**Joint Comments of the American Bar Association's
Section of Antitrust Law,
Section of Business Law,
Section of International Law and Practice
and Section of Intellectual Property Law
on Draft Commission Regulation on the Application of Article 81(3) of the EC Treaty to Categories of Technology Transfer Agreements
and Draft Commission Notice on Guidelines on the Application of Article 81
to Technology Transfer Agreements***

The Section of Antitrust Law, the Section of Business Law, the Section of International Law and Practice, and the Section of Intellectual Property Law (collectively, the "Sections") of the American Bar Association welcome the opportunity to respond to the request of the European Commission for comments on the Draft Commission Regulation on the Application of Article 81(3) of the EC Treaty to Categories of Technology Transfer Agreements ("Revised TTBER") and the Draft Commission Notice on Guidelines on the Application of Article 81 to Technology Transfer Agreements ("Draft Guidelines"). The views expressed herein are being presented jointly on behalf of the Sections. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the policy of the American Bar Association.

The membership of the Sections includes over 114,000 lawyers, most of whom are based in the United States. Given the increasingly global nature of business and in particular the worldwide provision of products and services that constitute or depend upon new technologies as well as the increasing importance of cross-border licensing agreements, the Sections have a great interest in the Revised TTBER and Draft Guidelines. Moreover, given the long history of competition law in the United States, the Sections have substantial familiarity with legal and economic analyses of the potential competitive effects of transfers of technology. These comments offer a perspective based upon the experience in the United States in the fields of antitrust, business and intellectual property law. The Sections hope and intend that these comments, from our perspective as U.S. practitioners and grounded in the historical development of U.S. antitrust law and practice regarding similar issues, will assist the Commission in finalization of a regulation and guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements.

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I Overview and General Comments

The Sections of Antitrust Law, International Law and Practice, and Intellectual Property Law together provided comments to the Commission in April 2002 in response to the Commission Evaluation Report on the Transfer of Technology Block Exemption Regulation No. 240/96; Technology Transfer Agreements Under Article 81 (the "TTBE Report"). At that time, the Sections commended the Commission for undertaking a comprehensive review of its policies and practice in this important area, and in particular welcomed the TTBE Report's proposal to shift from a legalistic to a more economics and effects-based analysis. The Sections there noted that the proposal that competition law scrutiny be focused primarily on inter-brand competition issues and possible efficiencies created by licensing agreements is supported by most modern economic thought. The Sections' Comments on the TTBE Report included a review of approaches to the antitrust-intellectual property interface in the United States and fundamental principles of the 1995 U.S. Department of Justice and Federal Trade Commission *Antitrust Guidelines for the Licensing of Intellectual Property* (the "US Guidelines"), as well as specific comments on proposals in the Report. We appreciate that the Commission has taken into account the Section's comments on the TTBE Report as well as the comments of others and has given substantial thought to the Revised TTBER and Draft Guidelines.

The Sections offer these comments in an effort to assist the Commission in achieving its goals of encouraging procompetitive licensing transactions that will benefit consumers, while preventing anticompetitive agreements that harm consumers.

The Sections welcome the Commission's proposed Revised TTBER and Draft Guidelines and commend the Commission's efforts to "modernize" this important aspect of competition law as the Commission issues a new generation of block exemption regulations. From our point of view, the proposed reforms constitute a major improvement to the current highly complex and formalistic TTBER, introducing a conceptually sounder, more economics-based approach to the competition law treatment of technology licensing agreements. The Draft Guidelines provide significant clarification at a time when much responsibility for enforcement of EU competition law will be decentralized in the Member States and companies will be required to self-assess the legality of agreements. The proposals also bring EU competition law closer to U.S. rules on technology licensing. In particular, the Commission's proposal adopts important core principles: (1) licensing typically leads to integration of complementary assets and dissemination of innovations, and is generally pro-competitive; (2) licensing benefits consumers through the reduction of costs and the introduction of new products, and promotes greater investment in research and development by increasing expected returns; and (3) anticompetitive effects are most likely where there is market power and recognize that it is inappropriate to assume that patents create market power.

Important differences remain, however, notably with respect to the treatment of intra-technology restraints, and we believe those differences will inhibit global licensing efforts.

We agree with the policy enunciated in Reg. 1/2003 that conduct not covered by a block exemption should not necessarily be an infringement of Article 81 of the EC Treaty. It appears, however, that many activities that are not within the exemption of the Revised TTBER are deemed to be hardcore restrictions and therefore infringe Article 81.[1] Many of the concerns expressed in these comments would be substantially allayed if conduct which is not exempt under the Revised TTBER did not so often result in a finding of infringement of Article 81. The Commission may want to consider whether conduct which is not exempt under the Revised TTBER may at times be pro-competitive and therefore should not be deemed a hardcore restriction. In their current forms, the Revised TTBER and Draft Guidelines may have the unintended result of deterring procompetitive conduct.

We recognize the Commission's desire to rely on market share thresholds in the Revised TTBER, and acknowledge that the Draft Guidelines articulate the principle that those thresholds serve only as safe harbors, with no presumption that conduct outside the safe harbor should be condemned. We are concerned, however, that, in practice, in cases where the thresholds are exceeded, the parties will bear the burden of showing the competitive benefits of the agreement.

We recognize that a major goal of the TTBER is to provide legal certainty, but fear that in fact substantial uncertainty will result from the use of market share thresholds, particularly as applied over the life of a long term development and commercialization agreement. An agreement to develop a new technology which becomes successful may lose the protection of the block exemption as a result, forcing renegotiation. We suggest that such later analyses should be undertaken with sensitivity to the reasonable expectations of participants whose significant investments in reliance on an agreement were made before it is deemed to be anticompetitive.[2]

Furthermore, market share thresholds may not lead to greater legal certainty, given the difficulty of measuring market shares and limited utility of market shares in dynamic, technology-driven markets where the future is uncertain and market definitions often change quickly. One potential option to consider is adopting safe harbors based on the number of independent sources of technology. The experience in the United States with this approach has been positive .[3]

[1] The Draft Guidelines indicate (in ¶ 73) that "When a technology transfer agreement contains a hardcore restriction…it follows from…the TTBER that the agreement as a whole falls outside the scope of the block exemption… Moreover, the Commission holds the view that in the context of individual assessment hardcore restrictions of competition will only in exceptional circumstances fulfill the four conditions of Article 81(3)."

[2] *See* U.S. Federal Trade Commission and Department of Justice, Antitrust Guidelines for Collaborations Among Competitors ¶ 2.4 (April 2000) ("US Joint Venture Guidelines"). See also, Comments of ABA Section of Antitrust Law on US Joint Venture Guidelines, available at http://www.abanet.org/antitrust/collaborations.html .

[3] *See* US Guidelines ¶ 4.3. See also US Joint Venture Guidelines ¶ 4.3.

The Sections urge the Commission to implement more consistently the common principle expressed in the Draft Guidelines (¶¶ 14, 24), and the US Guidelines (¶3.3) that antitrust concerns are most likely to arise when a licensing arrangement harms competition among entities that would have been actual or likely potential competitors in a relevant market in the absence of the license. This concern is consistent with Paragraph 14(a) of the Draft Guidelines. The Draft Guidelines, however, go on in Paragraph 14(b) to ask whether an agreement restricts competition that would have existed in the absence of a questioned restriction. The draft would condemn any restriction unless it is "objectively necessary." We suggest that the Commission consider instead recognition in the Draft Guidelines of the significance of the parties' unique characteristics and their reasonable understandings, rather than focusing exclusively on whether firms could have adopted a less restrictive agreement. When U.S. antitrust authorities examine whether a restraint is reasonably necessary to achieve procompetitive benefits that outweigh likely anticompetitive effects,[4] they will condemn a restraint only where it is clear that the parties could have achieved similar efficiencies by means that are significantly less restrictive. U.S. enforcement authorities will not engage in a search for a theoretically least restrictive alternative that is not realistic in the practical prospective business situation faced by the parties.[5] The Commission might consider a similar approach. The current proposal may well have the unintended consequence of discouraging technology transfer in circumstances where transfer is, on balance, pro-competitive.

While it may be appropriate in certain circumstances to question whether restraints in a license agreement may anticompetitively foreclose access to, or significantly raise the price of, an important input, or may facilitate coordination to increase price or reduce output, we suggest that the Draft Guidelines' concern with intra-technology restrictions could be viewed as inconsistent with mainstream economics thinking. Field-of-use, territorial, and other limitations on intellectual property licenses are generally viewed as serving procompetitive ends by allowing licensors to exploit their intellectual property as efficiently and effectively as possible. They give licensees incentives to invest in commercialization and distribution, and increase licensors' incentives to license, by protecting against free-riding. The proposed approach may be counterproductive to the Commission's efforts toward market integration in the EU, because it may limit dissemination of technology, particularly to Member States with less advanced economies.

The Sections wish to highlight the potential negative impact from the Revised TTBER's deeming certain provisions in licensing agreements, which may be procompetitive, to be "hardcore restrictions." Inclusion of such provisions in a licensing agreement will not only cause the agreement to lose the benefit of the TTBER, but will also cause an agreement outside the TTBER market share thresholds to be condemned.

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4 U.S. authorities reach this question only when an anticompetitive effect must be justified. *See* US Guidelines ¶ 4.2. When there would have been no competition absent a license, there is no horizontal theory of anticompetitive effect. *See* US Guidelines ¶3.3.

5 *See* US Guidelines ¶ 4.2.

Paragraph 10 of the Draft Guidelines explains that hardcore licensing provisions, identified in Article 4 of the Revised TTBER, are those which have as their "object" the achievement of anti-competitive effects "by their very nature." Such provisions are presumed to have negative effects on competition without proof and cannot be saved by efficiencies.

The Sections agree that price fixing, market division, and output restrictions among horizontal competitors should be legally condemned. Such agreements would be treated as "per se" illegal in the United States.[6] The drafts, however, seem to presume there is price fixing where a cross-license agreement between competitors provides for reciprocal royalty or threshold royalty payments. The drafts also appear to condemn as a market, territorial or customer allocation scheme, licenses that simply define the extent of the licensee's right to use intellectual property, particularly in cross-licenses. Agreements with such restrictions often serve procompetitive goals, to achieve design freedom, clear blocking positions, avoid litigation, and integrate complementary technologies. We suggest that, absent restrictions on a licensee's use of its own technology, evidence that restrictions in licensing agreements are a sham to allocate markets with intellectual property of dubious validity or significance, or other evidence that an agreement constitutes "de facto" price fixing or market division, such agreements should not be condemned as hardcore restrictions. By prohibiting agreements with such restrictions, the result may be no license in some instances, rather than unrestricted agreements. We believe the Commission should reconsider its approach to such license terms, as discussed further below in Sections IV and V.

