to apply when that is no longer the case[60]. When applying Article 81(3) in accordance with these principles it is *necessary to take into account the initial sunk investments* made by any of the parties and the time needed and the restraints required to commit and recoup an efficiency enhancing investment. *Article 81 cannot be applied without taking due account of such ex ante investment.* The *risk* facing the parties and the *sunk investment* that must be committed to implement the agreement can thus lead to the agreement falling outside Article 81(1) or fulfilling the conditions of Article 81(3), as the case may be, *for the period of time required to recoup the investment.*

[57] In Case T-86/95, *Compagnie Générale Maritime and others*, [2002] ECR II-1011, paragraphs 343 to 345, the Court of First Instance held that Article 81(3) does not require that the benefits are linked to a specific market and that in appropriate cases regard must be had to benefits 'for every other market on which the agreement in question might have beneficial effects, and even, in a more general sense, for any service the quality or efficiency of which might be improved by the existence of that agreement'. Importantly, however, in this case the affected group of consumers was the same. The case concerned intermodal transport services encompassing a bundle of, inter alia, inland and maritime transportation provided to shipping companies across the Community. The restrictions related to inland transport services, which were held to constitute a separate market, whereas the benefits were claimed to occur in relation to maritime transport services. Both services were demanded by shippers requiring intermodal transport services between northern Europe and South-East and East Asia. The judgment in CMA CGM, cited in note 53 above, also concerned a situation where the agreement, while covering several distinct services, affected the same group of consumers, namely shippers of containerised cargo between northern Europe and the Far East. Under the agreement the parties fixed charges and surcharges relating to inland transport services, port services and maritime transport services. The Court of First Instance held (cf. paragraphs 226 to 228) that in the circumstances of the case there was no need to define relevant markets for the purpose of applying Article 81(3). The agreement was restrictive of competition by its very object and there were no benefits for consumers.

[58] See paragraphs 126 and 132 of the Guidelines on horizontal co-operation agreements cited in note 5 above.

[59] See the *Ford judgment* cited in note 18.

[60] See in this respect for example Commission Decision in TPS, OJ 1999 L 90, page 6. Similarly, the prohibition of Article 81(1) also only applies as long as the agreement has a restrictive object or restrictive effects.

Some agreements irreversible

45. In some cases the restrictive agreement is an irreversible event. Once the restrictive agreement has been implemented the *ex ante* situation cannot be re-established. In such cases the assessment must be made exclusively on the basis of the facts pertaining at the time of implementation. For instance, in the case of a research and development agreement whereby each party agrees to abandon its respective research project and pool its capabilities with those of another party, it may from an objective point of view be technically and economically impossible to revive a project once it has been abandoned. The assessment of the anti-competitive and pro-competitive effects of the agreement to abandon the individual research projects must therefore be made as of the time of the completion of its implementation. If at that point in time the agreement is compatible with Article 81, for instance because a sufficient number of third parties have competing research and development projects, the parties' agreement to abandon their individual projects remains compatible with Article 81, even if at a later point in time the third party projects fail. However, the prohibition of Article 81 may apply to other parts of the agreement in respect of which the issue of irreversibility does not arise. If for example in addition to joint research and development, the agreement provides for joint exploitation, Article 81 may apply to this part of the agreement if due to subsequent market developments the agreement becomes restrictive of competition and does not (any longer) satisfy the conditions of Article 81(3) taking due account of *ex ante* sunk investments, cf. the previous paragraph.

Any agreement may qualify under A 81(3)

46. Article 81(3) does not exclude *a priori* certain types of agreements from its scope. As a matter of principle *all restrictive agreements that fulfil the four conditions of Article 81(3) are covered by the exception rule*[61]. However, *severe restrictions of competition are unlikely to fulfil the conditions* of Article 81(3). Such restrictions are usually black listed in block exemption regulations or identified as hardcore restrictions in Commission guidelines and notices. Agreements of this nature generally fail (at least) the two first conditions of Article 81(3). They neither create objective economic benefits[62] nor do they benefit consumers[63]. For example, a horizontal agreement to fix prices limits output leading to misallocation of resources. It also transfers value from consumers to producers, since it leads to higher prices without producing any countervailing value to consumers within the relevant market. Moreover, these types of agreements generally also fail the indispensability test under the third condition[64].

Purpose of A 81

47. Any claim that restrictive agreements are justified because they *aim at ensuring fair conditions of competition on the market is by nature unfounded* and must be

[61] See paragraph 85 of the *Matra judgment* cited in note 52.
[62] As to this requirement see paragraph 49 below.
[63] See e.g. Case T-29/92, *Vereniging van Samenwerkende Prijsregelende Organisaties in de Bouwnijverheid (SPO)*, [1995] ECR II-289.
[64] See e.g. Case 258/78, *Nungesser*, [1982] ECR 2015, paragraph 77, concerning absolute territorial protection.

discarded[65]. The *purpose of Article 81 is to protect effective competition by ensuring that markets remain open and competitive*. The protection of fair conditions of competition is a task for the legislator in compliance with Community law obligations[66] and not for undertakings to regulate themselves.

3.2 First condition of Article 81(3): Efficiency gains

3.2.1 General remarks

48. According to the first condition of Article 81(3) the restrictive agreement must contribute to improving the production or distribution of goods or to promoting technical or economic progress. The provision *refers expressly only to goods, but applies by analogy to services*.

Only objective benefits

49. It follows from the case law of the Court of Justice that only objective benefits can be taken into account[67]. This means that efficiencies are not assessed from the subjective point of view of the parties[68]. *Cost savings that arise from the mere exercise of market power by the parties cannot* be taken into account. For instance, when companies agree to fix prices or share markets they reduce output and thereby production costs. Reduced competition may also lead to lower sales and marketing expenditures. Such cost reductions are a direct consequence of a reduction in output and value. The cost reductions in question do not produce any pro-competitive effects on the market. In particular, they do not lead to the creation of value through an integration of assets and activities. They merely allow the undertakings concerned to increase their profits and are therefore irrelevant from the point of view of Article 81(3).

Efficiencies

50. The purpose of the first condition of Article 81(3) is to define the types of efficiency gains that can be taken into account and be subject to the further tests of the second and third conditions of Article 81(3). The aim of the analysis is to ascertain *what are the objective benefits created by the agreement and what is the economic importance of such efficiencies*. Given that for Article 81(3) to apply the pro-competitive effects flowing from the agreement must outweigh its anti-competitive effects, it is necessary to verify what is the link between the agreement and the claimed efficiencies and what is the value of these efficiencies.

