AIPLA
AMERICAN INTELLECTUAL PROPERTY LAW ASSOCIATION
2001 JEFFERSON DAVIS HIGHWAY ▪ SUITE 203 ▪ ARLINGTON, Virginia 22202

November 24, 2003

European Commission
Directorate-General for Competition
Unit A 1 — Policy Development (Antitrust/mergers)
Technology Transfer Review
B-1049 Brussels, Belgium

Re: AIPLA Comments on Draft Commission Regulation and Guidelines on the Application of Article 81 of the Treaty establishing the European Community to Technology Transfer Agreements.

Dear Director General:

The American Intellectual Property Law Association (AIPLA) appreciates the opportunity to present its views on the Draft Commission Regulation on the Application of Article 81(3) of the Treaty establishing the European Community to Categories of Technology Transfer Agreements and the Draft Guidelines on the Application of Article 81 of the that Treaty to Technology Transfer Agreements.

AIPLA is a national bar association of more than 15,000 members engaged in private and corporate practice, in government service, and in the academic community. AIPLA represents a wide and diverse spectrum of individuals, companies, and institutions involved directly or indirectly in the practice of patent, trademark, copyright, and unfair competition law, as well as other fields of law affecting intellectual property.

AIPLA fully supports and commends the efforts of the Commission to increase the flexibility and improve the predictability as to what technology transfer practices are acceptable. We also applaud the efforts to introduce economic principles into the analysis and review of technology transfer agreements. However, AIPLA is concerned that certain provisions of the Draft Regulation and Draft Guidelines are unnecessarily restrictive and may prohibit practices that are either neutral or that have substantial pro-competitive effects.

Specifically, AIPLA recommends changes to a number of specific provisions to increase predictability and the elimination of certain provisions that are unnecessarily strict. AIPLA respectfully submits that some of the specific criteria to qualify for the exemption are too narrow and would proscribe certain agreements that would not usually, let alone always, cause competitive harm.

AIPLA is particularly concerned with: (1) the definitions of competitors; (2) the 20% and 30% market share cutoff to qualify for the exemption; and (3) several of the arrangements interpreted as coming within the proscribed "hardcore" practices, such as field-of-use restrictions, total sales royalties, and exclusive licensing. These provisions are inappropriate because they would tend to inhibit licensing practices and would proscribe agreements that threaten no competitive harm and, in fact, are likely to be pro-competitive.

Recitals

The Draft Regulations and Draft Guideline place heavy emphasis on "technology" or "innovation" markets in addition to product or service markets.

In AIPLA's view, the analysis of innovation markets should be very limited. We note that the innovation market assessment would not be used for market share or competitor tests under the block exemption, although it could be appropriate in some circumstances outside of the draft Regulations. On the other hand, the Draft Regulation requires the analysis of technology markets to assess whether the parties are competitors and to assess market shares.

We submit that it is not appropriate to place the same emphasis on technology markets as is placed on product or service markets, and that it may actually inhibit rather than enhance competition. Moreover, the application of market share triggers to such inchoate or potential technology markets is highly problematic and speculative. Even were an analysis of these technology markets possible, these markets are so inherently dynamic that the analysis would result in greater uncertainty with subsequent changes in the market.

Definitions

Although AIPLA generally supports the definitions in the Draft Regulations, we respectfully suggest that certain of the definitions be broadened and/or clarified.

"Technology Transfer Agreement" and "Intellectual Property Rights"

The scope of the Draft Regulations and Draft Guidelines depends on the definition of "technology transfer agreement," which in turn incorporates "intellectual property rights." However, both definitions exclude trademark and trade dress rights, even where these are primarily related to distribution or use in conjunction with technology transfer rights. We see no reason for this exclusion where trademarks are used in technology transfer agreements, even if trademark or trade dress licensing is the primary objective of the license. The same applies to copyright, other than relating to software, and database rights.

AIPLA suggests that the definitions of "Technology Transfer Agreement" and "Intellectual Property Rights" in the Draft Regulation and Draft Guidelines be broadened to include copyrights, database rights, trademarks and trade dress rights. These are intellectual property rights that have many similarities to the intellectual property rights expressly included in the Draft Regulations and Draft Guidelines.

"Competing Undertakings"

Although undertakings in a one-way or two-way blocking position should not be considered to be competing, AIPLA believes that the requirements for proving such a blocking position are unduly restrictive.

Essentially, the Draft Regulations and Draft Guidelines require a court decision or the statement of a well-qualified expert to establish that the intellectual property would preclude competition from the other party. A court decision on the underlying intellectual property rights would not likely be available since most licenses are negotiated well before a dispute would be adjudicated.