The Sections are also concerned that the Draft Guidelines may impose unrealistic burdens that may lead to condemnation and deterrence of procompetitive conduct. Most notably, the Draft Guidelines would require a final court decision or opinion of an independent expert to establish that patents are blocking. The Sections note that licenses are often entered to avoid the risks and cost of litigation, and such a rule may inhibit efficient licenses.

II Definition of Competitors

The Sections agree with the Commission's drawing a distinction between competitors and noncompetitors and for treating licenses involving the latter more leniently. The Sections also agree with the positions stated in the Draft Guidelines (¶¶ 24-26) that the test should be whether the parties would have been competitors in a relevant market in the absence of the license agreement,[7] and, therefore, situations involving blocking patents or "drastic innovations" should be treated as licensing

6 *See* US Guidelines ¶ 3.4.

7 The U.S. antitrust enforcement 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." US Guidelines ¶3.3.

between noncompetitors.

The Sections raise two main concerns, however, with the definition of competitors in the Revised TTBER and Draft Guidelines. First, we note that there appear to be significant differences between the Revised TTBER and the Draft Guidelines in terms of how they define "competitors." These differences may lead to confusion and uncertainty. Second, we believe that the Draft Guidelines place a significant burden on the parties to provide "convincing evidence" that the patents are blocking or to show that it is "obvious" that the innovation is sufficiently drastic that the licensee's technology is obsolete or uncompetitive. We believe that this burden may be counter productive to the goals of the EU.

A. Differences between the Draft Revised TTBER and the Draft Guidelines

The Revised TTBER defines undertakings as competitors based on whether the undertakings license competing technologies (are actual competitors in the technology market), sell the contract products in the same relevant market (are actual competitors in the product market) or would enter the relevant product market in response to a price increase (are potential competitors in the product market). Although neither the Revised TTBER nor the Draft Guidelines specify the time at which this test in the Revised TTBER should be applied, if the test were to be applied at a time *after* entry into the license agreement, this definition could lead to parties being deemed to be competitors whenever the licensor chooses itself to manufacture in addition to licensing others to manufacture the licensed product.[8] As the Sections explained in their comments on the TTBE Report, they believe that the key test of whether parties should be deemed competitors in the licensing context is whether they would or could be competing in the area of the license, in the absence of the license. In contrast, paragraph 24 of the Draft Guidelines provides that: "In order to determine the competitive relationship between the parties it must be examined whether the parties would have been actual or potential competitors in the absence of the agreement." The Sections believe that the Draft Guidelines propose the better approach, and suggest, therefore, that the definition of "competing undertakings" in the Revised TTBER be revised to conform to the Draft Guidelines.

In addition, the Draft Guidelines state that "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." No corresponding language is found in the Revised TTBER. The Sections suggest that the Revised TTBER would benefit from having the definition of "competing undertakings" conform to this aspect of the Draft Guidelines.

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[8] *Cf.* Draft Guidelines ¶ 26, stating that the "classification of the relationship between the parties will therefore change" if certain circumstances change.

Moreover, depending on how one reads Article 1.1(h) of the Revised TTBER, the Commission apparently may treat parties in a blocking position as competitors based on competition in goods markets, notwithstanding the fact that the blocking position would have foreclosed such competition from taking place lawfully absent the license. To the extent that a competitive relationship, which would not lawfully exist absent a license, is sufficient to render the parties competitors in goods markets for purposes of the Revised TTBER's hardcore classification, the limitations on the definition of "competitor" would appear to be insufficient to allay concerns.

B. Burden of Proof on the Parties

The Draft Guidelines conclude that parties owning blocking patents should not be considered competitors, and that where the licensor has achieved such a drastic innovation that the technology of its licensee has become obsolete, the parties likewise should not be considered competitors. (Draft Guidelines, ¶¶ 25-26.) The Draft Guidelines reserve such treatment as noncompetitors for only the clearest cases, however. Thus, in assessing whether a blocking position exists, the Commission:

- will rely on objective factors as opposed to the subjective views of the parties,
- will assume that technologies that are technologically substitutable are potentially competing "unless the parties provide convincing evidence of the existence of a blocking position,"
- will reject a "drastic innovation" argument unless at the time of the conclusion of the agreement (or some later relevant time) it is "obvious" that the licensee's technology is obsolete or uncompetitive, and
- will treat settling parties as competitors or will impose significant limits on their licensing restraints even if they are not competitors.

(Draft Guidelines, ¶¶ 25-26, 199, 198.)

There is, of course, some virtue in clarity, and the experience of U.S. enforcers and courts in dealing with assertions that apparent competitors should not be treated as such because of alleged blocking positions confirms that the absence of a bright line may often be an invitation to uncertain outcomes and costly litigation.[9] There are also costs,

[9] For example, U.S. courts and agencies have stated a wide variety of legal standards and reached a wide variety of outcomes in cases involving the settlement of patent infringement litigation between pioneer and generic pharmaceutical companies where the validity and infringement of the patents in suit were in dispute at the time of the settlement. *See, e.g. Valley Drug Co. v. Geneva Pharmaceuticals, Inc.*, No. 02-12091(11th Cir., Sept. 12, 2003)*; In re Cardizem CD Antitrust Litig.*, 332 F.3d 896 (6th Cir. 2003); *Andrx Pharm., Inc. v. Biovail Corp. Int'l*, 256 F.3d 799 (D.C. Cir. 2001); *In re Ciprofloxacin Hydrochloride Antitrust Litig.*, 261 F. Supp. 2d 188 (E.D.N.Y. 2003); *In re Schering-Plough Corp.*, No. 9297, 2002 WL 1488085 (F.T.C.) (June 27, 2003) (initial decision); *In re Hoechst Marion Roussel, Inc.*, No. 9293, 2001 WL 502087 (F.T.C) (May 8, 2001) (decision and order); *In re Abbott Labs.*, No. C-3945, 2000 WL 681848 (F.T.C.) (May 22, 2000) (decision and order).

however, to rules that overinclusively categorize companies as competitors when they do not in fact compete. First, such rules may discourage the licensor from licensing at all. For example, the possibility that a court judgment or an "independent" expert opinion will be required to establish the existence of a blocking position, as indicated by paragraph 25 of the Draft Guidelines, will exacerbate the risk and tend to create disincentives to licensing. Parties enter into licenses in part to reduce the risks associated with uncertainty. Requiring parties to identify blocking patents and confirming their blocking status through opinions of experts whose "independence" will be "closely examined" imposes a burden that undermines the risk-mitigation aspect of licensing. See Section IX below. Second, they may cause the licensor to avoid more capable licensees who may possess the valuable skills and assets needed to commercialize a technology efficiently, in favor of less capable licensees who may lack such skills and assets but run less risk of being classed as competitors. Third, the rules may make it more difficult for a company with obsolescing technology to adopt a competitor's superior technology. Fourth, the rule may discourage portfolio licensing to the detriment of innovation in industries in which such licensing is common to enable undertakings to have design freedom. In many innovative industries, licenses are granted for portfolios of patents held or acquired during a specified period. That is done to provide freedom to innovate without the need to design around the licensor's patents and thereby obviate the need for a potentially costly redesign around the licensor's patents that could occur if the licensor were to sue for infringement and succeed. Finally, the rules may discourage settlements of disputes.

The Sections therefore recommend that the burden of proving a noncompetitive relationship be relaxed by (1) allowing consideration of the reasonable beliefs of the parties at the time of the license, (2) lowering the standard from "convincing evidence of the existence of a blocking position" to "evidence that the parties had a reasonable basis to believe a blocking position more likely than not exists," (3) allowing "other circumstantial evidence" to be used in addition to judicial decisions and expert opinion, (4) changing the standard for showing a "drastic innovation" from "obvious" to "more likely than not," and (5) treating parties settling a patent dispute in the same way that parties entering a license prior to a dispute are treated. In addition, the Sections recommend that the Commission make a routine practice of giving informal individual guidance that particular parties are not competitors, beyond the limitations set forth in the Draft Notice on Informal Guidance Relating to Novel Questions Concerning Articles 81 and 82 ("Informal Guidance Notice").

III Use of Market Share Thresholds

When the current TTBER was being considered prior to its adoption in 1995, a proposal contained market share thresholds similar to those contained in the Revised TTBER. U.S. commentators observed at that time that, despite the superficial resemblance to market share thresholds in the U.S. Guidelines, such thresholds would have very different effects in the TTBER. They noted that, under European law as it then existed, agreements were automatically void and unenforceable if not exempted. Under those circumstances, the proposal would create uncertainty and vastly increase the cost and difficulty of licensing, because relevant markets are notoriously difficult to define, especially in technology areas, and shares of such markets are sometimes almost as difficult to measure.[10] In any event, the current TTBER changed the role of the market share thresholds so that, instead of being a condition of an exemption, they became a factor relevant to invoking the withdrawal mechanism.

The Revised TTBER again makes the market share thresholds a condition of an exemption, but in a different context. Whereas the current TTBER operates in a framework in which agreements were automatically void and unenforceable if not exempted, the inapplicability of the Revised TTBER, in the context of modernization, means simply that the general principles of EC Treaty Article 81(3) apply. This makes the use of market share thresholds somewhat more similar to their use in the U.S., but important differences remain.

Markets are no easier to define, and market shares are no easier to measure, than in 1995, and consequently the use of market share thresholds as a condition of an exemption will substantially decrease the utility of the Revised TTBER. This is especially so because, under Article 8, an agreement that qualifies for the exemption when entered into can lose that exemption as the parties' market share grows, subject to a transitional period. In counseling on a proposed license agreement, therefore, competition lawyers will have to advise their clients to assume that the exemption will eventually be lost, and that the license agreement should be negotiated to comply with the general principles of Article 81(3), as explained in the Draft Guidelines, rather than to comply with the Revised TTBER.

The net result is that the Revised TTBER, rather than serving as the principal guide to the application of competition law to intellectual property transactions, is likely to play a subordinate role to that of the Draft Guidelines. In this respect, the Revised TTBER is likely to function much like the "antitrust safety zone" in paragraph 4.3 of the US Guidelines, which – like the Revised TTBER – exempts transactions beneath a very low market share, and which is one of the least used parts of the US Guidelines.

It is true that the general inapplicability of the "antitrust safety zone" in paragraph 4.3 of the US Guidelines has not created great problems. The Sections note, however, that this is in the context of no presumption of illegality outside the safety zone,[11] a narrower range of conduct condemned as "hardcore" violations, and a substantial body of case law confirming the legality of many licensing practices, as well as a system of informal guidance in the form of Business Review Letters from the US DOJ and Advisory Opinions from the FTC. Accordingly, the Sections recommend that the

[10] In fact, in recognition of this fact, the US Guidelines (¶4.3) and the US Joint Venture Guidelines (¶4.3) both adopted safe harbors based on the number of independent sources of technology.