Substantiate

51. All efficiency claims must therefore be *substantiated* so that the following can be verified:

[65] See in this respect e.g. the judgment in SPO cited in note 63.
[66] National measures must, *inter alia*, comply with the Treaty rules on free movement of goods, services, persons and capital.
[67] See e.g. the judgment in *Consten and Grundig* cited in note 21.
[68] See in this respect Commission Decision in *Van den Bergh Foods*, OJ 1998 L 246, p. 1.

(a) The *nature* of the claimed efficiencies;
(b) The *link* between the agreement and the efficiencies;
(c) The *likelihood* and *magnitude* of each claimed efficiency; and
(d) *How* and *when* each claimed efficiency would be achieved.

52. Letter (a) allows the decision-maker to *verify whether the claimed efficiencies are objective* in nature, cf. paragraph 49 above.

53. Letter (b) allows the decision-maker to *verify whether there is a sufficient causal link* between the restrictive agreement and the claimed efficiencies. This condition normally requires that the efficiencies result from the economic activity that forms the object of the agreement. Such activities may, for example, take the form of distribution, licensing of technology, joint production or joint research and development. To the extent, however, that an agreement has wider efficiency enhancing effects within the relevant market, for example because it leads to a reduction in industry wide costs, these additional benefits are also taken into account.

54. *The causal link between the agreement and the claimed efficiencies must normally also be direct*[69]. Claims based on indirect effects are *as a general rule too uncertain* and too remote to be taken into account. A direct causal link exists for instance where a technology transfer agreement allows the licensees to produce new or improved products or a distribution agreement allows products to be distributed at lower cost or valuable services to be produced. An example of indirect effect would be a case where it is claimed that a restrictive agreement allows the undertakings concerned to increase their profits, enabling them to invest more in research and development to the ultimate benefit of consumers. While there may be a link between profitability and research and development, this link is generally not sufficiently direct to be taken into account in the context of Article 81(3).

55. Letters (c) and (d) allow the decision-maker *to verify the value of the claimed efficiencies*, which in the context of the third condition of Article 81(3) must be *balanced against the anti-competitive effects of the agreement*, see paragraph 101 below. Given that Article 81(1) only applies in cases where the agreement has likely negative effects on competition and consumers (in the case of hardcore restrictions such effects are presumed) efficiency claims must be substantiated so that they can be verified. Unsubstantiated claims are rejected.

56. In the case of *claimed cost efficiencies* the undertakings invoking the benefit of Article 81(3*) must as accurately as reasonably possible calculate or estimate the value of the efficiencies and describe in detail how the amount has been computed*. They must also describe the method(s) by which the efficiencies have been or will be achieved. The data submitted must be *verifiable* so that there can be a sufficient degree of certainty that the efficiencies have materialised or are likely to materialise.

57. In the case of *claimed efficiencies in the form of new or improved products* and other non-cost based efficiencies, the undertakings claiming the benefit of Article 81(3) must describe and explain in detail what is the nature of the efficiencies and how and why they constitute an objective economic benefit.

58. In cases *where the agreement has yet to be fully implemented* the parties must substantiate any projections as to the date from which the efficiencies will become operational so as to have a significant positive impact in the market.

[69] See in this respect Commission Decision in Glaxo Wellcome, OJ 2001 L 302, page 1.

3.2.2 The different categories of efficiencies

59. The types of efficiencies listed in Article 81(3) are broad categories which are intended to *cover all objective economic efficiencies*. There is considerable overlap between the various categories mentioned in Article 81(3) and the same agreement may give rise to several kinds of efficiencies. It is therefore not appropriate to draw clear and firm distinctions between the various categories. For the purpose of these guidelines, a distinction is made *between cost efficiencies* and efficiencies of a *qualitative nature* whereby value is created in the form of new or improved products, greater product variety etc.

Efficiencies must stem from integration of economic activities

60. In general, *efficiencies stem from an integration of economic activities* whereby undertakings combine their assets to achieve what they could not achieve as efficiently on their own or whereby they entrust another undertaking with tasks that can be performed more efficiently by that other undertaking.

Value chain – markets and hierarchies

61. The *research and development, production and distribution* process may be viewed as a value chain that can be divided into a number of stages. At each stage of this chain an undertaking must make a choice between performing the activity itself, performing it together with (an)other undertaking(s) or outsourcing the activity entirely to (an)other undertaking(s).

Horizontal and vertical agreements may create efficiencies

62. In each case where the choice made involves cooperation on the market with another undertaking an agreement within the meaning of Article 81(1) normally needs to be concluded. These agreements can be *vertical,* as is the case where the parties operate at different levels of the value chain *or horizontal*, as is the case where the firms operate at the same level of the value chain. *Both categories of agreements may create efficiencies* by allowing the undertakings in question to perform a particular task at lower cost or with higher added value for consumers. Such agreements *may also contain or lead to restrictions of competition* in which case the prohibition rule of Article 81(1) and the exception rule of Article 81(3) may become relevant.

The following types of efficiency not exhaustive

63. The types of efficiencies mentioned in the following are only examples and are not intended to be exhaustive.

3.2.2.1 Cost efficiencies

Dynamic efficiencies

64. Cost efficiencies flowing from agreements between undertakings can originate from a number of different sources. One very important source of cost savings is the

development of *new production technologies and methods*. In general, it is when *technological leaps are made that the greatest potential for cost savings is achieved*. For instance, the introduction of the assembly line led to a very substantial reduction in the cost of producing motor vehicles.

Integration of existing assets

65. Another very important source of efficiency is synergies resulting from an integration of existing assets. When the parties to an agreement combine their respective assets they may be able to attain a cost/output configuration that would not otherwise be possible. *The combination of two existing technologies that have complementary strengths* may reduce production costs or lead to the production of a higher quality product. For instance, it may be that the production assets of firm A generate a high output per hour but require a relatively high input of raw materials per unit of output, whereas the production assets of firm B generate lower output per hour but require a relatively lower input of raw materials per unit of output. Synergies are created if by establishing a production joint venture combining the production assets of A and B the parties can attain a high(er) level of output per hour with a low(er) input of raw materials per unit of output. Similarly, if one undertaking has optimised one part of the value chain and another undertaking has optimised another part of the value chain, the combination of their operations may lead to lower costs. Firm A may for instance have a highly automated production facility resulting in low production costs per unit whereas B has developed an efficient order processing system. The system allows production to be tailored to customer demand, ensuring timely delivery and reducing warehousing and obsolescence costs. By combining their assets A and B may be able to obtain cost reductions.