This essentially means that the parties must rely on expert opinion to substantiate their belief that they are not in competition. The inevitable "battle of the experts," many years after the fact, introduces an unacceptable level of expense and uncertainty into the entire licensing process. The result will likely be to discourage some beneficial licensing.

The Draft Regulations analyze competition from the dual perspective of product markets and technology markets.[1] In the view of AIPLA, it is inappropriate to include an analysis of technology markets in the manner suggested. In defining relevant product markets, the Draft Guidelines adopt the approach of the Commission's market definition guidelines,[2] which are concerned solely with product markets and make no reference to technology markets.

The Guidelines define technology markets in terms of "the licensed technology and its substitutes, i.e. other technologies which customers could use as substitutes." These are defined according to "the same principles as the definition of product markets."[3]

This analogy is unfortunate for several reasons. First, product markets, which are essentially markets for goods and services, are defined almost entirely by reference to a price elasticity test that assumes a "market price" characterized by numerous transactions at readily ascertainable prices. Technology licenses do not exhibit these characteristics. The "price" in most technology licenses is generally difficult to determine due to the complexity of the transaction. Most license agreements contain a web of cross-obligations that are simply not quantifiable. In some cases, the only consideration for transferring a patent right may be the cross-license of another patent right, in which no money changes hands at all. Other cases may involve the license of multiple patents for a single royalty. Still other cases may involve consideration in the form of marketing services, research and development undertakings, and other forms of non-cash obligations.

---

[1] TTBER, art. 1(h). The Guidelines (§ 22) also incorporate a third concept of "innovation markets" into the analysis, although this concept does not appear in the TTBER. The reservations about technology markets expressed in these comments apply with greater force to innovation markets, which are one step even further removed from goods markets.

[2] Draft Guidelines on the Application of Article 81 of the EC Treaty to Technology Transfer Agreements, 2003 O.J. (C 235) 17, 19, *referring to* Commission Notice on The Definition of Relevant Market for the Purposes of Community Competition Law, 1997 O.J. (C 372) 5.

[3] Guidelines, ¶ 20.

An analytical paradigm that proceeds from the assumption that a license is traded like a good—one license per patent, with the only consideration to the licensor being a cash royalty—simply does not reflect the reality of today's licensing transactions, which are far more varied and complex.

Technology transfers lack a true technology "market." Markets require a course of commercial activity, supporting the supply of and demand for a commodity among multiple potential buyers and sellers. Many technology "markets," however, are woefully thin, consisting of one or two licensing transactions. "Markets" which consist of one or two transactions are neither viable nor accurate indicators of competitive conditions.

Beyond that, any analysis of a technology licensing "market" must also take into account the imputed "royalty" for in-house use of the relevant technology by firms that are not out-licensing their technology. Yet, this data, in most instances, is impossible to obtain due to the sensitivity and confidentiality of this proprietary information. Also, calculation of this internal value may not be necessary in a company and simply may not be available.

Potential Technology Markets

The final sentence of paragraph 24 of the Draft Guidelines suggests analyzing potential technology markets. However, the Draft Regulations suggest that only actual competition is to be assessed for technology markets, both for analyzing whether the parties are competitors and for assessing the application of the market share caps.

This appears to be contradictory. The guidelines should clarify the relevance of the sentence, for example, by indicating that the assessment of potential competition in relation to technology markets is relevant only for agreements that do not come within the block exemption.

AIPLA also believes it would be helpful to clarify in the analysis at paragraphs 20-21 of the Draft Guidelines the method of identifying relevant technology markets and calculating market share.

The appropriate method consists of first identifying all relevant product and services markets, and then calculating the separate shares of the licensor and licensee technology as a proportion of sales in each relevant product market. In this respect, it should also be explained that the calculation for each product market encompasses not only technology under the restricted definition in Article 1(b) of the Draft Regulation, but also the share of coverage of the whole of the relevant product or service market, including freely available, non-proprietary technology (this appears to be the case from the example in paragraph 71 of the Draft Regulations).

Article 3: Market Shares

Article 3 of the Draft Regulations defines certain market share thresholds for competing undertakings and non-competing undertakings.

AIPLA agrees that market share values are typically useful in assessing competitive impact. Nonetheless, AIPLA believes that the use of specific market share values as thresholds is too limiting, in general, and that the particular values of 20% and 30% used in the Draft Regulation and Draft Guidelines are too restrictive.