[11] The Sections commend the position taken by the Commission that there is no presumption of illegality outside the block exemption (Draft Guidelines ¶ 122), and urge that the spirit of this position be fully and consistently implemented, in particular by reducing the broad categories of license arrangements that are considered hardcore restrictions. See Sections IV and V below.

conditions under which informal guidance will be issued in this context be expanded beyond the limitations set forth in the Informal Guidance Notice.

In addition, the Revised TTBER itself can be made somewhat more useful if the Commission were to make the exemption applicable, not just when market shares fall below a 20% or 30% threshold, but also when, in a technology market, there are several independently controlled technologies in addition to the technologies controlled by the parties to the licensing arrangement, that may be substitutable for the licensed technology at a comparable cost to the user. *See* US Guidelines ¶ 4.3; US Joint Venture Guidelines ¶4.3. This would enable lawyers to counsel their clients at a time when the ultimate market shares that any particular technologies will achieve are still unpredictable.

IV Analysis of Proposed Hardcore Restrictions in Licenses Involving Competitors

Article 4 of the Revised TTBER as explained by the Draft Guidelines classifies several types of restrictions in license agreements involving competing undertakings as "hardcore." The Revised TTBER proposes to apply this classification to agreements that "directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object" the features listed in Article 4. These hardcore restrictions are (a) restrictions on resale prices, (b) certain running royalty provisions in cross-licenses,[12] (c) total sales royalties,[13] (d) limitations on output or sales, (e) market or customer allocation, (f) field-of-use limitations in reciprocal licenses,[14] and (g) restrictions on a licensee's ability to exploit its own technology or to carry out research and development. We will focus our comments on aspects of several of those proposed hardcore provisions of the Revised TTBER as explained by the Draft Guidelines, after offering some general comments.

There is much to be said for the predictability that clear-cut classifications offer. In principle, establishing safe harbors in the Revised TTBER offers a sensible way of reducing legal uncertainty with regard to practices that virtually never harm competition. Conversely, the blacklisting of hardcore restrictions offers a similarly sensible approach

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[12] Although running royalties in cross-licenses are not cited in the Revised TTBER as hardcore violations, paragraph 77 of the Draft Guidelines indicates that they are within Article 4(1)(a).

[13] Although total sales royalties are not cited in the Revised TTBER as hardcore violations, paragraph 78 of the Draft Guidelines indicates that they are within Article 4(1)(a).

[14] Although field-of-use limitations are not identified separately as hardcore violations, both Article 4(c) and the Draft Guidelines indicate that field-of-use limitations in licenses between competitors are deemed to be hardcore violations. As to reciprocal licenses, the Sections support the position expressed in paragraph 80 of the Draft Guidelines, that "an agreement is non-reciprocal where one competitor licenses a technology from another competitor but does not himself grant a license for a competing technology." Even more, we support the position in footnote 38 of the Draft Guidelines, that "Cross licensing of different non-competing technologies is treated as two non-reciprocal licenses." We believe that these are two very useful and important characterizations of such cross-licenses.

to practices that clearly have an anticompetitive purpose and invariably harm competition.

We support the position that the Commission has taken, that the classification of a practice as hardcore must be "based on the nature of the restriction and experience showing that such restrictions are almost always anti-competitive."[15] This approach in principle appropriately recognizes that the desire for predictability should not be satisfied at the expense of discouraging or penalizing practices that do not harm competition. Rigid line drawing may sweep procompetitive activities within the general condemnation of anticompetitive behavior. In the United States, the Supreme Court has underscored that it is "only after considerable experience with certain business relationships that courts classify them as per se violations." *Broadcast Music, Inc. v. CBS*, 441 U.S. 1, 19 (1979). U.S. courts therefore have emphasized the necessity for sufficient judicial experience with particular practices in rule of reason cases, in which competitive effects are examined based on the individual facts and circumstances, before the more sweeping per se condemnation may be justified for those practices.

Although the bases for reaching the hardcore classification in the European Union and the United States are thus similar, it is apparent that the approach of the Revised TTBER and Draft Guidelines will condemn a far broader range of practices as hardcore. The Revised TTBER and Draft Guidelines are much more apt to adopt sweeping presumptions that result in wholesale blacklisting of entire categories of common licensing provisions. Thus, in spite of the Commission's commendable efforts to align its approach with the economic analysis on which U.S. law is now based, in some respects the Revised TTBER and Draft Guidelines would create greater divergence.

The Sections believe that Article 4 is overly broad in classifying as hardcore infringements some common licensing terms, such as field-of-use license grants and running royalties. The Sections believe that experience with these practices shows that they tend to enhance competition more often than they lead to competitive harm. We recommend that the Commission reexamine several of the practices reached by Article 4 to confirm whether there is a sufficient basis to conclude that these practices are almost always anticompetitive.[16]

The Sections also observe that Article 4 may fail to achieve the goal of

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15 Draft Guidelines ¶ 72.

16 The Sections also understand that these hardcore classifications may go beyond the categorizations that have been recognized under existing EU competition law. In particular, the Court of First Instance has held that agreements that do not have the restriction of competition as their purpose and aim may be found to infringe Article 81(1) only if a detailed market analysis shows that they have an anticompetitive effect. *European Night Services v. Commission*, Case T-374/94 at ¶ 136; *Delimitis v. Henninger Braü AG*, Case C-234/89. Common licensing practices such as field-of-use license grants and running royalties cannot be said to have the restriction of competition as their normal object, and thus would appear not to merit the hardcore categorization as a matter of both sound competition policy and existing Community law.

predictability because of ambiguities in its terms. Given the severe consequences that attach to hardcore violations, it is important that the boundaries that define the scope of hardcore restrictions be free of ambiguity. Otherwise legitimate activity will be unduly inhibited. The Sections accordingly suggest that the Commission clarify some ambiguous aspects of Article 4, as discussed below.

A. Restriction of a Party's Ability to Determine its Prices

Article 4(1)(a) includes among the "hardcore restrictions," if contained in agreements between actual or potential competitors, the "restriction of a party's ability to determine its prices when selling products to third persons." While it is well recognized that such restrictions can be anticompetitive, the Sections believe that some of the guidance provided regarding the proper interpretation of the general proscription in Article 4(1)(a) is overly broad and if followed would render as infringements conduct that does not have an anticompetitive purpose and does not invariably harm competition.

1. Running Royalty Obligations in Cross-Licenses

The Draft Guidelines indicate that the use of a running royalty in cross-licenses may constitute a hardcore violation. Paragraph 147 of the Draft Guidelines states that "[i]n the context of cross-licensing between competitors royalty obligations may amount to price fixing and thus constitute a hardcore restriction of competition." According to paragraph 77, the Commission will treat as price fixing a running royalty obligation in a cross-license "where the parties could reasonably have chosen a less restrictive payment scheme such as lump sum payments or one-way payment of net royalties and where the amount of the royalty is such that it is likely to have a not insignificant impact on prices."

Because the reciprocal payment of running royalties may in some circumstances be used as a mechanism for coordinating prices to the detriment of consumers, the Commission is justified in fearing that such arrangements could be used for anticompetitive means.[17] However, there is insufficient experience to suggest that running royalty provisions in reciprocal licenses between competitors typically have the restriction of competition as their object. It is important, therefore, that the competitive effects of such agreements be closely evaluated before finding an infringement of Article 81 and that such agreements not be considered hardcore restrictions.

In fact, running royalties are often the most efficient way of establishing a price for a technology transfer, and the labeling of such royalties in reciprocal licenses as hardcore restrictions creates a substantial risk that the Revised TTBER and Draft Guidelines could discourage procompetitive licensing activity. Procompetitive reasons that support the use of running royalties apply with equal vigor to non-reciprocal licenses

[17] The US Guidelines recognize that "A restraint in a licensing arrangement may harm such competition ... if it facilitates market division or price-fixing." US Guidelines ¶ 3.1. The US Guidelines further recognize that "When cross-licensing or pooling arrangements are mechanisms to accomplish naked price fixing or market division, they are subject to challenge under the per se rule." *Id*. at ¶ 5.5 (citing *United States v. New Wrinkle, Inc.*, 342 U.S. 371 (1952)).

and reciprocal licenses. Yet the Revised TTBER appears to recognize the existence of procompetitive justifications in the case of non-reciprocal licenses only.

Most prominent among the procompetitive reasons for the use of running royalties is the problem of valuation. For example, the value of a license to a particular patent may depend on the extent to which the patented technology will be used over the life of the license, which may be highly uncertain. Running royalties allow the parties to meter the use of the patented technology and compensate the patent holder based on that use. Forcing the parties to agree on a lump sum royalty in advance will often create an insurmountable valuation dispute that could serve as a barrier to licensing.

A related reason for running royalties is risk allocation. A licensee may not be willing to pay a large lump sum royalty because of uncertainty as to the value of the technology or the prospects for the success of its product. A running royalty allows the licensee to reduce the risk by making its payments contingent on the success of the technology and its own product.

Running royalties also serve the purpose of financing a payment. They allow the licensee to pay from its earnings on the sale of the licensed product rather than to make an upfront payment before it has begun to earn revenues from the sale of the licensed product.

Although the Draft Guidelines implicitly acknowledge that running royalties may sometimes be a superior payment mechanism to lump sum royalties, and suggest that they will not be treated as a hardcore infringement in such circumstances (see ¶77), other analysis in the Draft Guidelines casts doubt regarding the Commission's receptiveness to running royalties.[18] In particular, paragraph 199 of the Draft Guidelines suggests that the Commission may be skeptical of objective justifications for the use of running royalties. Paragraph 199 states that (cross-)licenses negotiated in connection with settlements

[18] Indeed, even the discussion in paragraph 77 exhibits excessive hostility towards running royalties. First, it states that "the Commission will treat the arrangement as price fixing where the agreement does not lead to a significant integration of complementary technologies." It is not clear whether the Commission would regard the clearing of a blocking position as "a significant integration of complementary technologies," but the discussion of settlements in paragraphs 196-201 augurs poorly for this interpretation. Second, even in the case of a significant integration of complementary technologies, paragraph 77 states that the Commission will "consider that the arrangement constitutes price fixing where the parties could reasonably have chosen a less restrictive payment scheme such as lump sum payments or one-way payment of net royalties." In the context of intellectual property, where fixed costs of research and development are often high and marginal costs of copying are nearly zero, imposing such a "less restrictive payment" requirement would ensure that, averaged over a large number of cases, the return to innovation will be suboptimal. Imagine, for example, two blocking patents of equal value. The Commission's standard would require royalty-free licensing, even if the patents represent important discoveries that required enormous investments. Accordingly, if the parties competed price down to a level approximating marginal cost, that would result in little or no return to the investments in intellectual property. Such a result could only be justified if the Commission were to apply the concept of "competitor" in a way similar to the US approach, in which the possession of blocking patents would automatically ensure that the parties were not treated as competitors and not subject to treatment as engaging in hardcore restrictions.