Economies of scale

66. Cost efficiencies may also result from economies of scale, i.e. declining cost per unit of output as output increases. To give an example: investment in equipment and other assets often has to be made in indivisible blocks. If an undertaking cannot fully utilise a block, its average costs will be higher than if it could do so. For instance, the cost of operating a truck is virtually the same regardless of whether it is almost empty, half-full or full. Agreements whereby undertakings combine their logistics operations may allow them to increase the load factors and reduce the number of vehicles employed. Larger scale may also allow for better division of labour leading to lower unit costs. Firms may achieve economies of scale in respect of all parts of the value chain, including research and development, production, distribution and marketing. Learning economies constitute a related type of efficiency. As experience is gained in using a particular production process or in performing particular tasks, productivity may increase because the process is made to run more efficiently or because the task is performed more quickly.

Economies of scope

67. Economies of scope are another source of cost efficiency, which occur when firms achieve cost savings by producing different products on the basis of the same input. Such efficiencies may arise from the fact that it is possible to use the same

components and the same facilities and personnel to produce a variety of products. Similarly, economies of scope may arise in distribution when several types of goods are distributed in the same vehicles. For instance, a producer of frozen pizzas and a producer of frozen vegetables may obtain economies of scope by jointly distributing their products. Both groups of products must be distributed in refrigerated vehicles and it is likely that there are significant overlaps in terms of customers. By combining their operations the two producers may obtain lower distribution costs per distributed unit.

Better planning of production

68. Efficiencies in the form of *cost reductions* can also follow from *agreements that allow for better planning of production*, reducing the need to hold expensive inventory and allowing for better *capacity utilisation*. Efficiencies of this nature may for example stem from the use of "*just in time*" *purchasing*, i.e. an obligation on a supplier of components to continuously supply the buyer according to its needs thereby avoiding the need for the buyer to maintain a significant stock of components which risks becoming obsolete. Cost savings may also result from agreements that allow the parties to rationalise production across their facilities.

3.2.2.2 Qualitative efficiencies

69. Agreements between undertakings may generate various efficiencies of a qualitative nature which are relevant to the application of Article 81(3). In a number of cases the *main efficiency enhancing potential of the agreement is not cost reduction; it is quality improvements* and other efficiencies of a qualitative nature. Depending on the individual case such efficiencies may therefore be of equal or greater importance than cost efficiencies.

Technical advances

70. *Technical and technological advances form an essential and dynamic part of the economy*, generating significant benefits in the form of new or improved goods and services. By cooperating undertakings may be able to create efficiencies that would not have been possible without the restrictive agreement or would have been possible only with substantial delay or at higher cost. Such efficiencies constitute an important source of economic benefits covered by the first condition of Article 81(3). Agreements capable of producing efficiencies of this nature include, in particular, research and development agreements. An example would be A and B creating a joint venture for the development and, if successful, joint production of a cell-based tyre. The puncture of one cell does not affect other cells, which means that there is no risk of collapse of the tyre in the event of a puncture. The tyre is thus safer than traditional tyres. It also means that there is no immediate need to change the tyre and thus to carry a spare. Both types of efficiencies constitute objective benefits within the meaning of the first condition of Article 81(3).

Combining complementary assets

71. In the same way that the *combination of complementary assets can give rise to cost savings*, combinations of assets may also *create synergies* that create efficiencies

of a qualitative nature. The combination of production assets may for instance lead to the production of higher quality products or products with novel features. This may for instance be the case for licence agreements, and agreements providing for joint production of new or improved goods or services. Licence agreements may, in particular, ensure more rapid dissemination of new technology in the Community and enable the licensee(s) to make available new products or to employ new production techniques that lead to quality improvements. Joint production agreements may, in particular, allow new or improved products or services to be introduced on the market more quickly or at lower cost[70]. In the telecommunications sector, for example, cooperation agreements have been held to create efficiencies by making available more quickly new global services[71]. In the banking sector cooperation agreements that made available improved facilities for making cross-border payments have also been held to create efficiencies falling within the scope of the first condition of Article 81(3) [72].

Specialised distribution

72. *Distribution agreements* may also give rise to *qualitative efficiencies*. Specialised distributors, for example, may be able to provide services that are better tailored to customer needs or to provide quicker delivery or better quality assurance throughout the distribution chain[73].

3.3 Third condition of Article 81(3): Indispensability of the restrictions

73. According to the third condition of Article 81(3) the restrictive agreement must not impose restrictions, which are not indispensable to the attainment of the efficiencies created by the agreement in question. This *condition implies a two-fold test*. First, the restrictive agreement as such must be *reasonably necessary* in order to achieve the efficiencies. Secondly, the individual restrictions of competition that flow from the agreement *must also be reasonably necessary for the attainment of the efficiencies*.

Objective

74. In the context of the third condition of Article 81(3) the decisive factor is whether or not the restrictive agreement and individual restrictions make it possible to perform the activity in question more efficiently than would likely have been the case in the absence of the agreement or the restriction concerned. The question is not whether in the absence of the restriction the agreement would not have been concluded, but *whether more efficiencies are produced with the agreement or restriction than in the absence of the agreement or restriction*[74].

[70] See e.g. Commission Decision in *GEAE/P&W*, OJ 2000 L 58, page 16; in *British Interactive Broadcasting/Open*, OJ 1999 L 312, page 1; and in Asahi/Saint Gobain, OJ 1994 L 354, page 87.

[71] See e.g. Commission Decision in Atlas, OJ 1996 L 239, page 23, and in *Phoenix/Global One*, OJ 1996 L 239, page 57.

[72] See e.g. Commission Decision in *Uniform Eurocheques*, OJ 1985 L 35, page 43

[73] See e.g. Commission Decision in *Cégétel + 4*, OJ 1999 L 88, page 26.

[74] As to the former question, which may be relevant in the context of Article 81(1), see paragraph 18 above.