To the extent that the Commission intends to use market share thresholds, AIPLA urges that the market share threshold be expanded to at least 40% in the case of non-competitors. AIPLA believes that this threshold is intended to catch dominant companies, and that 30% is too low for these purposes. AIPLA considers that 40% is the lowest appropriate figure, in line with Article 7(1) of Regulation 240/96. With respect of the market share figure of 20% for competitors, AIPLA considers that the figure of 25% in Article 8(2) and 8(3) should be replaced by 30%, to allow for fluctuation in market share.

In addition, AIPLA requests an amendment to clarify that the market share thresholds will be applied to the technology transfer agreement only when the license is entered into, and that the agreement will not lose its exemption solely because the party's market shares have grown to exceed the threshold. Pro-competitive agreements would be discouraged if a licensee could be punished with the loss of the block exemption simply because it built its position in the market from nothing to above the relevant threshold. Such a licensee could be subject to a less certain and potentially more hostile regulatory regime above the relevant market share thresholds.

Hardcore Restrictions and Provisions not Considered To be Exemptible in the Guidelines

AIPLA agrees that certain types of provisions in technology transfer agreements are problematic and tend to threaten competition. AIPLA therefore supports the European Commission's approach of identifying certain types of provisions as "hardcore" restrictions that are not eligible for the Block Exemption. Moreover, AIPLA agrees that those provisions that are considered "hardcore" provisions in the final regulation and guidelines should include only those restrictions that are almost always anticompetitive.

However, AIPLA submits that the itemization of hardcore provisions in the Draft Regulation is over broad and impugns certain restrictions that are unlikely to lead to competitive harm and may, in fact, benefit or enhance competition. To that end, AIPLA recommends that the number of provisions proscribed as "hardcore" be reduced to those few provisions that have been shown "almost always" to cause harm to competition.

Price Fixing and Resale Price Restrictions

AIPLA agrees that price fixing between competitors and resale price restrictions are generally recognized as anticompetitive. Nonetheless, we do not agree with the circumstances where running royalties and royalties based on total sales are classified as price fixing. This is discussed further below.

Limitations of Output or Sales

AIPLA also agrees that limitations on output or sales may be anticompetitive. The Draft Regulations and Draft Guidelines recognize that limitations on the output of contract goods may have pro-competitive effects and excepts that limited subset of limitations from the "hardcore" provisions. Although limitations on output or sales may in some cases increase output if multiple additional licensees are induced to license the technology, these restrictions generally do not provide benefits to competition and AIPLA agrees with their inclusion among hardcore provisions that are not eligible for the exemption.

Nonetheless, the degree of reciprocity may, in some instances be hard to determine and the Draft Regulations and Draft Guidelines are not entirely clear where the dividing line between proscribed and permissive agreements lies.

Allocation of Markets and Customers and Exclusive Licenses

AIPLA recognizes that the Commission, in order to foster a common market, may not wish to extend the benefit of the exemption to agreements with market or customer allocation provisions. However, AIPLA requests an amendment to clarify that the presence of such provisions will result only in the loss of the exemption, and will not be considered to infringe the Guidelines.

The Draft Guidelines (paragraph 82) and Article 4(1)(c) of the Draft Regulation address the hardcore prohibition on the allocation of markets and customers between competitors. AIPLA notes that this prohibition is interpreted to include any exclusive license in which the licensor agrees not to exploit the licensed technology himself.

In addition, outside of the block exemption, such as above the market share thresholds, the Draft Guidelines appear to suggest that exclusive agreements are never pro-competitive. This would mean that such exclusive licenses could never be granted in an agreement between competitors, even on a non-reciprocal basis. However, exclusive licensing is currently exempted under the current Regulation (240/96), even between competitors.

AIPLA is not aware of any experience that the Commission may have acquired since the adoption of that Regulation that this has caused any serious competition problems. Indeed, exclusive licensing is routine in many industries and is viewed as being necessary—even among competitors—in many instances in order to persuade a potential licensee to take a license and invest in a new technology. For example, where one competitor licenses another, and agrees not to exploit its technology by selling or manufacturing in the licensed territory, competition is not reduced, nor is the number of competitors reduced. Rather, one competitor has simply stepped into the shoes of the other in exploiting the technology.

Thus, AIPLA believes that exclusive licenses, or licenses limited to a particular product market or customer group or technical field, do not almost always "restrict competition that existed prior to the agreement." [4] It is wrong to suggest that exclusive licenses, or licenses limited to a particular product market or customer group or technical field, "restrict competition that existed prior to the agreement." Even a limited license

[4] Guidelines paragraph 81

permits a licensee to do something that he was unable lawfully to do prior to the license being granted. The Commission's Evaluation Report rightly recognized a distinction between limited licenses and the situation where "powerful licensors or licensees imposed restraints unrelated with [i.e. ancillary to] the licensed IPR" (paragraph 104 and ff.).