"should be royalty free or, where the objective value of the technologies in question is different, provide for one-way (lump sum) royalties, reflecting the objective difference in value."

Given that running royalties can, and often do, serve procompetitive purposes, it is only where objective evidence shows that the royalty scheme is being used to support pricing coordination that the royalty arrangement should be deemed to constitute an infringement. For example, where royalties are substantial relative to downstream prices for products or services incorporating the technology, or where competitively sensitive confidential information, such as sales prices and quantities, is exchanged between competitors without mechanisms limiting access to such information, there may be a risk of such coordination. However, even a substantial royalty level may simply reflect the relative value of the contributed technology to the overall product value. More generally, there is insufficient experience with the misuse of royalty payments to coordinate marketplace pricing to conclude that running royalties are invariably anticompetitive and much evidence that such royalty payments constitute a legitimate way of compensating intellectual property owners for the use of intellectual property rights.[19]

2. Total Sales Royalties

Paragraph 78 of the Draft Guidelines indicates that total sales royalties are viewed as a hardcore restriction under Articles 4(1)(a) and 4(1)(d) of the Revised TTBER unless the parties can establish in exceptional cases that "the restriction is indispensable for pro-competitive licensing to occur" (under Article 81(3)).[20] The Draft Guidelines allow for such an exceptional possibility where it would be impossible or difficult to monitor the royalty due because "the licensor's technology leaves no visible trace on the final product and practicable alternative monitoring methods are unavailable." The Draft Guidelines recognizes only one of the legitimate reasons for the use of total sales royalties.

Total sales royalties are commonly used as a mechanism for allocating payment

[19] In fact, although *reciprocal* royalty obligations might support price collusion in *some* circumstances, the use of running royalty that is not reciprocal in nature can seldom give rise to collusion. The absence of reciprocity in the royalty term of a license is a strong (albeit not conclusive) indicator that the parties are not engaged in a price collusive scheme, under which two parties, each of which could compete with each other without a license, would be compensated by the other for staying out of a market or for keeping prices high. However, the converse is not true – the presence of reciprocal royalty obligations is not necessarily anticompetitive. Accordingly, only a price collusive scheme that has as its object the restriction of competition rather than the legitimate licensing of blocking or complementary patents should be considered to be a hardcore offense. It would be overly restrictive to ban all running royalty arrangements because of this relatively uncommon use of royalties. Moreover, the possibility of such anticompetitive use of royalties also exists with lump sum royalties, so that both types of royalty arrangements should be treated similarly and deemed to be infringements only on the basis of actual anti-competitive effects.

[20] Total sales royalties can have an anticompetitive effect if they prevent a licensee from licensing from a competitor of the licensor by forcing the licensee effectively to pay two royalties if it uses the competitor's technology. This was the theory of the first case brought by the United States Department of Justice against Microsoft Corporation. 59 Fed. Reg. 42,845 (1994).

for the use of technology where it is difficult (not just impossible) to monitor usage of licensed intellectual property. For example, it is common for Internet site operators to give away for free an Internet service that incorporates a licensed technology and to seek to garner revenues from the sale of ancillary products and services. Limiting the licensor to a royalty based on the service given away for free would effectively mean that it will not be compensated for the use of its intellectual property. Forcing it to license for a lump sum royalty also runs into the problem of uncertain or divergent valuations. Although it is possible that such a situation would be captured by the exception of paragraph 78, the high burden of proof that is placed on the licensing party to justify such a scheme is likely to discourage licensors from granting licenses in many cases in which a total sales royalty would not foreclose competition.

The Sections suggest that total sales royalties be analyzed in terms of their foreclosure effects under a standard competitive analysis and that they be deemed to constitute infringement only where they have the effect of excluding competition and have no objective justification.[21]

B. Limitations on Output and Sales

Article 4(1)(b) of the Revised TTBER proposes to treat as a hardcore restriction "the limitation of output or sales, except limitations on the output of contract products imposed on the licensee in a non-reciprocal agreement." As a general matter, limitations on output or sales in agreements between competitors may raise significant competitive concerns because they can serve as mechanisms for reducing output and raising price. Nonetheless, as paragraph 164 of the Draft Guidelines states, "non-reciprocal output restrictions in agreements between competitors may also have pro-competitive effects. In particular, they may be necessary in order to induce the licensor to disseminate his technology and to do so as widely as possible. For instance, a licensor may be reluctant to licence his competitors if he could not limit the licence to a particular production site with a specific capacity (a site licence)." A licensor's ability to place restrictions on the use of the licensed technology – including restrictions on output of products manufactured with the licensed technology – thus may in some cases lead to an overall increase in output.

Given this recognition by the Commission that output limitations in license agreements may sometimes fulfill a procompetitive purpose, the Revised TTBER sweeps too broadly in proposing to condemn such limitations as a hardcore restriction. We suggest that the approach suggested in the Draft Guidelines is the better one and that all non-reciprocal output restrictions be excepted from the hardcore classification.[22]

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[21] In fact, the US Supreme Court has held that, where total sales royalties are entered into for the convenience of the parties, as articulated by the license agreement, there can be no presumption of an unlawful purpose or effect. *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100 (1969).

[22] Of course, such agreements may infringe Article 81 when they serve as mechanisms for concealing naked output restrictions. The United States enforcement agencies deem output limitations unlawful "if they do not contribute to an efficiency-enhancing integration of economic activity among the

However, the Draft Guidelines also suggest, in paragraph 79, that a stepped royalty system that requires a licensee "to make payments to the other party if a certain level of output is exceeded" is deemed to constitute a hardcore sales or output limitation. Although such royalty schemes could be used to implement an output restriction, they more often serve as mechanisms for allocating risk where the value of a technology is disputed or uncertain. Thus, a license agreement may provide for the payment of an upfront lump sum and then for a stepped royalty (either lump sum or a running royalty) once the volume of the licensed product reaches a certain level. For example, if the parties expect that a product may sell 100,000 units but recognize that there is also a small chance that the product may become a blockbuster, they may provide for the payment of an upfront lump sum that covers the technology transfer and imputed royalties on the first 100,000 units but also include a mechanism for the payment of an additional royalty for units above 100,000. Such an arrangement will compensate the licensor in the event that the product becomes a great success but will allow the licensee to make a more affordable payment until such time that the product becomes a blockbuster and thereby also protect it from overpaying for the license.

Because this type of arrangement may have either procompetitive or anticompetitive effects depending on the circumstances, it should not be deemed to be a hardcore restriction. Accordingly, we suggest that the Commission make clear in the Draft Guidelines that royalty structures that escalate with output are not automatically deemed to be indirect output restrictions that constitute hardcore infringements. A similar clarification should also apply to the imposition of different royalty levels based on the identity of manufacturing facilities.

C. Allocation of Customers or Territories

It is apparent that intellectual property licenses may be used as a mechanism for allocating customers or territories to the detriment of competition. United States law recognizes the hardcore nature of customer or territorial allocations by treating both as per se offenses.[23] However, U.S. law differentiates between restraints that are ancillary to a legitimate business relationship and "naked" restraints, which have as their primary effect the stifling of competition. Under the US Guidelines, a restraint is deemed "ancillary" if it "can be expected to contribute to an efficiency-enhancing integration of economic activity."[24] Such restraints are evaluated under the rule of reason, under which a comprehensive review of market conditions and competitive effects is undertaken. When licensing arrangements serve as mechanisms for accomplishing naked market,

participants" and serve instead as mechanisms for achieving naked restrains on competition. *US Guidelines* ¶ 5.5

[23] *Palmer v. BRG of Georgia*, 498 U.S. 46 (1990) (per curiam); *United States v. Topco Associates, Inc.*, 405 U.S. 596 (1972).

[24] *US Guidelines* ¶ 3.4.

territorial, or customer allocation, they are subject to challenge under the per se rule.[25]

It is important, therefore, to distinguish between market, territorial, and customer allocation, on the one hand, and agreements that simply define the extent of the licensee's right to use licensed intellectual property, on the other.[26] When a restraint is placed in a license for intellectual property of dubious validity or significance, it may serve as a cover for a naked restraint. Thus, where the parties could compete in the absence of the license and do not compete as a result of a license, there is legitimate cause for competitive concern.[27] At the same time, agreements that specify the extent of a licensee's ability to use intellectual property but do not interfere, directly or indirectly, with their ability to compete without the use of the intellectual property do not have these anticompetitive characteristics.

It appears, however, that Article 4(1)(c) is intended to reach beyond sham licensing arrangements in which intellectual property of dubious validity or significance is used to allocate markets. For example, customer and territorial limitations on the license grant in cross-licenses appear to be caught within the definition of hardcore. The Sections believe that this approach is too sweeping and that the hardcore label should be reserved for the allocation of customers or territories that the parties would have been able to serve in competition with each other absent their agreement and that have been effectively divided as a result of the agreement. Such agreements typically would restrict activities that can be undertaken without the licensed technologies. For example, an agreement that prohibits competing parties from seeking the business of particular

[25] *US Guidelines*, ¶¶ 3.4, 5.6.

[26] US law recognizes that a license whereby an intellectual property owner grants to competitors the right to use its technology within limited fields or territories may be used to facilitate a market division whereby the licensees abandon the use of their comparable technologies. *See United States v. Studiengesellschaft Kohle, m.b.H*, 670 F.2d 1122, 1136 (D.C. Cir. 1981). However, this result may be obtained only where the agreement effectively restricts competition among the parties in the sale of goods in which they would have competed in the absence of the agreement. *Id*. This important distinction is one of the prominent themes of the US Guidelines. For example, suppose that party A has patents in countries 1-5 and party B has patents in countries 3-6. A cross-license whereby A and B are licensed under each other's patents in countries 3-5 but continue to reserve for themselves the countries in which the other has no patents promotes competition in the countries in which both parties have patents and does not impair any competition in the countries in which only one party is patented. Such a license could be anticompetitive only if it is possible to compete in the unlicensed countries without infringing the patents and the parties, as a result of their agreement, refrain from doing so although they were not formally precluded from competing.