Least restrictive means

75. The first test contained in the third condition of Article 81(3) requires that the *efficiencies be specific to the agreement in question* in the sense that there are no other economically practicable and less restrictive means of achieving the efficiencies. In making this latter assessment the market conditions and business realities facing the parties to the agreement must be taken into account. Undertakings invoking the benefit of Article 81(3) are not required to consider hypothetical or theoretical alternatives. The Commission will not second guess the business judgment of the parties. It will only intervene where it is reasonably clear that there are realistic and attainable alternatives. The parties must only explain and demonstrate why such seemingly realistic and significantly less restrictive alternatives to the agreement would be significantly less efficient.
76. It is particularly relevant to examine whether, having due regard to the circumstances of the individual case, the parties could have achieved the efficiencies by means of another *less restrictive type of agreement* and, if so, when they would likely be able to obtain the efficiencies. It may also be necessary to examine whether the parties could have achieved the efficiencies on their own. For instance, where the claimed efficiencies take the form of cost reductions resulting from economies of scale or scope the undertakings concerned must explain and substantiate why the same efficiencies would not be likely to be attained through internal growth and price competition. In making this assessment it is relevant to consider, *inter alia*, what is the minimum efficient scale on the market concerned. The minimum efficient scale is the level of output required to minimise average cost and exhaust economies of scale[75]. The larger the minimum efficient scale compared to the current size of either of the parties to the agreement, the more likely it is that the efficiencies will be deemed to be specific to the agreement. In the case of agreements that produce substantial synergies through the combination of complementary assets and capabilities the very nature of the efficiencies give rise to a presumption that the agreement is necessary to attain them.

Example

77. These principles can be illustrated by the following hypothetical example:
A and B combine within a joint venture their respective production technologies to achieve higher output and lower raw material consumption. The joint venture is granted an exclusive licence to their respective production technologies. The parties transfer their existing production facilities to the joint venture. They also transfer key staff in order to ensure that existing learning economies can be exploited and further developed. It is estimated that these economies will reduce production costs by a further 5 %. The output of the joint venture is sold independently by A and B. In this case the indispensability condition necessitates an assessment of whether or not the benefits could be substantially achieved by means of a licence agreement, which would be likely to be less restrictive because A and B would continue to produce independently. In the circumstances described

[75] Scale economies are normally exhausted at a certain point. Thereafter average costs will stabilise and eventually rise due to, for example, capacity constraints and bottlenecks.

this is unlikely to be the case since under a licence agreement the parties would not be able to benefit in the same seamless and continued way from their respective experience in operating the two technologies, resulting in significant learning economies.

Restrictions indispensable

78. Once it is found that the agreement in question is necessary in order to produce the efficiencies, the *indispensability of each restriction of competition* flowing from the agreement must be assessed. In this context it must be assessed whether individual restrictions are reasonably necessary in order to produce the efficiencies. The *parties to the agreement must substantiate their claim* with regard to both the nature of the restriction and its intensity.

79. *A restriction is indispensable if* its absence would eliminate or significantly reduce the efficiencies that follow from the agreement or make it significantly less likely that they will materialise. The assessment of alternative solutions must take into account the actual and potential improvement in the field of competition by the elimination of a particular restriction or the application of a less restrictive alternative. *The more restrictive the restraint the stricter the test* under the third condition[76]. Restrictions that are black listed in block exemption regulations or identified as hardcore restrictions in Commission guidelines and notices are unlikely to be considered indispensable.

Actual context – structure of market – avoid hold up problem

80. The assessment of indispensability is made within the actual context in which the agreement operates and must in particular take account of the structure of the market, the economic risks related to the agreement, and the incentives facing the parties. The more uncertain the success of the product covered by the agreement, the more a restriction may be required to ensure that the efficiencies will materialise. Restrictions may also be indispensable in order to align the incentives of the parties and ensure that they concentrate their efforts on the implementation of the agreement. A restriction may for instance be necessary in order to avoid hold-up problems once a substantial sunk investment has been made by one of the parties. Once for instance a supplier has made a substantial relationship-specific investment with a view to supplying a customer with an input, the supplier is locked into the customer. In order to avoid that ex post the customer exploits this dependence to obtain more favourable terms, it may be necessary to impose an obligation not to purchase the component from third parties or to purchase minimum quantities of the component from the supplier[77].

Limited duration

81. In some cases a *restriction may be indispensable only for a certain period of time*, in which case the exception of Article 81(3) only applies during that period.

[76] See in this respect paragraphs 392 to 395 of the judgment in Compagnie Générale Maritime cited in note 57.

[77] See for more detail paragraph 116 of the Guidelines on Vertical Restraints cited in note 5.

In making this assessment it is necessary to take *due account of the period of time required for the parties to achieve the efficiencies* justifying the application of the exception rule[78]. In cases where the benefits cannot be achieved without considerable investment, account must, in particular, be taken of the period of *time required to ensure an adequate return* on such investment, see also paragraph 44 above.

Examples

82. These principles can be illustrated by the following hypothetical examples:
P produces and distributes frozen pizzas, holding 15% of the market in Member State X. Deliveries are made directly to retailers. Since most retailers have limited storage capacity, relatively frequent deliveries are required, leading to low capacity utilisation and use of relatively small vehicles. T is a wholesaler of frozen pizzas and other frozen products, delivering to most of the same customers as P. The pizza products distributed by T hold 30% of the market. T has a fleet of larger vehicles and has excess capacity. P concludes an exclusive distribution agreement with T for Member State X and undertakes to ensure that distributors in other Member States will not sell into T's territory either actively or passively. T undertakes to advertise the products, survey consumer tastes and satisfaction rates and ensure delivery to retailers of all products within 24 hours. The agreement leads to a reduction in total distribution costs of 30% as capacity is better utilised and duplication of routes is eliminated. The agreement also leads to the provision of additional services to consumers. Restrictions on passive sales are hardcore restrictions under the block exemption regulation on vertical restraints[79] and can only be considered indispensable in exceptional circumstances. The established market position of T and the nature of the obligations imposed on it indicate this is not an exceptional case. The ban on active selling, on the other hand, is likely to be indispensable. T is likely to have less incentive to sell and advertise the P brand, if distributors in other Member States could sell actively in Member State X and thus free ride on the efforts of T. This is particularly so, as T also distributes competing brands and thus has the possibility of pushing more of the brands that are the least exposed to free riding.
S is a producer of carbonated soft drinks, holding 40% of the market. The nearest competitor holds 20%. S concludes supply agreements with customers accounting for 25% of demand, whereby they undertake to purchase exclusively from S for 5 years. S concludes agreements with other customers accounting for 15% of demand whereby they are granted quarterly target rebates, if their purchases exceed certain individually fixed targets. S claims that the agreements allow it to predict demand more accurately and thus to better plan production, reducing raw material storage and warehousing costs and avoiding supply shortages. Given the market position of S and the combined coverage of the restrictions, the restrictions are very unlikely to be considered indispensable. The exclusive purchasing obligation exceeds what is required to plan production and the same is true of the target rebate scheme. Predictability of demand can be achieved by less restrictive means. S could,