A limited license should not be treated as an ancillary restraint, or as hardcore per se. Nor is it the case that an intellectual property owner who grants an exclusive license will thereby be withdrawing from the market in question. The licensor may not have been present in that market previously. Yet, given the start-up costs and risks involved, the only commercially-viable way of opening up that market very often will be to grant an exclusive license. The proposed black-listing of exclusive licenses will have a significant anti-competitive effect and will be a positive disincentive to the dissemination of technology. These effects will be exacerbated by the presumption that "only in exceptional circumstances [will A.81(3) apply]."

AIPLA recommends that the interpretation that exclusive licensing between competitors is always equivalent to market allocation should be removed, in view of the substantial beneficial effects that they offer and the fact that it does not normally injure competition and, rather, offers substantial pro-competitive benefits.

Restrictions on the Licensee's Ability to Practice Their Own Technology and to Carry out Research and Development

The Draft Regulations and Draft Guidelines also proscribe restrictions that seek to prohibit the licensee from using its own technology. AIPLA also supports this restriction.

Running Royalties in Certain Cross-License Agreements

The Draft Guidelines appear to suggest (paragraph 77) that, where competitors agree to running royalties on a reciprocal basis in a cross-license, the Commission will interpret this to be price-fixing. It therefore appears that it will be considered a hardcore restriction contrary to Article 4(1)(a) of the Draft Regulation if either: (a) the agreement does not lead to a significant integration of complementary technologies; or (b) it does lead to such an integration but 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.

If this is not what the Draft Guidelines were intended to say, then AIPLA suggests that the true intentions be clarified. If that is what the Guidelines intend to say, then AIPLA respectfully submits that such a presumption goes too far, and places the wrong emphasis on the circumstances where the normally pro-competitive use of running royalties may nevertheless be prohibited as a means of price fixing.

For example, running royalties are commonly used to spread risk and reward between the licensee and licensor. Payment to the licensor is tied more closely to the licensee's actual use of the licensed technology and, therefore, the actual value of the technology not only to the licensee but to the ultimate consumer. In addition, running royalties may also be used to finance the licensing transaction, allowing the licensee to spread the burden of the payment obligation over the actual period of use of the technology. In so doing, running royalties help avoid many of the difficult and speculative issues of valuing a fixed, up-front payment.

These justifications apply equally to the case of reciprocal running royalty provisions in cross-licenses between competitors as they do to non-reciprocal running royalty arrangements in agreements between non-competitors. However, the Draft Guidelines' suggestion, that reciprocal running royalties in agreements between competitors will be seen as price fixing unless the conditions in (a) and (b) above are satisfied, goes too far. The Draft Guidelines' emphasis that the justification for running royalties will be the exception rather than the rule may exclude legitimate cases, particularly if the question of whether the parties "could reasonably have chosen a less restrictive payment scheme" is given extensive interpretation.

Thus, AIPLA believes that it is not justified to give running royalty obligations in cross-licenses the hardcore treatment of price-fixing. The interpretation in the Guidelines should indicate that, below the market share threshold, such reciprocal running royalties will only be treated as price-fixing and come within Article 4(1)(c) in exceptional circumstances, e.g., where there are clear indicators that the arrangement has no justification and is merely being used to disguise a price-fixing agreement. AIPLA has particular concerns about the treatment of running royalty provisions in settlement agreements, which are discussed below.

Total Sales Royalties

The Draft Guidelines also indicate (paragraph 78) that, in agreements between competitors, royalties calculated on the basis of all product sales, irrespective of whether the licensed technology is being used, will be interpreted as price-fixing agreements falling within the hardcore prohibition of Article 4(1)(a) or restrictions on the licensee's use of his own technology, falling within the hardcore prohibition of Article 4(1)(d). This interpretation will apply to both reciprocal and non-reciprocal arrangements, and such a Total Sales Royalties provision will only be permitted where it is indispensable, such as where it is impossible or unduly difficult to calculate and monitor royalties payable otherwise, as in the case where the licensor's technology leaves no visible trace on the final product and practicable alternative monitoring methods are unavailable.

AIPLA agrees that total sales royalties may, in limited circumstances, have been used to disguise price fixing, or to limit the use of the licensee's own technology. Nonetheless, the Draft Guidelines impose an extremely high burden on all license agreements that contain total sales royalty provisions, and AIPLA believes that such a burden is not merited by practical experience with total sales royalties.