[27] An example of a territorial division established through a license agreement is provided by the allegations of the complaint in *United States v. American National Can Co.,* Civ. No. 96-01458 (D.D.C., filed Jun. 25, 1996), 61 Fed. Reg. 34,862 (Jul. 3, 1996). There the Justice Department alleged that American National Can acquired an exclusive license from KMK Maschinen AG to use KMK's technology for manufacturing laminated toothpaste tubes in the United States and agreed to cease manufacturing tube-making equipment, while KMK agreed to cease the manufacture and sale of laminated tubes in the United States. Based on the complaint, it appears that there was no valid intellectual property constraint to the parties' continued competition in each other territory. The license agreement was thus a mechanism for dividing territories.

customers would appear to be inherently suspect. Similarly, there is reason for concern with "cross licensing arrangements whereby each party is granted an exclusive right to exploit the licensed technology in a particular territory," as suggested by paragraph 81 of the Draft Guidelines. The type of analysis endorsed in the US Guidelines is well suited to addressing any such market divisions attempted under the cover of licensing, as the *American National Can* complaint demonstrated.[28]

The Sections recognize that a concern for securing and maintaining the single market may lead to considering stricter treatment for territorial and customer licensing limitations than for other license terms. Nevertheless, the fact that the Revised TTBER and Draft Guidelines appear to be somewhat more permissive with respect to territorial provisions in *vertical* licenses suggests that the Commission properly recognizes the different considerations that come into play in the licensing of intellectual property, which itself exists in different forms in different countries.

D. Field-of-Use License Grants

Article 4(1)(c)(i)'s blacklisting of field-of-use provisions in cross-licenses appears inconsistent with the principle that a hardcore restriction of competition is one that experience has shown to be almost always anticompetitive or that has its object the restriction of competition. Although it is true that competitors may use field-of-use limitations as mechanisms for allocating markets by reserving for each competitor a protected portion of the market, the use of such limitations for this anticompetitive purpose is far from predominant.[29] The Draft Guidelines themselves recognize (at ¶174) that a licensor is normally "entitled to grant licences to different licensees limited to one

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[28] We also believe that the suggestion in Draft Guidelines ¶ 82, that an exclusive license "whereby the licensor grants an exclusive licence according to which he undertakes not to exploit the licensed technology himself" is necessarily an anticompetitive sharing of markets, is unduly harsh. The US Guidelines recognize that such an arrangement should be treated as equivalent to a merger. *US Guidelines* ¶ 5.7.

[29] As the U.S. enforcement agencies state in the *US Guidelines*, "[f]ield-of-use, territorial, and other limitations on intellectual property licenses may serve procompetitive ends by allowing the licensor to exploit its property as efficiently and effectively as possible." *US Guidelines* ¶ 2.3. Whether pertaining to fields of use, customers to which a licensee may sell a licensed product, or territories into which a licensee may sell, these limitations on the scope of the license grant enable a licensor to maximize the exploitation of the licensed technology by granting license rights that enhance incentives to use the licensed intellectual property. As the *US Guidelines* indicate, these license limitations promote the exploitation of licensed technology "by protecting the licensee against free-riding on the licensee's investments by other licensees or by the licensor" and increase the licensor's incentive to license "by protecting the licensor from competition in the licensor's own technology in a market niche that it prefers to keep to itself." *Id.* Notably, field-of-use limitations in licenses which are not between competitors are not deemed to be hardcore violations and, contrariwise, qualify for exemption where the market share criteria are satisfied. This treatment of field-of-use license grants in the draft Revised TTBER and Draft Guidelines appears to be based on recognition that the benefits of field-of-use license grants in increasing incentives to license will typically outweigh the potential benefit of inducing additional intra-technology competition through a prohibition of field-of-use terms. See paragraph 174 of the Draft Guidelines, which expressly recognizes the benefits of field-of-use licensing when used in agreements not involving competitors.

or more fields of use."

In the context of reciprocal licensing, field-of-use licensing is much more commonly used when one party to the license agreement has a broader or stronger intellectual property portfolio than the other and wishes to license the other in some but not all of the areas in which it holds significant IPRs. The use of such limitations may also reflect the value of monetary consideration that changes hands. A party may not sufficiently value a particular field to offer sufficient monetary value for a license to the intellectual property right that would include that field.

Field-of-use licensing may also reflect other differences in the technological focus of the parties' portfolios. In circumstances in which each party has strong intellectual property rights in a field in which the other does not, field-of-use limitations promote licensing by enabling the parties to license intellectual property without having to sacrifice the advantages created by their strong intellectual property. Such agreements may also simply reflect patent holders' desire to maintain whatever competitive advantages they may have in their core markets by virtue of their patent position. Unless the agreements inhibit competition that would have existed in their absence, they cannot be said to allocate markets.

There may also be valid reasons for limiting the use of the licensed intellectual property to separate fields, such as where each party controls blocking patents within each market. The Revised TTBER and Draft Guidelines capture cases in which there is a partial limitation that affects only one party or affects one party significantly more than the other. Where the field-of-use limitations result in the granting of greater use rights to one party than to the other, they may reflect an imbalance in the parties' patent portfolios rather than a collusive scheme to allocate markets or customers. The Commission appears to recognize that non-reciprocal restraints even in reciprocal licenses often serve procompetitive purposes, as shown in the discussion of output restrictions in paragraph 164 of the Draft Guidelines. These same principles apply with at least equal vigor to non-reciprocal or asymmetric field-of-use license grants.

The Sections recognize that not all field-of-use license grants are benign. There are documented cases of the use of such provisions to carve up markets. For example, in the U.S. case of *United States v. Crown Zellerbach Corp.*, a federal district court condemned as per se unlawful arrangements whereby a minor patent that was not necessary for participation in a product market was used as a mechanism for allocating markets.[30] The agreements in *Crown Zellerbach* constituted unlawful market allocations because the licensees could have competed with the licensors absent the agreements but refrained from competing as a result of the agreements. As one U.S. federal appellate court put it, the competition laws are violated when cross-licensing is used to allocate

[30] 141 F. Supp. 118 (N.D. Ill. 1956). The license agreement required the licensee to manufacture only products subject to the licensor's patent. The court condemned this restraint because, while the patent confers the right to exclude others from use of the patented invention, it "does not legalize the exclusion of competition from unpatented products." *Id*. at 126.

"fields of manufacture among companies which otherwise would be in competition."[31] More recently, the Commission's *Racal/Decca*[32] case condemned a market allocation scheme that was facilitated by field-of-use licensing of questionable intellectual property[33] that "[i]n spite of the name 'licence agreement,'" had "no relation to a real licence agreement."[34] Similarly the paradigm case discussed in paragraph 83 of the Draft Guidelines may raise the possibility of anticompetitive outcomes under licenses whereby competitors in one market grant rights to each other in completely different markets, such as in a cross-license whereby "A limits the licence to product market X and B limits his licence to product market Y." However, there is no basis for presuming that the object and effect of field-of-use terms in reciprocal licenses is ordinarily the allocation of markets rather than for the procompetitive reasons described above. Indeed, the relative rarity of market allocation cases based on such licenses cautions that blanket condemnation of arrangements is inappropriate without further analysis of the facts and circumstances.

Only analysis of the individual facts of each case can therefore determine whether field-of-use licensing has been used to allocate markets or customers or, contrariwise, to increase competition by enabling parties to compete in a field with the other's intellectual property. Experience has shown neither that the anticompetitive use of such provisions is predominant nor that ferreting out anticompetitive uses is difficult.[35]

The suggestion in paragraph 83 of the Draft Guidelines that a hardcore infringement can be avoided by licensing symmetrical (i.e., identical) fields of use does not adequately address the disincentive to licensing that the categorical approach to field-of-use licensing will create. In particular, it fails to take into account imbalances in

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31 *Cutter Laboratories, Inc. v. Lyophile-Cryochem Corp.*, 179 F.2d 80, 92 (9th Cir. 1949).

32 OJ [1989] L43/27.

33 Both the licensor and its licensees recognized that the intellectual property rights being licensed were at best of dubious quality. *Id*. at ¶¶ 23, 106.

34 *Id*. at ¶104.

35 Footnote 59 of the Draft Guidelines indicates that in analyzing the effects of field-of-use license grants, "benefits for one group of consumers cannot be balanced against harms to another distinct group of consumers," citing point 39 of the Article 81(3) Draft Guidelines. Point 39 of those other guidelines, however, focuses clearly on the "relevant market" – e.g., "[n]egative effects on consumers in one geographic market or product market cannot normally be balanced against … positive effects for consumers in another unrelated … market." It does not support the more ambiguous and narrow approach of footnote 59, which speaks of impacts on "groups" of customers. Footnote 59 thus appears to create a stricter test for what benefits can be considered than is normally used in competition law analysis. And if fields of use are treated under the Draft Guidelines as dividing up customers, footnote 59 might be read to suggest that the preferences of any person or group who would not be able to secure a particular licensed product because of a field-of-use provision would have suffered a harm which could not be outweighed by the benefits which others in the same market enjoyed from the licensing involved. Where some tradeoffs between consumer benefits occur, we suggest that it is better to look at *net* consumer benefits in the relevant product and geographic markets, and not at some narrower special construct.

intellectual property portfolios that render field-of-use provisions necessary in the first place. As a result, the treatment of field-of-use limitations is likely to discourage licenses that otherwise would be entered into and defeat the goal of increasing incentives to license.

The Sections also respectfully disagree with the suggestion that a grant of a particular field of use should be deemed hardcore "irrespective of whether the licensee remains free to use his own technology." Draft Guidelines ¶ 81. To the extent that a license does not preclude a licensee from using its own technology, it does not affect competition if the licensee either (i) has no viable competing technology and thus would not have been a competitor absent the license or (ii) has a viable competing technology and continues to market it in competition with the licensor. The licensee's freedom to use its technology only becomes material in the more unusual case in which a licensee has a viable (that is, equally or more economic) competing technology that it ceases to use as a result of a license agreement. Such a case, of course, involves far more than a simple field-of-use or territorial grant; it may involve an agreement to use the intellectual property license as a cover for collusive activity. See Section IV.5. below.