[78] See Joined Cases T-374/94 and others, *European Night Services*, [1998] ECR II-3141, paragraph 230.
[79] See Commission Regulation no. 2790/1999 on the application of Article 81(3) of the Treaty on categories of vertical agreements and concerted practices, OJ 1999 L 336, page 21.

for example, provide incentives for customers to order large quantities at a time by offering quantity rebates or by offering a rebate to customers that place firm orders in advance for delivery on specified dates.

3.4 Second condition of Article 81(3): Fair share for consumers

3.4.1 General remarks

83. According to the second condition of Article 81(3) consumers must receive a fair share of the efficiencies generated by the restrictive agreement.

'Consumers' means

84. The concept of '*consumers*' encompasses *all direct or indirect users of the products* covered by the agreement, including producers that use the products as an input, wholesalers, retailers and final consumers, i.e. natural persons who are acting for purposes which can be regarded as outside their trade or profession. In other words, consumers within the meaning of Article 81(3) are *the customers of the parties to the agreement and subsequent purchasers*. These customers can be undertakings as in the case of buyers of industrial machinery or an input for further processing or final consumers as for instance in the case of buyers of impulse ice cream or bicycles.

'Fair share' means

85. The concept of '*fair share*' implies that the *pass-on of benefits* must at least compensate consumers for any actual or likely negative impact caused to them by the restriction of competition found under Article 81(1). In line with the overall objective of Article 81 to prevent anti-competitive agreements, the net effect of the agreement must at least be neutral from the point of view of those consumers directly or likely affected by the agreement[80]. If such consumers are worse off following the agreement, the second condition of Article 81(3) is not fulfilled. The positive effects of an agreement must be balanced against and compensate for its negative effects on consumers[81]. When that is the case consumers are not harmed by the agreement. Moreover, society as a whole benefits where the efficiencies lead either to fewer resources being used to produce the output consumed or to the production of more valuable products and thus to a more efficient allocation of resources.

Sufficient benefits over all passed on

86. It is not required that consumers receive a share of each and every efficiency gain identified under the first condition. It suffices that sufficient benefits are passed on

[80] See in this respect the judgment in Consten and Grundig cited in note 21, where the Court of Justice held that the improvements within the meaning of the first condition of Article 81(3) must show appreciable objective advantages of such a character as to compensate for the disadvantages which they cause in the field of competition.

[81] It is recalled that positive and negative effects on consumers are in principle balanced within each relevant market (cf. paragraph 43 above).

to compensate for the negative effects of the restrictive agreement. In that case consumers obtain a fair share of the overall benefits[82]. If a restrictive agreement is likely to lead to higher prices, consumers must be fully compensated through increased quality or other benefits. If not, the second condition of Article 81(3) is not fulfilled.

Overall impact

87. The decisive factor is the overall impact on consumers of the products within the relevant market and not the impact on individual members of this group of consumers[83]. In some cases a certain *period of time* may be required before the efficiencies materialise. Until such time the agreement may have only negative effects. The fact that pass-on to the consumer occurs with a certain time lag does not in itself exclude the application of Article 81(3). However, the greater the time lag, the greater must be the efficiencies to compensate also for the loss to consumers during the period preceding the pass-on.

Time value of improvement

88. In making this assessment it must be taken into account that the value of a gain for consumers in the future is not the same as a present gain for consumers. The value of saving 100 Euro today is greater than the value of saving the same amount a year later. A gain for consumers in the future therefore does not fully compensate for a present loss to consumers of equal nominal size. In order to allow for an appropriate comparison of a present loss to consumers with a future gain to consumers, the value of future gains must be discounted. The discount rate applied must reflect the rate of inflation, if any, and lost interest as an indication of the lower value of future gains.

89. In other cases the agreement may enable the parties to obtain the efficiencies earlier than would otherwise be possible. In such circumstances it is necessary to take account of the likely negative impact on consumers within the relevant market once this lead-time has lapsed. If through the restrictive agreement the parties obtain a strong position on the market, they may be able to charge a significantly higher price than would otherwise have been the case. For the second condition of Article 81(3) to be satisfied the benefit to consumers of having earlier access to the products must be equally significant. This may for instance be the case where an agreement allows two tyre manufacturers to bring to market three years earlier a new substantially safer tyre but at the same time, by increasing their market power, allows them to raise prices by 5%. In such a case it is likely that having early access to a substantially improved product outweighs the price increase.

Balance benefit against restriction of competition – sliding scale

90. The second condition of Article 81(3) incorporates a sliding scale. The greater the restriction of competition found under Article 81(1) the greater must be the efficiencies and the pass-on to consumers. This sliding scale approach implies that if the restrictive effects of an agreement are relatively limited and the efficiencies are sub-

[82] See in this respect paragraph 48 of the *Metro (I)* judgment cited in note 54.
[83] See paragraph 163 of the judgment in *Shaw* cited in note 56.

stantial it is likely that a fair share of the cost savings will be passed on to consumers. In such cases it is therefore normally not necessary to engage in a detailed analysis of the second condition of Article 81(3), provided that the three other conditions for the application of this provision are fulfilled.

91. If, on the other hand, the restrictive effects of the agreement are substantial and the cost savings are relatively insignificant, it is very unlikely that the second condition of Article 81(3) will be fulfilled. The impact of the restriction of competition depends on the intensity of the restriction and the degree of competition that remains following the agreement.