Total sales royalties are also not "almost always" anticompetitive in the ways suggested. Although they may not be "indispensable to pro-competitive licensing," there are many valid reasons why they are nonetheless beneficial to it and why they cause no injury to competition.

Total sales royalties may be very desirable to the parties, even where they are not "indispensable," for a variety of legitimate reasons unrelated to any intent to injure competition. In the software licensing area, for example, many manufacturers have distributed certain software free of charge in order to attract business to other product or service offerings. Were parties to an agreement limited to imposing royalties on only the licensed product, the licensee's flexibility in distributing its product would be inhibited, and the licensor would have incentives not to license technology that they would otherwise license under a total sales royalty provision.

It is clear that where the Total Sales Royalty applies to markets in which the parties are not competitors, it should not be interpreted as hardcore price-fixing or limitation on the use by the licensee of his technology. The Guidelines do not make any allowance for this.

More important, however, there may be other reasons beyond the one mentioned in paragraph 77 that justify a Total Sales Royalty, even in a market where the parties are competitors. For example, the licensee may simply not wish to submit to invasive monitoring and auditing of its activities by the licensor. Legitimate concerns regarding confidentiality, particularly among competitors, may encourage licensees to accept total sales -- which can typically be readily verified without invasive inspection of internal records or auditing -- rather than more invasive procedures.

Thus, total sales royalties may be used for various reasons without an intent to harm, or have any adverse effect on, competition. Total sales royalties should not be proscribed by the Draft Regulations or Draft Guidelines. Therefore, AIPLA believes that hardcore treatment of total sales royalties, as with running royalty obligations in cross-licenses, is not justified. We request that this interpretation be removed from the Draft Guidelines, and the agreements be reviewed based on the facts of each case.

Field of Use Restrictions

Finally, paragraph 83 of the Draft Guidelines suggests that Article 4(1)(c) of the Draft Regulation would be interpreted so as to prohibit at least some field-of-use restrictions in licenses between competitors, on the theory that they amount to market allocation agreements.

However, it is clear from the preceding discussion that field-of-use restrictions do not necessarily raise competition law issues. To the contrary, field-of-use restrictions, which limit the scope of a license to a particular field of application or product market [5], are in themselves entirely pro-competitive: they enable licensors to find optimal licensees for specific fields or markets, further disseminating technology, and allow licensees to obtain and pay for only the rights they need, enhancing demand for technology.

[5] *See* paragraph 170. Although it does not represent a change from current EC policy, paragraph 170's assertion that "[a] restriction on the licensee based on the use made by the buyer of the products incorporating the licensed technology" is not a field of use restriction shows regrettable disregard for the real likelihood that the same product may have very different uses and correspondingly different values to different consumers, just as the same technology may have very different values to different licensees. Prohibiting discrimination based on the end use of the product is no more efficient than would be discrimination based on the product made with the licensed technology. We urge the Commission to revisit this important economic issue.

In the cross-license scenario envisioned in paragraph 83, two competitors—that is, owners of substitute technologies—agree to allow competition between themselves in two competing technologies that they already have or may develop. A grants B a license under A's patent to product market X, and B grants A a license under B's patent to product market Y. If this is all that has happened, it is difficult to see an obvious competitive problem; each has simply enabled the other to use its technology in one of the fields in which they compete. Both firms can compete in both product markets; the only difference is that now, B may use A's patent as well as its own in product market X, whereas A may use B's patent and its own in product market Y. This same reasoning applies to a reciprocal, exclusive, field-of-use license.

Thus, field-of-use restrictions are not anticompetitive. AIPLA recommends that Article 4(c)(i) and paragraphs 83, 84 and 171 of the Guidelines be deleted.

Article 5: Conditions

Article 5 sets forth a number of conditions which render technology transfer agreements ineligible for the exemption: (1) exclusive licensing back of licensee's improvements or new applications; (2) assignment grant backs or grant overs of licensee's improvements or new applications; and (3) obligations not to challenge the intellectual property rights. AIPLA recognizes the validity of these restrictions and supports them with two exceptions.

First, although exclusive grant backs may concentrate technology in the licensor, AIPLA contends that grant backs in general do not necessarily injure competition. In many instances, they support the dissemination and distribution of technology as well as help protect and encourage the initial license of the parent technology by the licensor. To that extent, AIPLA believes that the focus of the condition on exclusive grant backs of license rights or assignment of improvements and new applications is the appropriate focus. AIPLA recommends against wholesale prohibition of non-exclusive grant backs.