Finally, the Draft Guidelines appear to propose another major change from established Community law with respect to field-of-use licensing, suggesting that a field of use cannot be narrower than a product market. However, both recital 22 and Article 2 (1) 8 of the existing TTBE expressly refer to a valid field of use as one that grants a license for "one or more technical fields of application … *or* to one or more product markets" (emphasis added). The Draft Guidelines suggest instead, at paragraph 170, that a license that allows one licensee to manufacture transmissions for automobiles with four cylinders or less and another licensee for automobiles with more than four cylinders is not a field-of-use restriction and is instead a "customer restriction" and thus subject to hardcore treatment. There appears to be no reason for this departure from past Commission practice that deems fields of use to be legitimate if they apply either to a technical field of application or a product market. Four-cylinder engines possess technical parameters (e.g., torque, horsepower, etc.) that are different from eight-cylinder engines, which car designers consider when matching transmissions to engines for reliable performance. Moreover, a patent holder may wish to license different companies in each sphere or to license companies in one sphere in which it does not have capabilities while reserving for itself the exclusive rights to practice its own inventions in the sphere in which it has capabilities.[36] There is thus, as the US Guidelines recognize (¶3.4), no basis for presuming that this type of licensing will diminish competition or harm customers, so as to obviate the need for conducting an analysis of the competitive

[36] For example, manufacturer A may license manufacturer B technology for use in making parts for B's products, but not to make parts for A's products, while B licenses A other technology with the restriction that A not use the technology to make parts for B's products; it is difficult to discern the competitive harm that may result from such restrictions, whereas the pro-competitive benefits are apparent. Such a license leaves unaffected whatever pre-license ability each party had to compete in the sale of parts for the other party's products using its own technology. And, by removing any infringement cloud over each party's further development of its own parts, the license may intensify competition between them in the development of new generations of competing products and associated parts.

effects of each license arrangement.[37]

E. Restrictions on a Licensee's Ability to Exploit Its Own Technology

Article 4(1)(d) also applies the hardcore categorization to restrictions in licenses between competitors that curtail the licensee's ability to exploit its own technology and to restrictions on the parties' ability to carry out independent research and development except where the latter are indispensable to prevent the disclosure of licensed know-how to third parties. The Draft Guidelines clarify this provision in paragraph 87 by stating that the licensee must 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." The clarification in the Draft Guidelines is helpful in making clear that a restriction on the use of the licensor's technology is not deemed to be a hardcore restriction. Rather, the hardcore classification is reserved to such cases where it is possible for the licensees to compete without the licensed technology but the license agreement is used as a cover for a collusive scheme.[38] The Sections agree, in situations involving the presence of market power, with the conclusion in paragraph 87 of the Draft Guidelines. However, where there is an absence of market power, we suggest that there should not be such a requirement and that the possible pro-competitive effects of such an arrangement in those circumstances should be considered. If, for example, there are many competing technologies that are not restricted by the license, the restriction will not have competitive significance and might benefit consumers, for example, by establishing better standardization and quality control among the mix of downstream products, making them easier to use. We recommend that the Commission at the least include the qualification in paragraph 87 of the Draft Guidelines in the Revised TTBER itself.

V Analysis of Proposed Hardcore Restrictions in Licenses Involving Non-Competitors

Article 4 of the Revised TTBER also classifies a few types of restrictions in

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[37] The Sections understand that *Windsurfing v. Commission*, [1986] ECR 611, held unlawful restrictions that limited the sale of sail rigs produced pursuant to a license to specified types of sailboards. A restriction on the sale of a product produced pursuant to a license should be distinguished, however, from a restriction of the manufacture of a product for a particular purpose, where the characteristics of the licensed product differ depending on the intended purpose. Whereas a sale restriction affects the sale of the licensed product, a manufacture restriction limits the scope of the rights granted under a license to *manufacture* the licensed product. Thus, the Draft Guidelines go beyond the *Windsurfing* case in classifying infringing license limitations. The Sections urge the Commission not to expand the *Windsurfing* holding in this manner. Restrictions on the sale of product manufactured pursuant to a license that limit the product's sale for certain specified use categories, like other types of purely vertical nonprice restrictions is more likely to enhance competition than to harm it. Accordingly, the Sections believe that the condemnation of field-of-use restrictions that limit sales of the licensed product to specific types of end uses as a hardcore infringement is unwarranted.

[38] If, however, our understanding of the Draft Guidelines is incorrect, and the intent of the parties is not considered, then the hardcore classification may still be overbroad in this respect.

license agreements involving non-competing undertakings as "hardcore". These are minimum resale price maintenance, certain field-of-use, customer, and territorial limitations,[39] and restrictions of sales to end users by licensees that belong to a selective distribution system. As in the case of agreements involving competitors, the Sections are concerned that the enhanced predictability offered by the clear-cut classifications of the Revised TTBER will come at the cost of discouraging procompetitive licensing activity, particularly with respect to field-of-use, customer, and territorial limitations in purely vertical licenses. In the absence of market power and concern that restraints may facilitate collusion or foreclose competitors, we respectfully suggest that there should be no concern about vertical non-price restraints.

Article 4(2)(b) of the Revised TTBER classifies certain field-of-use, customer, and territorial limitations in licenses involving non-competitors as hardcore infringements, subject to five exceptions. The field-of-use limitations that are deemed to be hardcore violations, according to paragraph 170 of the Draft Guidelines, are those that are "based on the use made by the buyer of the products incorporating the licensed technology." The Draft Guidelines illustrate the concept of an improper use restriction by indicating that a field-of-use limitation that allows one licensee to manufacture transmissions for automobiles with four cylinders or less and another for automobiles with more than four cylinders is deemed to be a hardcore restriction. The Draft Guidelines also suggest that the creation of different fields of use within a single product market may also be a hardcore infringement.[40]

The five exceptions to the hardcore classification of these various license limitations are (a) restrictions of sales into an exclusive territory or customer group reserved for the licensor, (b) restrictions of sales into an exclusive territory or group reserved for another licensee, (c) requirements that licensees manufacture contract products only for internal own use, (d) restrictions of sales to end users by a wholesaler licensee, and (e) restrictions of sales to unauthorized distributors by the members of a selective distribution system.

The Sections wish to point out that the treatment of vertical nonprice restrictions as hardcore infringements, albeit with enumerated exceptions, differs from the treatment of these license terms under U.S. law, where a showing of adverse competitive effects is necessary for the condemnation of these terms. U.S. law requires all nonprice restraints

[39] Although fields-of-use limitations are not cited in the Revised TTBER as hardcore infringements, paragraph 170 of the Draft Guidelines indicates that certain field-of-use restrictions are within Article 4(2)(b). The Sections respectfully suggest that the Commission reexamine this departure from existing practice and focus on the actual competitive effects of field-of-use license grants rather than on the arbitrary distinction between a field of use that is equal to or greater than a product market and one that is a subset of a product market. There is nothing intrinsic to the two classifications that would differentiate them from the standpoint of competitive effects.

[40] As discussed in the context of agreements between competitors, paragraph 170 treats as a hardcore customer restriction a field-of-use license grant that is based on the use made by the buyer of the licensed goods.

among noncompetitors to be evaluated under the rule of reason.[41] See generally US Guidelines ¶ 2.3 ("[f]ield-of-use, territorial, and other limitations on intellectual property licenses may serve procompetitive ends by allowing the licensor to exploit its property as efficiently and effectively as possible."). While the Sections do not mean to suggest that merely because U.S. law takes this approach, the EU should do the same, the Sections do believe that there is a real benefit to international licensing transactions having a similar framework to govern their operations across borders.

The Revised TTBER and Draft Guidelines deem customer or territorial restrictions that exclude licensees from selling into *non-exclusive* customer groups or territories to be hardcore restrictions, along with non-exclusive field-of-use restrictions that are based on customer groups or end uses.

We respectfully submit that this hardcore classification may prohibit more procompetitive licensing activities than anticompetitive practices, and that an evaluation of vertical nonprice license restrictions based on their competitive effects in each case is more likely to promote the procompetitive diffusion of technology. For example, a licensee granted a non-exclusive territory may be more willing to invest to develop that territory if it had the assurance that it would be sharing the territory with only two or three other licensees, and not two or three dozen other licensees. Moreover, a licensor may wish to exclude an exclusive licensee from selling into non-exclusive territories, in order to ensure that the licensee will not only be assured of an exclusive area that it could develop without fear of free riders, but also will focus its efforts on its own exclusive territory that the licensor granted, without temptation to venture elsewhere in the security of an exclusive base territory. In any event, the nonexclusive grant of the right to sell to specified customer groups or endusers is unlikely to promote a licensee cartel, which is more likely to be effectual when the allocations are exclusive.[42] In fact, to consider such a restriction in the context of non-exclusive territories to be hardcore while deeming such restrictions not hardcore in the context of exclusive territories might have the unintended result of encouraging the granting of exclusive territories. Such a result may restrict competition more than a restriction against selling in non-exclusive territories.

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

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41 *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977).

42 This greater likelihood does not mean that the grant of the right to sell into exclusive territories or customer groups is typically likely to facilitate licensee cartels or other anticompetitive results.

As in the case of license agreements involving competitors, the Sections believe that the classification of field-of-use limitations involving non-competitors as hardcore violations is particularly likely to inhibit procompetitive licensing activity. The Draft Guidelines recognize that field-of-use limitations involving non-competitors often serve a procompetitive purpose by promoting "dissemination of new and valuable technology by giving the licensor an incentive to licence for exploitation in fields in which he does not want to exploit the technology himself."[43] These principles are equally valid whether the field of use is greater than, equal to, or smaller than a product market and regardless of the product uses for which the license grant is limited.

VI Tying

The Sections believe that providing a block exemption for tying where the parties satisfy the market share thresholds is a significant improvement over the existing approach. The Sections also support the Commission's decision to exempt tying regardless of whether the parties are competitors, a decision that reflects the reality that the most likely competitive harm arises from foreclosure in the tied market, which may result regardless of whether the tie is established by competing or non-competing parties.

The Sections support the Commission's willingness to consider the possible efficiencies from, as well as the anticompetitive effects of, tying as reflected in the Draft Guidelines. In particular, we welcome the Commission's recognition that a licensor's desire to maintain goodwill that it may have in its trademark or brand name provides a legitimate justification for engaging in tying. The Commission may want to consider whether to make specific reference to the franchising context, where the licensor's desire to use tying as a method for protecting its trademarks and brand names is likely to be at its greatest. In addition, the Commission may want to consider clarifying the last sentence of ¶ 186 of the Draft Guidelines. Perhaps due to a lack of context, we are unclear as to the Commission's meaning in that sentence.

The Sections agree with the Commission's conclusion in the Draft Guidelines that "[f]or 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," because otherwise, "the licensor cannot use his technology for the anti-competitive purpose of foreclosing suppliers in the tied product." ¶ 185. In addition, we agree that "the tie must cover a certain proportion of the market for the tied product for foreclosure effects to occur." ¶ 185. With respect to the Commission's discussion in the Draft Guidelines of how tying may have the effect of increasing royalties "when the tying product and the tied product are partly substitutable and the products are not used in fixed proportion," the Sections note that such increased royalties may actually have beneficial effects, by encouraging the expansion of output to those buyers who are willing to pay a price that exceeds the seller's marginal cost but that is below the seller's monopoly profit maximizing price. Allowing such beneficial effects to take place is especially important

[43] Draft Guidelines ¶ 173.

in the case of intellectual property, where the fixed costs of research and development generally vastly exceed the marginal cost of producing a unit of a product embodying the invention. Therefore, we urge that tying not be considered in infringement of Article 81 merely by the fact that royalties may be increased as a result. Instead, tying should be condemned where it actually may contribute to significant foreclosure of competition in the tied product or maintenance of a monopoly in the tying product.