92. If the agreement has both substantial anti-competitive effects and substantial pro-competitive effects a careful analysis is required. In the application of the balancing test in such cases it must be taken into account that competition is an important long-term driver of efficiency and innovation. Undertakings that are not subject to effective competitive constraints – such as for instance dominant firms – have less incentive to maintain or build on the efficiencies. The more substantial the impact of the agreement on competition, the more likely it is that consumers will suffer in the long run.

Analytical framework to assess pass-on

93. The following two sections describe in more detail the analytical framework for assessing consumer pass-on of efficiency gains. The first section deals with *cost efficiencies*, whereas the section that follows covers other types of efficiencies such as *new or improved products* (qualitative efficiencies). The framework, which is developed in these two sections, is particularly important in cases where it is not immediately obvious that the competitive harms exceed the benefits to consumers or *vice versa*[84].

94. In the application of the principles set out below the Commission will have regard to the fact that in many cases it is difficult to accurately calculate the consumer pass-on rate and other types of consumer pass-on. Undertakings are only required to substantiate their claims by *providing estimates* and other data to the extent reasonably possible, taking account of the circumstances of the individual case.

3.4.2 Pass-on and balancing of cost efficiencies

In many markets may restrict output to raise price or discriminate

95. When markets, as is normally the case, are not perfectly competitive, undertakings are able to influence the market price to a greater or lesser extent by altering their output[85]. They may also be able to price discriminate amongst customers.

Efficiencies may increase output

96. Cost efficiencies may in some circumstances lead to increased output and lower prices for the affected consumers. *If due to cost efficiencies* the undertakings in

[84] In the following sections, for convenience the competitive harm is referred to in terms of higher prices; competitive harm could also mean lower quality, less variety or lower innovation than would otherwise have occurred.

question *can increase profits by expanding output, consumer pass-on may occur*. In assessing the extent to which cost efficiencies are likely to be passed on to consumers and the outcome of the balancing test contained in Article 81(3) *the following factors are in particular taken into account:*

(a) The characteristics and structure of the market,
(b) The nature and magnitude of the efficiency gains,
(c) The elasticity of demand, and
(d) The magnitude of the restriction of competition.

All factors must normally be considered. Since *Article 81(3) only applies in cases where competition on the market is being appreciably restricted*, see paragraph 24 above, there can be no presumption that residual competition will ensure that consumers receive a fair share of the benefits. However, the degree of competition remaining on the market and the nature of this competition influences the likelihood of pass-on.

Relevant factors

97. *The greater the degree of residual competition the more likely it is that individual undertakings will try to increase their sales by passing on cost efficiencies*. If undertakings compete mainly on price and are not subject to significant capacity constraints, pass-on may occur relatively quickly. If competition is mainly on capacity and capacity adaptations occur with a certain time lag, pass-on will be slower. Pass-on is also likely to be slower when the market structure is conducive to tacit collusion[86]. If competitors are likely to retaliate against an increase in output by one or more parties to the agreement, the incentive to increase output may be tempered, unless the competitive advantage conferred by the efficiencies is such that the undertakings concerned have an incentive to break away from the common policy adopted on the market by the members of the oligopoly. In other words, the efficiencies generated by the agreement may turn the undertakings concerned into so-called "mavericks"[87].

Fixed or variable costs

98. The nature of the efficiency gains also plays an important role. According to economic theory *undertakings maximise their profits by selling units of output until marginal revenue equals marginal cost*. Marginal revenue is the change in total revenue resulting from selling an additional unit of output and marginal cost is the change in total cost resulting from producing that additional unit of output. It follows from this principle that as a general rule *output and pricing decisions of a profit maximising undertaking are not determined by its fixed costs*

[85] In perfectly competitive markets individual undertakings are price takers. They sell their products at the market price, which is determined by overall supply and demand. The output of the individual undertaking is so small that any individual undertaking's change in output does not affect the market price.

[86] Undertakings collude tacitly when in an oligopolistic market they are able to coordinate their action on the market without resorting to an explicit cartel agreement.

[87] This term refers to undertakings that constrain the pricing behaviour of other undertakings in the market who might otherwise have tacitly colluded.

(i.e. costs that do not vary with the rate of production) *but by its variable costs* (i.e. costs that vary with the rate of production). After fixed costs are incurred and capacity is set, pricing and output decisions are determined by variable cost and demand conditions. Take for instance a situation in which two companies each produce two products on two production lines operating only at half their capacities. A specialisation agreement may allow the two undertakings to specialise in producing one of the two products and scrap their second production line for the other product. At the same time the specialisation may allow the companies to reduce variable input and stocking costs. Only the latter savings will have a direct effect on the pricing and output decisions of the undertakings, as they will influence the marginal costs of production. The scrapping by each undertaking of one of their production lines will not reduce their variable costs and will not have an impact on their production costs. It follows that *undertakings may have a direct incentive to pass on to consumers in the form of higher output and lower prices efficiencies that reduce marginal costs*, whereas they have no such direct incentive with regard to efficiencies that reduce fixed costs. *Consumers are therefore more likely to receive a fair share of the cost efficiencies in the case of reductions in variable costs than they are in the case of reductions in fixed costs.*

Elasticity of demand – pass-on rate – ability to discriminate

99. The fact that undertakings may have an incentive to pass on certain types of cost efficiencies does not imply that the pass-on rate will necessarily be 100%. *The actual pass-on rate depends on the extent to which consumers respond to changes in price*, i.e. the elasticity of demand. The greater the increase in demand caused by a decrease in price, the greater the pass-on rate. This follows from the fact that the greater the additional sales caused by a price reduction due to an increase in output the more likely it is that these sales will offset the loss of revenue caused by the lower price resulting from the increase in output. *In the absence of price discrimination the lowering of prices affects all units sold by the undertaking,* in which case marginal revenue is less than the price obtained for the marginal product. *If the undertakings concerned are able to charge different prices to different customers, i.e. price discriminate, pass-on will normally only benefit price sensitive consumers*[88].

Production cost may not equal total cost

100. It must also be taken into account that efficiency gains often do not affect the whole cost structure of the undertakings concerned. In such event the impact on the price to consumers is reduced. If for example an agreement allows the parties to reduce production costs by 6%, but production costs only make up one third of the costs on the basis of which prices are determined, the impact on the product price is 2%, assuming that the full amount is passed-on.