Second, with respect to obligations not to challenge the licensor's rights, AIPLA recognizes that there may be circumstances under which a licensee is not estopped from challenging the licensed intellectual property rights. However, this does not apply to lawfully negotiated settlement agreements, which advance the judicial policy of encouraging litigating parties to end their disputes sooner rather than later. Care should be taken to ensure the repose of lawfully negotiated settlement agreements, even if the licensee is foregoing the right to later challenge the intellectual property rights.

Article 6: Withdrawal of the Benefit of the Regulations

AIPLA agrees that the Commission, as well as the Member States, should preserve their right to review technology transfer agreements on a case-by-case basis and withdraw the exemption in appropriate circumstances.

Article 7: Non-Application of the Regulation

Similarly, AIPLA supports the provision regarding non-application of the regulation when the agreement involves more than a market share of 50%. Although the 50% market share level is arbitrary and does not necessarily indicate that competition is being injured, it provides a reasonable level of concentration to remove the exemption and to review the agreement on its individual merits.

No presumption should arise, however, that such agreements violate the Draft Guidelines merely because they reach or exceed the 50% market share threshold. Rather, AIPLA submits that each agreement should be evaluated on its own merits.

Article 8: Application of the Market Share Thresholds

Subject to the comments noted earlier regarding the specific levels of market share threshold being broadened, AIPLA supports in general the issue of market share thresholds.

We note that the requirement of substantiation is somewhat vague and may raise concerns. However, AIPLA supports the provisions as long as the Draft Regulations and Draft Guidelines are not construed to encourage litigation that is not otherwise ongoing and the requirement of substantiation by independent expert opinion is reasonably invoked. The Draft Regulations and Draft Guidelines should not be implemented or enforced in a manner that unnecessarily encourages litigation or imposes undue burdens on the parties to substantiate the facts.

Application of Article 81 to Settlement Agreements under the Guidelines

The AIPLA supports the Guidelines' indication that the block exemption applies generally to licenses and non-assertion agreements entered into in the context of settlements of infringement disputes (which we refer to as "settlement licenses").

This is an important recognition of the pro-competitive value of such licenses, which not only avoid costly and wasteful infringement litigation, but also enable the alleged infringer to proceed with competitive activity that the licensed intellectual property otherwise might have blocked. While much of Part IV.3 clearly sets forth this wise approach, a few passages create uncertainty that might undermine it. We suggest a few slight revisions to make clear that the block exemption applies to all good-faith settlement licenses that lack "hardcore restrictions" and fall below applicable market-share thresholds.

Paragraph 201 indicates that the block exemption applies to settlement licenses absent "hardcore restrictions," but then notes that it does not apply "where licenses are granted only for the purpose of settling a dispute or avoiding future disputes and not for the purpose of production."

This distinction is impossible to draw; under this approach, the applicability of the block exemption might well depend on whose view of a settlement license one takes. The licensee may still have the same doubts as to the licensed patent's validity or applicability that may have engendered the infringement dispute in the first place, but is willing to take a license lest a court side with the patentee. The licensor, of course, likely feels differently: it believes that the licensee has been infringing its patent, and that the license enables the licensee to continue to use the licensed technology without further liability. A settlement license embodies a compromise between these two views; it surely enables the licensee to utilize the licensed technology, but whether the licensee actually will do so is a question the settlement has avoided.[6]

Hinging the block exemption's applicability on that question will make it impossible to determine whether the exemption applies. A better rule would be that, absent hardcore restrictions, the exemption applies to any settlement license under the market-share threshold unless the underlying infringement claims against the licensee's product are objectively baseless.

It is also not clear whether the analysis set forth in Paragraphs 196-201 applies to all settlement licenses, or only those involving cross-licenses. Presumably it is meant to cover all such licenses, given their common pro-competitive function. But most of the discussion addresses cross-licenses without explicitly discussing the analysis of one-way settlement licenses. For example, paragraph 196 states "Cross licensing in the context of settlement agreements … is not as such restrictive of competition," and paragraph 197 states "restrictions on the parties concerning the use of their respective technologies." It would be helpful to extend the discussion in these paragraphs to more clearly address one-way settlement licenses.

The first sentence of paragraph 199 makes an important point about the potential of running royalties, in rare instances, to serve as facilitating devices for collusion among competitors. The second sentence, however, addresses this issue with an overbroad and regulatory proscription of all running royalties—at least as to settlement cross-licenses—mandating either royalty-free licensing or lump-sum royalties.