The Sections encourage the Commission to clarify the relationship between its tying analysis and its concern about restrictions on the licensee's ability to exploit its own technology, because a tie, as a practical matter, may effectively limit a licensee from exploiting its own technology. Under the Revised TTBER, the Commission could arguably rule that a tying arrangement constituted an impermissible condition under Article 5(3), which denies exemption to agreements between non-competitors that include "any direct or indirect obligation limiting the licensee's ability to exploit its own technology," or a hardcore restriction under Article 4(1)(d), which bars "the restriction of the licensee's ability to exploit its own technology" in agreements between competitors. The Sections respectfully suggest that the Commission should clarify that it does not intend for tying arrangements to fall under Article 4(1)(d) or Article 5(3).

The Sections agree with the Commission's approach of retaining the right to withdraw the Revised TTBER in the event that the cumulative effect of parallel networks of similar restrictive agreements prohibiting licensees from using third parties' technologies is unduly restrictive of competition, and agree that this principle should extend to tying arrangements. We agree with the Commission's concern that a cumulative effect could result either from the cumulative effect across licensors, or could result from the cumulative effect across a single licensor's agreements. However, we urge the Commission to extend to the tying context its statement that "a serious cumulative effect is unlikely to arise as long as less than 50% of the market is tied" (¶191), which it makes in its discussion of non-competition clauses, while we recognize that such a safe harbor may have limited utility because of the difficulties of market definition and measurement discussed earlier.

VII Non-Competition Clauses

The Sections support the Commission's application of the Revised TTBER to non-competition arrangements of any duration equal to or less than the duration of the underlying agreement. The Sections also appreciate that the Commission applies a similar analytical framework to tying and non-competition clauses, recognizing that both may result in foreclosure of competing technologies. The U.S. has also adopted this approach. See US Guidelines ¶4.1.1 ("Harm to competition [from a licensing restraint] also may occur if the arrangement poses a significant risk of retarding or restricting the development of new or improved goods or processes.").

The Sections support the Commission's recognition of the pro-competitive effects of non-competition clauses along with the potential anti-competitive effects. We agree with the Commission's conclusion that such clauses may "promote the dissemination of technology by reducing the risk of misappropriation of the licensed technology, particularly know-how" and may reduce the problem of calculating and monitoring royalty payments. The Sections also agree that licensors should consider minimum output or royalty obligations as possible substitutes for non-competition clauses, but also recognize that the impact of some such clauses may be similar to non-competition clauses in some circumstances and that the parties should be allowed to negotiate their own business deals within the permissible range of possibilities, rather than being straitjacketed into specific provisions.

The Sections encourage the Commission to make reference to an additional procompetitive benefit of non-competition clauses, particularly in exclusive licensing arrangements: that the licensee would be committed to exploiting the licensor's technology rather than that of a rival. The presence of a non-competition clause can give the licensor greater confidence that the licensee will devote its scarce capital resources to exploiting the licensor's technology and not that of a competitor and that the licensor's technology will not be set aside to the advantage of a competitor.

The Sections are puzzled, however, by the Commission's special concern about "non-compete obligations [that] are targeted at undertakings that are the most likely to license the competing technologies." ¶ 192. Although we agree with the Commission that such targeting could raise competitive concerns, we believe that the Commission should consider whether this test is too susceptible to manipulation after the fact, thus creating uncertainty for licensors that are using non-competition clauses in an insubstantial part of the market. For example, if a particular licensee ultimately is very successful, it might in hindsight appear also to have been most likely to license competing technologies but for the non-competition obligation.

The Sections suggest that the Commission may want to revisit the rationale behind the Commission's conclusion that foreclosure is greater where licensees are making an input for their own use rather than products for distribution to third parties. The Sections respectfully urge that the economic analysis should be the same in both cases. Regardless of the licensee's use of the licensed technology, a competing licensor is barred from a potential licensee.

VIII Grantbacks

The Sections welcome the proposed extension of the TTBER to cover non-exclusive grantbacks of improvements that are not reciprocal. We believe that, in many instances, grantbacks can provide a valuable incentive to a licensor to license its technology.

The proposed Revised TTBER will not exempt (1) assignments to the licensor of any improvements or new applications of the licensed technology; or (2) exclusive grantbacks of severable improvements and new applications. This is similar to the approach of the existing TTBER, which the Sections suggest lacks clarity in this area. The Sections believe that the Draft Guidelines would benefit from explaining the meaning of the term "severable" and clarifying whether the language "new application of the licensed technology" is intended to have any independent meaning distinct from "severable improvements." In any event, it is difficult to see a justification for distinguishing between "severable improvements" in the case of exclusive grantbacks and "improvements" in the case of assignments because, as the Commission recognizes, there may be no economic difference between an exclusive license and an assignment.

It would be helpful if the Draft Guidelines could discuss in greater detail the assessment of grantbacks that fall outside the scope of the Revised TTBER and make it clear that exclusive grantbacks may, in certain circumstances, meet the conditions for individual exemption. For example, the US Guidelines (¶5.6) provide helpful guidance by focusing on the harms that may arise with respect to the licensee's incentives to engage in research and development and thereby limit rivalry in innovation markets, noting that a particularly relevant factor is the licensor's market power in the relevant technology or innovation market (US Guidelines ¶¶ 2.2, 5.6). In addition and for purposes only of example, the US Guidelines acknowledge the importance of considering the procompetitive effects that may result from grantback provisions. These include (1) promoting dissemination of licensees' improvements to the licensed technology, (2) increasing the licensors' incentives to disseminate the licensed technology, and (3) otherwise increasing competition and output in a relevant technology or innovation market. US Guidelines ¶5.6. The Sections submit that all of these factors are important, particularly in the biotechnology and pharmaceutical industries, where exclusive licensing of technologies along with careful allocation of subsequently developed technologies between the parties provide the engine that drives the development and commercialization of new products.

The Sections are concerned regarding the likely impact of paragraph 102 of the Guidelines, which states: "The risk of negative effects on innovation is higher in the case of cross licensing between competitors where a grant back obligation is combined with an obligation on each licensor to share with the other party improvements of his technology. The sharing of all improvements between competitors prevents both competitors from gaining a competitive lead over the other." The Sections suggest that the Commission should consider the market realities that some industries in which it is common for there to be cross-licenses to entire portfolios, including future patents, are very innovative and fiercely competitive. In other industries, harm to innovation may result from "an obligation to share future improvements". We submit that the issue should appropriately be examined in light of the characteristics of the industry concerned and the actual impact of each license term on the parties' incentives.

IX Blocking Patents and Settlement Agreements

On the topic of blocking patents and the related topic of settlement agreements regarding disputes over the scope, validity and infringement of intellectual property rights, the Sections believe that consumers will benefit from the fact that the Draft

Guidelines and the U.S. antitrust laws and the US Guidelines have adopted basically similar approaches.[44] Initially, the Sections note that the Draft Guidelines at times draw a distinction between licenses that are entered into as settlements of legal disputes and other licenses. The Sections respectfully question whether that distinction is warranted. It implicitly presumes that licenses that are not labeled as settlement agreements possess no element of a settlement. However, since the purpose of a license agreement is the avoidance of a legal dispute, most licenses in fact embody a settlement. Many licenses that are not labeled as settlement agreements are entered into with explicit contemplation of litigation as the alternative, and many settlements of patent disputes are embodied in patent licenses. Accordingly, the Sections suggest that the distinction between settlement agreements and other license agreements may not be a useful one in most circumstances.

The Sections concur with the assessments reflected in paragraphs 196 to 201 of the Draft Guidelines that the Revised TTBER should apply to settlement agreements and non-assertion agreements, that cross licensing in the context of settlement and non-assertion agreements is not, as such, restrictive of competition since they allow the parties to compete *ex post*, and that such agreements that do not contain any hardcore restrictions should be subject to the block exemption. The Sections concur with the caveat in paragraph 196 of the Draft Guidelines that "the individual terms and conditions of such agreements may be caught by Article 81(1)."

We suggest that clarification of certain definitions in the Revised TTBER, and lowering certain evidentiary thresholds in the Draft Guidelines, for establishing a blocking position, would help decrease uncertainty and avoid substantial transaction costs that are otherwise likely to result in deterring pro-competitive and efficiency-enhancing conduct. The scope of coverage of patent rights and validity of those rights may be the subject of intense and expensive litigation. The Sections would urge against the adoption of any standards or thresholds in the Draft Guidelines that might in practice require inefficient litigation to resolve disputes as to the scope of intellectual property rights where such disputes might be more efficiently resolved through settlement, which might more expeditiously allow disputed technologies to be deployed for the benefit of consumers.

The Sections agree that it may be necessary to assess "objective" factors, and not rely solely upon "the subjective views of the parties" (Draft Guidelines ¶ 25). The Sections suggest, however, that the requirement of "convincing evidence" of the existence of a blocking position described in paragraph 25 of the Draft Guidelines, which suggest that "[r]elevant evidence comprises final court decisions on the matter and opinions of independent experts" is too limiting, and that the Draft Guidelines should confirm that good faith positions of the parties or other factors may be a sufficient basis

[44] See US Guidelines ¶¶ 2.3 ("Licensing may promote the coordinated development of technologies that are in a blocking relationship."); 5.5 ("Settlements involving the cross-licensing of intellectual property rights can be an efficient means to avoid litigation and, in general, courts favor such settlements. When such cross-licensing involves horizontal competitors, however, the Agencies will consider whether the effect of the settlement is to diminish competition among entities that would have been actual or likely potential competitors in a relevant market in the absence of the cross-license.").

for establishing a blocking relationship. We caution that requiring a final determination of a court, or even an independent expert assessment, before finding the existence of blocking relationships and exempting the settlement of litigation, may require the substantial expenditure of funds and resources, and may force parties otherwise willing to settle upon terms accommodating multiple technologies to pursue an expensive resolution that might be more likely to result in one technology prevailing and thereby limiting competition from the other technology.

The Sections are also concerned that paragraph 197 may be overly restrictive, particularly to the extent that it broadly suggest that agreements that impose restrictions on the parties concerning the use of their respective technologies, where the parties are deemed to be non-competitors because of a two-way blocking position, are "unlikely to fulfil the conditions of Article 81(3)." The Sections concur that such restraints may be anticompetitive in particular circumstances, but caution that a rigid view of restrictions in settlements of two-way blocking positions may result in undue expense and delay in implementation of beneficial technologies.

The Sections concur that hardcore restraints in such agreements should remove them from the block exemption as provided in paragraph 201 of the Draft Guidelines. The Sections further note that a net payment or consideration flowing to the party accused of violating intellectual property rights rather than to the rights holder may appropriately raise concern that the agreement may be anticompetitive.