[88] The restrictive agreement may even allow the undertakings in question to charge a higher price to customers with a low elasticity of demand.

Balance restriction of competition and cost efficiencies

101. Finally, and very importantly, it is necessary to balance the two opposing forces resulting from the restriction of competition and the cost efficiencies. On the one hand, any increase in market power caused by the restrictive agreement gives the undertakings concerned the ability and incentive to raise price. On the other hand, the types of cost efficiencies that are taken into account may give the undertakings concerned an incentive to reduce price, see paragraph 98 above. The effects of these two opposing forces must be balanced against each other. It is recalled in this regard that the consumer pass-on condition incorporates a sliding scale. When the agreement causes a substantial reduction in the competitive constraint facing the parties, extraordinarily large cost efficiencies are normally required for sufficient pass-on to occur.

3.4.3 Pass-on and balancing of other types of efficiencies

Qualitatative efficiencies

102. Consumer pass-on can also take the form of qualitative efficiencies such as new and improved products, creating sufficient value for consumers to compensate for the anti-competitive effects of the agreement, including a price increase.

Requires value judgment – burden of proof

103. Any such assessment necessarily requires value judgment. It is difficult to assign precise values to dynamic efficiencies of this nature. However, the fundamental objective of the assessment remains the same, namely to ascertain the overall impact of the agreement on the consumers within the relevant market. Undertakings claiming the benefit of Article 81(3) must substantiate that consumers obtain countervailing benefits (see in this respect paragraphs 57 and 86 above).

Improved products important source of consumer welfare

104. The availability of new and improved products constitutes an important source of consumer welfare. *As long as the increase in value stemming from such improvements exceeds any harm from a maintenance or an increase in price caused by the restrictive agreement, consumers are better off than without the agreement* and the consumer pass-on requirement of Article 81(3) is normally fulfilled. In cases where the likely effect of the agreement is to increase prices for consumers within the relevant market it must be carefully assessed whether the claimed efficiencies create real value for consumers in that market so as to compensate for the adverse effects of the restriction of competition.

3.5 Fourth condition of Article 81(3): No elimination of competition

Ultimate aim of A 81 is to protect competitive process

105. According to the fourth condition of Article 81(3) *the agreement must not afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products concerned*. Ultimately the *protection of*

rivalry and the competitive process is given priority over potentially pro-competitive efficiency gains which could result from restrictive agreements. The last condition of Article 81(3) recognises the fact that *rivalry between undertakings is an essential driver of economic efficiency, including dynamic efficiencies* in the shape of innovation. In other words, *the ultimate aim of Article 81 is to protect the competitive process*. When competition is eliminated the competitive process is brought to an end and short-term efficiency gains are outweighed by longer-term losses stemming *inter alia* from expenditures incurred by the incumbent to maintain its position (rent seeking), misallocation of resources, reduced innovation and higher prices.

Relationship with A 82

106. The concept in Article 81(3) of *elimination of competition in respect of a substantial part of the products concerned is an autonomous Community law concept* specific to Article 81(3)[89]. However, in the application of this concept it is necessary to take account of the relationship between Article 81 and Article 82. According to settled case law the application of Article 81(3) cannot prevent the application of Article 82 of the Treaty[90]. Moreover, since Articles 81 and 82 both pursue the aim of maintaining effective competition on the market, consistency requires that Article 81(3) be interpreted as precluding any application of this provision to restrictive agreements that constitute an abuse of a dominant position[91,92]. However, not all restrictive agreements concluded by a dominant undertaking constitute an abuse of a dominant position. This is for instance the case where a dominant undertaking is party to a non-full function joint venture[93], which is found to be restrictive of competition but at the same time involves a substantial integration of assets.

Depends on reduction in competition

107. *Whether competition is being eliminated* within the meaning of the last condition of Article 81(3) *depends on* the degree of competition existing prior to the agreement and on the impact of the restrictive agreement on competition, *i.e. the*

[89] See Joined Cases T-191/98, T-212/98 and T-214/98, *Atlantic Container Line (TACA)*, [2003] ECR II-, paragraph 939, and Case T-395/94, *Atlantic Container Line*, [2002] ECR II-875, paragraph 330.

[90] See Joined Cases C-395/96 P and C-396/96 P, Compagnie maritime belge, [2000] ECR I-1365, paragraph 130. Similarly, the application of Article 81(3) does not prevent the application of the Treaty rules on the free movement of goods, services, persons and capital. These provisions are in certain circumstances applicable to agreements, decisions and concerted practices within the meaning of Article 81(1), see to that effect Case C-309/99, *Wouters*, [2002] ECR I-1577, paragraph 120.

[91] See in this respect Case T-51/89, Tetra Pak (I), [1990] ECR II-309, and Joined Cases T-191/98, T-212/98 and T-214/98, *Atlantic Container L*; *ine (TACA)*, [2003] ECR II-, paragraph 1456.

[92] This is how paragraph 135 of the Guidelines on vertical restraints and paragraphs 36, 71, 105, 134 and 155 of the Guidelines on horizontal cooperation agreements, cited in note 5, should be understood when they state that in principle restrictive agreements concluded by dominant undertakings cannot be exempted.

[93] Full function joint ventures, i.e. joint ventures that perform on a lasting basis all the functions of an autonomous economic entity, are covered by Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings, OJ 1990 L 257, p 13.

reduction in competition that the agreement brings about. The more competition is already weakened in the market concerned, the slighter the further reduction required for competition to be eliminated within the meaning of Article 81(3). Moreover, the greater the reduction of competition caused by the agreement, the greater the likelihood that competition in respect of a substantial part of the products concerned risks being eliminated.

Realistic analysis of competitive constraints

108. The application of the last condition of Article 81(3) requires a realistic analysis of the various sources of competition in the market, the level of competitive constraint that they impose on the parties to the agreement and the impact of the agreement on this competitive constraint. Both actual and potential competition must be considered.

Not only market shares

109. While *market shares are relevant*, the magnitude of remaining sources of actual competition cannot be assessed exclusively on the basis of market share. *More extensive qualitative and quantitative analysis* is normally called for. The *capacity of actual competitors to compete and their incentive to do so must be examined*. If, for example, competitors face capacity constraints or have relatively higher costs of production their competitive response will necessarily be limited.