Arrangements that impose no marginal cost for utilizing licensed intellectual property may be desirable in certain limited instances. One example may be a resolution of competitive concerns from a merger or acquisition where there is a specific policy need to maximize incentives to utilize the licensed technology.

However, this consideration is inapplicable to infringement licenses, which are not meant to speedily ameliorate anticompetitive conduct. Mandating a lump-sum payment as the only alternative to a royalty-free cross-license will make it unduly difficult for parties to come to a reasonable agreement. The actual value of the license may not be clear until the licensee has brought the infringing product to market; at that point, the lump sum may turn out to be too much or too little. A running royalty, in contrast, allows the licensee to utilize the licensed intellectual property commensurately with its actual value, paying based on the intensity of its use.

---

[6] Consequently, we would amend paragraph 197 to state that the "main benefit" of settlement licenses "is the bringing to an end of the dispute or the avoidance of future disputes on terms that allow some or all of the allegedly infringing activity to proceed." A settlement license that makes usage of the licensed technology economically unfeasible is not of much benefit; similarly, a license that enables some, but not all, of the allegedly infringing activity may still be of substantial competitive benefit. This amendment would suggest that settlement licenses imposing restrictions on the licensee's use of its own technology (and, necessarily, the licensor's as well) are more likely to satisfy Article 81(3) than paragraph 197 now states.

Absent the rare circumstances in which the royalty could serve as a facilitating device for collusion, its use is consistent with the pro-competitive purposes of settlement licenses. AIPLA therefore recommends that the second sentence of paragraph 199 be deleted.

Application of Article 81 to Technology Pools under the Draft Guidelines

In general, AIPLA strongly supports the Guidelines' approach to the application of competition law to technology pools (which we will refer to simply as "pools"). By focusing on the fundamental issue these pools present—the relationship of the technologies combined in the pools—the Guidelines will lead to principled and coherent application of competition law, fully consistent with the rights of intellectual property owners.

The comments that follow concern relatively isolated issues that, in our view, could detract somewhat from the overall positive effect these Guidelines should have on pool formation and licensing.

Standard-Setting and Pool Formation

Pools frequently are associated with either formal standards (such as MPEG-2 compression) or de facto standards (such as DVD-Video). However, Paragraph 203 rightly notes that "there is no inherent link" between pools and such standards. Two points in the Guidelines, however, tend to blur the distinction between standard-setting and pool formation.

The less critical one, in paragraph 218, suggests that a pool's independent expert might select some patents for inclusion based on competition among them. This is different from the approach employed so far by pools, whose independent experts have examined patents based on essentiality to a pre-existing standard. In contrast, the selection described in paragraph 218 may more properly be a part of the standard-setting process than pool formation. Indeed, this selection among substitute technologies, apparently any of which would comply with the standard, would raise some of the foreclosure issues discussed in paragraphs 214 and 215.

More troubling is paragraph 224, which seems to confuse pool formation with standard-setting and is as problematic with respect to standard-setting as it is with respect to pools.

Formal standard-setting generally benefits from broad participation by interested parties, transparency, and due process. However, it is not at all clear that such protections are useful in connection with the design of products by consortia, which still must subject their technology choices to the judgment of the marketplace.

Moreover, it is highly questionable whether the inclusive standard-setting model is necessary or even appropriate for pool formation. If the standard has been set or the product or service defined, it is for the expert to determine what legal rights are essential, and for the owners of those rights to decide whether and on what terms to compromise their economic power by forming a pool. The terms they agree upon will still be subject to the will of the marketplace, which has readily turned its back on undesirable standards in the past. Also, inclusion of non-technology owners invites mischief. There is no guarantee that licensees will have consistent views, or that licensees who become involved in the pool will not attempt to co-opt it to the disadvantage of the licensors or competing licensees.

In short, the model suggested by paragraph 224 will hamper pools and, ultimately, make them less pro-competitive than they are now. AIPLA strongly urges that this paragraph be deleted from the Guidelines when they are issued.

Pools and Blocking Technologies

In relation to blocking technologies, the Guidelines suggest that a pool containing substitute technologies "amounts to a price-fixing cartel." However, paragraph 211 then states that pools containing blocking technologies will be treated as though they were pools of substitute technologies.

This is difficult to understand as a matter of economic analysis and is likely to be counterproductive. Whether the blocking relationship between two patents is one-way (patent A blocks patent B, but B does not block A) or mutual (each patent blocks the other), the relationship between the two patents is complementary—at least one of the patents adds value to the other. In neither instance can a licensee utilize either patent without a license under the other. While a simple cross-license or non-assertion agreement can clear up the blocking situation as between the patentees, such an agreement does no good at all for their actual or potential licensees, who would remain subject to the block.