The Sections concur with paragraph 198 of the Draft Guidelines in considering the impact on the parties' incentive to innovate and market power in assessing the effect on competition of a settlement agreement that grants rights to future developments in the other party's technology. The Sections are concerned, however, that paragraph 198 not be interpreted to preclude application of Article 81(3) in all circumstances where the parties have an appreciable degree of market power. They also urge that the relevant market for such an assessment is more properly either an innovation market or the technology market, not a product market. This might be an area in which assessment of a distinct innovation market or an assessment based on the number of competing technologies is more relevant than a focus on product revenue.

The Sections concur with paragraph 199 of the Draft Guidelines that "[r]oyalty obligations and other payment schemes in the context of settlement and non-assertion agreements may be caught by Article 81(1) when they allow the parties to co-ordinate their pricing" and that the analysis in paragraphs 77 and 147 of the Draft Guidelines is applicable in assessing pricing concerns. However, the Sections do not believe that the fact that such payment schemes may in some cases be used for anticompetitive purposes justifies a sweeping condemnation of all royalty-bearing license agreements resulting from settlements that do not provide for a lump sum payment. For the reasons discussed in Part V(A) above, the Sections suggest that Draft Guidelines ¶ 199 is overly restrictive where it suggests that all such licenses "should be royalty free or, where the objective value of the technologies in question is different, provide for one-way (lump sum) royalties, reflecting the objective difference in value."

The Sections concur with paragraph 200 of the Draft Guidelines that non-challenge clauses in settlement and non-assertion agreements generally should be considered to fall outside the scope of Article 81(1), as the purpose of such agreements is to settle existing dispute and/or avoid future disputes.

X Technology Pools

The Sections recognize that the Commission has opted not to include multi-party licenses, such as patent pools, in the Revised TTBER, which would have required a revision of Council Regulation No 19/65/EEC of 2 March 1965, providing for block exemptions. The fact that the Revised TTBER does cover licenses between a patent pool and individual licensees may provide some comfort to pool members and pool licensees even if the Revised TTBER does not cover the formation of the pool (Draft Guidelines ¶ 204). Moreover, the Guidelines' statement that agreements between more than two undertakings that would have been block exempted had they been concluded between only two undertakings will in principle be treated as if they were covered by the block exemption (Draft Guidelines ¶¶ 31, 33), should also provide comfort to companies engaged in multi-party licensing.

The Sections welcome the Draft Guidelines' framework for analysis of technology pools. We believe that framework will help to provide guidance to companies considering the formation of patent pools. Because that framework is generally consistent with analyses under U.S. law, this should facilitate global patent pools which are increasingly important in the global economy.

These comments are based particularly on experience in the United States in recent years with the US Guidelines, which does address cross-licensing and pooling arrangements, and with several Business Review Letters issued by the U.S. Department of Justice in recent years applying the framework to patent pools. *See* US Guidelines ¶ 5.5; MPEG-2 Business Review Letter (June 26, 1997) available *at* http://www.usdoj.gov/atr/public/busreview/1170.htm; DVD 3C Business Review Letter (Dec. 16, 1998), available at http://www.usdoj.gov/atr/public/busreview/2121.htm; DVD 6C Business Review Letter (June 10, 1999), available at http://www.usdoj.gov/atr/public/busreview/2485.pdf; 3G Patent Platform Partnership Business Review Letter (Nov. 12, 2002), available at http://www.usdoj.gov/atr/public/busreview/200455.pdf; Copyright Clearance Center Business Review Letter (August 1, 1993), digest available at http://www.usdoj.gov/atr/public/busreview/0088.htm. We commend those analyses to the Commission as providing useful guidance, while recognizing that even further clarification may now be appropriate in light of accumulated experience in Europe and in the United States.

The US Guidelines recognize, and we suggest that the Draft Guidelines state clearly, that patent pools may provide competitive benefits by: (1) integrating complementary technologies, (2) reducing transaction costs, (3) clearing blocking positions, and (4) avoiding costly infringement litigation. The key point is that pools are procompetitive where they serve to promote the dissemination of technology.

The Sections believe the US Guidelines are useful in recognizing that pools also can be anticompetitive, and should be challenged as per se unlawful when they are mechanisms to accomplish naked price fixing or market division. The US Guidelines also recognize that exclusion from a pooling arrangement, where pool participants collectively possess market power, may harm competition where excluded firms cannot effectively compete in the relevant markets for goods incorporating licensed technologies. In its Business Review Letters, the U.S. Department of Justice has separately considered the potential of pools to restrict competition (1) among intellectual property rights within the pool, (2) among downstream products incorporating the pooled patents, and (3) in innovation among parties to the pool. Such an overarching framework might provide greater clarity to the Draft Guidelines. *Compare* Draft Guidelines ¶¶ 205-206 (focusing on reducing transaction costs, price fixing and foreclosing alternative technologies), ¶ 219 (foreclosures and other anticompetitive effects).

We understand the Draft Guidelines to set forth two important principles: (1) pools of “essential” patents, each of which is necessary to implement a de facto or de jure industry standard, fall outside of Article 81(1), and (2) pools of competing patented technologies generally violate Article 81(1) and amount to collective tying. The analysis may be confusing to practitioners, however, in light of the discussion of the related but distinct concepts of essential and non-essential technologies, complementary and substitute patents, and blocking and non-blocking patents. Importantly, the Commission recognizes that the distinction between complementary and substitute technologies is “not clear-cut” in all cases. Draft Guidelines ¶ 210. In our view, it would be useful to explicitly recognize that competition analyses must be undertaken in the face of uncertainty as to patent scope and validity and deference may appropriately be given to reasonable, good-faith judgments. We also note that individual patent “claims” in patents, rather than “patents,” may more precisely be “essential.” In any event, the Sections suggest that it is appropriate to consider an entire patent as essential if any claim is essential, since it is customary to license entire patents and impractical to license specific claims in patents. The Commission may want to clarify, consistent with the experience and view of the US DOJ as reflected in its Business Review Letters, that a patent may be considered essential if it is essential as a practical matter even if not technically essential.[45]

[45] *Compare* MPEG-2 Business Review Letter (June 26, 1997) (no challenge of pool limiting portfolio to “technically essential patents”) available *at* http://www.usdoj.gov/atr/public/busreview/1170.htm; *and* 3G Patent Platform Partnership Business Review Letter (Nov. 12, 2002) (no challenge of pool of “technically essential” patents), available at http://www.usdoj.gov/atr/public/busreview/200455.pdf, *with* DVD 3C Business Review Letter (Dec. 16, 1998) (no challenge of pool of patents “necessary (as a practical matter)” such that the portfolio is unlikely to contain patents for which there are economically viable substitutes), available at http://www.usdoj.gov/atr/public/busreview/2121.htm; *and* DVD 6C Business Review Letter (June 10, 1999) (no challenge to pool where a patent is “essential” if “necessarily infringed,” or “there is no realistic alternative” to it in implementing the standard specifications), available at http://www.usdoj.gov/atr/public/busreview/2485.pdf

We also urge the Commission to consider whether the assumption in paragraph 211 of the Draft Guidelines that parties can solve two way blocking positions by granting a cross-license or concluding a non-assertion agreement, leading to the conclusion that the Commission will treat pools comprising blocking patents in the same way as pools comprising substitutes, is unduly restrictive and may inhibit the dissemination of technology. It also seems inconsistent with the recognition elsewhere in the Draft Guidelines that firms possessing blocking patents are not competitors. Third parties will require licenses to blocking patents in these circumstances, which may be most efficiently accomplished through a pool. In fact, licensees may benefit from the ability to license blocking patents from a pool, rather than negotiating for separate licenses for each of the blocking patents, because the jointly set profit maximizing price from the pool may be lower than the total price of several individual licenses, due to royalty stacking, or the elimination of double marginalization. The analysis in the Draft Guidelines would appear to import into the patent pool context the position that royalty free cross-licenses are typically adequate to clear the field of blocking patents, and foster second-guessing of the business judgments of businesspersons.

Whether licensors remain free to license technologies independently outside the pool, as identified in paragraphs 215(b) and 220, is an appropriate factor to consider in determining the actual competitive effect of the arrangement. Indeed, in the U.S., whether licenses are non-exclusive is an important factor in a rule of reason analysis, and the US DOJ has insisted in all its Business Review Letters that the pools at issue be non-exclusive. In examining the actual competitive impact of a pool, we suggest that the Commission should in all events look beyond whether licenses are facially non-exclusive and individual licenses are theoretically possible, to whether they are a realistic or practical alternative in the circumstances presented, considering the incentives on pool members.

Paragraph 219 focuses on "foreclosure and other anti-competitive effects on downstream markets." The Draft Guidelines suggest that where a pool has a "strong" position, both royalties and licensing terms must be non-discriminatory and the Commission will take into account whether licensors are subject to royalty obligations. The Commission's clarification that different royalties for different uses are not precluded is quite helpful. The U.S. DOJ has also considered as relevant whether a proposed royalty is "sufficiently small relative to total the costs of manufacture" to prevent foreclosure or collusion downstream, which we believe would be useful additional guidance. The Sections also suggest that the Commission consider making clear that pooling arrangements generally need not be open to all who would like to join. See US Guidelines ¶ 5.5. It is only exclusion from pooling arrangements among parties that collectively possess market power that may, under some circumstances, harm competition. Unless pool participants collectively possess market power and disadvantaged firms are effectively excluded from downstream markets, there should be no competition concerns. Even when such circumstances exist, U.S. authorities will "evaluate whether the arrangement's limitations on participation are reasonably related to the efficient development of the pooled technologies and … assess the net effect of those limitations in the relevant market." US Guidelines ¶ 5.5.

The Draft Guidelines recognize the risk that pools may shield invalid patents. *See* Draft Guidelines ¶ 222. In evaluating incentives impacting patent pools under the rule of reason, the Commission may want to consider the impact of royalty allocation formulas on the incentive of pool members to challenge invalid or non-essential patents, as well as the existence of mechanisms and incentives for licensees to identify invalid or not infringed patents in a pool.

Finally, the Sections have reservations regarding the suggestion in paragraph 224 of the Draft Guidelines, that open processes are always superior to other processes for setting standards licensed through pools. We recognize that the extent to which processes are open is a factor that may be considered in the competitive analysis. On the other hand, open processes have their own costs; they are often slow and cumbersome. In rapidly evolving technologies, it is often important to have streamlined processes, such as promoter/adaptor models and joint ventures, that may not be fully open. Such processes should not be inherently suspect. Indeed, where there are substantial network externalities, the alternative to a less open process (if only fully open ones are permitted) may instead be the creation of de facto standards issued by a single firm, which may result in much less competition than a less open process.

Conclusion

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

November 25, 2003