Competition on price or innovation

110. In the assessment of the impact of the agreement on competition it is also relevant to examine its *influence on the various parameters of competition*. The last condition for exception under Article 81(3) is not fulfilled, if the agreement eliminates competition in one of its most important expressions. This is particularly the case *when an agreement eliminates price competition*[94] *or competition in respect of innovation and development of new products*.

Past conduct

111. *The actual market conduct of the parties* can provide insight into the impact of the agreement. If following the conclusion of the agreement the parties have implemented and maintained substantial price increases or engaged in other conduct indicative of the existence of a considerable degree of market power, it is an indication that the parties are not subject to any real competitive pressure and that competition has been eliminated with regard to a substantial part of the products concerned.

Past competitive interaction

112. *Past competitive interaction* may also provide an indication of the impact of the agreement on future competitive interaction. An undertaking may be able to

[94] See paragraph 21 of the judgment in *Metro (I)* cited in note 54.

eliminate competition within the meaning of Article 81(3) by concluding an agreement with a competitor that in the past has been a "maverick"[95]. Such an agreement may change the competitive incentives and capabilities of the competitor and thereby remove an important source of competition in the market.

Differentiated products

113. In cases *involving differentiated products*, i.e. products that differ in the eyes of consumers, the impact of the agreement *may depend on the competitive relationship between the products sold by the parties to the agreement*. When undertakings offer differentiated products the competitive constraint that individual products impose on each other differs according to the degree of substitutability between them. It must therefore be considered what is the *degree of substitutability between the products* offered by the parties, i.e. what is the competitive constraint that they impose on each other. The more the products of the parties to the agreement are close substitutes the greater the likely restrictive effect of the agreement. In other words, the more substitutable the products the greater the likely change brought about by the agreement in terms of restriction of competition on the market and the more likely it is that competition in respect of a substantial part of the products concerned risks being eliminated.

Actual and potential competition

114. While *sources of actual competition are usually the most important*, as they are most easily verified, sources of potential competition must also be taken into account. The *assessment of potential competition requires an analysis of barriers to entry* facing undertakings that are not already competing within the relevant market. Any assertions by the parties that there are low barriers to market entry must be supported by information identifying the sources of potential competition and the parties must also substantiate why these sources constitute a real competitive pressure on the parties.

Assessment of barriers to entry

115. In the assessment of *entry barriers* and the real possibility for new entry on a significant scale, it is relevant to examine, *inter alia*, the following:

- (*i*) The *regulatory framework* with a view to determining its impact on new entry.
- (*ii*) The *cost of entry including sunk costs*. Sunk costs are those that cannot be recovered if the entrant subsequently exits the market. The higher the sunk costs the higher the commercial risk for potential entrants.
- (*iii*) The *minimum efficient scale* within the industry, i.e. the rate of output where average costs are minimised. If the minimum efficient scale is large compared to the size of the market, efficient entry is likely to be more costly and risky.
- (*iv*) The *competitive strengths of potential entrants*. Effective entry is particularly likely where potential entrants have access to at least as cost efficient

[95] See paragraph 97 above.

technologies as the incumbents or other competitive advantages that allow them to compete effectively. When potential entrants are on the same or an inferior technological trajectory compared to the incumbents and possess no other significant competitive advantage entry is more risky and less effective.

(*v*) The *position of buyers and their ability to bring onto the market new sources of competition*. It is irrelevant that certain strong buyers may be able to extract more favourable conditions from the parties to the agreement than their weaker competitors[96]. The presence of strong buyers can only serve to counter a *prima facie* finding of elimination of competition if it is likely that the buyers in question will pave the way for effective new entry.

(*vi*) The *likely response of incumbents to attempted new entry*. Incumbents may for example through past conduct have acquired a reputation of aggressive behaviour, having an impact on future entry.

(*vii*) The *economic outlook for the industry* may be an indicator of its longer-term attractiveness. Industries that are stagnating or in decline are less attractive candidates for entry than *industries characterised by growth*.

(viii) *Past entry on a significant scale* or the absence thereof.

Examples

116. The above principles can be illustrated by the following hypothetical examples, which are not intended to establish thresholds:

Firm A is brewer, holding 70% of the relevant market, comprising the sale of beer through cafes and other on-trade premises. Over the past 5 years A has increased its market share from 60%. There are four other competitors in the market, B, C, D and E with market shares of 10%, 10%, 5% and 5%. No new entry has occurred in the recent past and price changes implemented by A have generally been followed by competitors. A concludes agreements with 20% of the on-trade premises representing 40% of sales volumes whereby the contracting parties undertake to purchase beer only from A for a period of 5 years. The agreements raise the costs and reduce the revenues of rivals, which are foreclosed from the most attractive outlets. Given the market position of A, which has been strengthened in recent years, the absence of new entry and the already weak position of competitors it is likely that competition in the market is eliminated within the meaning of Article 81(3).

Shipping firms A, B, C, and D, holding collectively more than 70% of the relevant market, conclude an agreement whereby they agree to coordinate their schedules and their tariffs. Following the implementation of the agreement prices rise between 30% and 100%. There are four other suppliers, the largest holding about 14% of the relevant market. There has been no new entry in recent years and the parties to the agreement did not lose significant market share following the price increases. The existing competitors brought no significant new capacity to the market and no new entry occurred. In light of the market position of the parties and the absence of competitive response to their joint conduct it can reasonably be conclud-

[96] See in this respect Case T-228/97, *Irish Sugar*, [1999] ECR II-2969, paragraph 101.

ed that the parties to the agreement are not subject to real competitive pressures and that the agreement affords them the possibility of eliminating competition within the meaning of Article 81(3).

A is a producer of electric appliances for professional users with a market share of 65% of a relevant national market. B is a competing manufacturer with 5% market share which has developed a new type of motor that is more powerful while consuming less electricity. A and B conclude an agreement whereby they establish a production joint venture for the production of the new motor. B undertakes to grant an exclusive licence to the joint venture. The joint venture combines the new technology of B with the efficient manufacturing and quality control process of A. There is one other main competitor with 15% of the market. Another competitor with 5% market share has recently been acquired by C, a major international producer of competing electric appliances, which itself owns efficient technologies. C has thus far not been active on the market mainly due to the fact that local presence and servicing is desired by customers. Through the acquisition C gains access to the service organisation required to penetrate the market. The entry of C is likely to ensure that competition is not being eliminated.

Index