This paragraph would suggest that the Commission prefers a situation in which two patentees keep their blocking patents to themselves and continue to block an industry, rather than joining together to enable it. In contrast, if the patents blocked each other only by virtue of the standard, the Guidelines would suggest that a pool is desirable. These disparate outcomes do not make sense. Even in the absence of a standard, a pool is a uniquely efficient and sensible means for freeing all potential users of patents that are in a blocking relationship.

Pools and Independent Experts

The Guidelines wisely point to the crucial role of an independent expert in determining what IP rights are essential to compliance with a standard. Paragraph 225 is well-taken, and provides a clear-eyed contrast to the preceding paragraph, discussed above.

However, paragraph 226 sets a standard for independence that cannot realistically be satisfied: To state that an expert's role "will be given no weight" if the expert is "in any way connected to the licensors or otherwise depend[s] on them" effectively disregards the expert's contribution. To be sure, a pool should ensure that the expert's decision-making is free from undue influence from any technology owner. But the requirement of paragraph 226 would prohibit any compensation of the expert by the pool or its members, as well as employment or retention by the pool.

It is not realistic to expect that a pool will ordinarily be able to engage the services of an expert who is paid and whose terms of employment are set by some disinterested third party, such as perhaps a university.[7] The requirements of antitrust enforcement agencies, on the other hand, will adequately protect the ability of the expert, once retained by the pool, to freely exercise his or her best judgment without fear of retribution by the pool or any individual member.

Pools Composed of Substitute Technologies

In relation to the anticompetitive potential of pools, Paragraph 205 observes, as noted above, that pools composed of substitute technologies are effectively cartels. This identifies a problem of a subset of pools rather than a trait shared by all of them.

The same is true of the other observation in the same paragraph: pools cannot be said generally to "foreclose alternative technologies" unless either licensors or licensees have agreed to terms that commit them to using the pool technology exclusively. Absent such an agreement, a pool could foreclose an alternative technology only if it built a network of users by offering licensees an attractive technology at an attractive price. This is not an anticompetitive effect calling for competition law to intervene.

Transitional Period: Article 9

According to Article 9.2 of the draft Regulation, any existing agreements still in force after October 2005 must be re-examined and possibly renegotiated. The current Regulation, in its transitional provisions, provided that any agreements exempted under the previous régime would remain exempt. By contrast, the new Regulation provides that the exemption that any agreements now enjoy under the current Regulation will cease after 31 October 2005.

AIPLA submits that this is not appropriate for several reasons. First, this type of retroactive application of the Draft Regulations and Draft Guidelines will destabilize and create substantial uncertainty in numerous established licensing relationships. Negotiating positions often change in the years after agreements are signed. It is inappropriate, for both licensees and licensors, to discover that their exclusive license rights, and concomitant rights to royalties, may no longer be enforceable.

Second, notions of fairness compel that relationships begun in reliance on the prior Regulation should be allowed to continue. No notice was given to the parties of those agreements at a time when they could have avoided any detriment from retroactive application of the Draft Regulation and Draft Guidelines.

Third, the Draft Regulation and Draft Guidelines generally establish a more economically based approach. To the extent that the prior restrictions were, as the Commission's Evaluation Report recognized, unduly limiting, the Draft Regulations and Draft Guidelines should not be offended by prior agreements that were promulgated under the more restrictive approach.

---

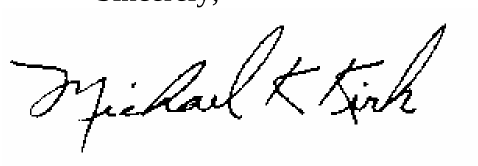
[7] The United States Department of Justice Antitrust Division encountered this problem in connection with the Philips/Sony/Pioneer DVD patent pool; its letter approving the pool indicated that the pool had adopted procedures and guarantees designed to ensure that the expert's determinations would not influence his retention or compensation.

For these reasons, AIPLA strongly recommends that agreements that are currently exempted should remain exempted for their lifetimes, so long as the Draft Regulations continue to apply.

Conclusion

AIPLA again thanks the Commission for the opportunity to review and comment on the Draft Regulations and Draft Guidelines. We hope that these comments are helpful and enhance the public review of the Draft Regulations and Draft Guidelines. AIPLA is willing to respond to any follow-up questions from the Commission on any of the topics raised.

Sincerely,



Michael K. Kirk
Executive Director
AIPLA