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International Licensing of Intellectual Property Rights: Issues Arising Under U.S., European, and Japanese Competition Law*

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Intellectual property holders involved in transnational licensing of intellectual property ("IP") rights properly have come to recognize that their licensing agreements could be subject to competition laws in various jurisdictions, laws that may sometimes yield conflicting outcomes. In order to manage the risk of antitrust violations, it is important for practitioners to consider the implications of competition laws in the various jurisdictions in which an IP license agreement may have effects.

More than 100 countries now have competition laws, although few to date have developed a significant body of precedent regarding the application of those laws to IP licensing transactions. The United States, the European Union, and Japan remain the three jurisdictions with the most comprehensive bodies of law in this area. The issuance last year of a Report on Antitrust Enforcement and Intellectual Property Rights by the U.S. Department of Justice Antitrust Division and the U.S. Federal Trade Commission, as well as Guidelines by the Japan Fair Trade Commission, serves as a reminder of the growing importance of this area. The good news is that applicable laws in these three jurisdictions have been converging, and a number of key principles are common to the three systems. The bad news is that important differences remain, which can cause serious risks if ignored.

This article briefly summarizes the sources of competition law applicable to IP licensing practices and then discusses certain examples of differences among these three systems. These differences should not be exaggerated; the fact that general principles are common to U.S., EU, and Japanese competition laws illustrates the degree of convergence that has occurred. The specific examples demonstrate, however, the continuing potential for differing outcomes in the three jurisdictions. These differences can be important in their own right, but they also serve as important reminders of the potential for further disparities in the future as countries such as South Korea and Brazil increase their levels of antitrust enforcement and countries such as China and India begin, in the very near future, to apply their competition laws to IP licensing transactions.

OVERVIEW AND GENERAL PRINCIPLES

While many other jurisdictions are ramping up competition law enforcement with regard to IP rights, the United States, the European Union, and Japan remain the primary jurisdictions with developed bodies of law in this area. In each of these jurisdictions, the enforcement agencies also have published guidelines explaining their likely enforcement positions. In the United States, a robust body of case law governs application of

continued on page 2

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the Sherman Act to IP licensing. A significant amount of precedent is quite dated, however, leading to questions of whether certain older decisions might be reconsidered in light of more recent developments outside the IP area. In response to these uncertainties, the Department of Justice and the Federal Trade Commission (together, the "U.S. Agencies") sought to clarify their enforcement positions, first in Antitrust Guidelines for the Licensing of Intellectual Property (the "IP Licensing Guidelines"), published in 1995, and subsequently in the Report on Antitrust Enforcement and Intellectual Property Rights ("Antitrust & IP Report"), published in 2007.

EU law contains a small number of court decisions involving application of Articles 81 and 82 of the EC Treaty (which prohibit agreements that restrict competition and abuse of a dominant market position, respectively) to situations involving the exercise of IP rights. In 2004, the EU adopted Commission Regulation (EC) No 772/2004 on the Application of Article 81(3) of the Treaty to Categories of Technology Transfer Agreements (the "Technology Transfer Block Exemption Regulation," or "TTBER"). The TTBER replaces the EC's 1996 Regulation on the Application of Article 81(3) of the EC Treaty to Categories of Technology Transfer Agreements and establishes a "block exemption" for certain types of licensing agreements from application of Article 81. The European Commission also issued the accompanying Guidelines on the Application of Article 81 of the EC Treaty to Technology Transfer Agreements (the "EC Guidelines"), which provide guidance as to how the European Commission is likely to apply Article 81 to license agreements that do not qualify for the block exemption.

Japan also has a small body of precedent applying its Antimonopoly Act to conduct involving IP. In 2007, the Japan Fair Trade Commission ("JFTC") issued the Guidelines for the Use of Intellectual Property under the Antimonopoly Act (the "Japan Guidelines"), which supersede the Patent and Know-How Licensing Guidelines of 1999 and supplement the Guidelines on Standardization and Patent Pool Arrangements, published in 2005. Importantly, many positions taken by the JFTC have not yet been tested in court.

These developments indicate a growing convergence in the treatment of IP licensing agreements under U.S., EU, and Japanese competition laws. In particular, these sources confirm that, with the exception of certain "hardcore" practices that are deemed likely to harm competition, restrictions in IP license agreements generally will be reviewed under a rule of reason-type analysis. Courts and competition authorities are likely to recognize the potential procompetitive benefits of restraints contained in IP licensing agreements and in most cases would find a violation only if actual harm to competition outweighed the procompetitive benefit(s) of the restraint, or if conduct ancillary to the license had an exclusionary effect by virtue of the dominant market position of the licensor.

Despite the growing convergence among U.S., EU, and Japanese law in this area, however, important differences remain. For example, while the TTBER and the EC Guidelines reflect a general trend toward application of a fact-based analysis similar to the rule of reason, EU law still relies in considerable part on classification of restraints by type and categorization of certain types of restraints as hardcore. Thus, application of EU law may depend on categorization of an agreement in terms of the share of the relevant market affected and whether it involves competitors or noncompetitors, provides for one-way or reciprocal licensing, and conveys exclusive or nonexclusive rights. While these factors are likely to be relevant in other jurisdictions as well, the analysis is likely to be more flexible (especially in the United States).

More generally, treatment of royalty rates, customer or territorial restraints, restraints affecting multiple licensees, and package or bundled licensing are examples of restraints that might be analyzed differently under the competition laws of these three jurisdictions. The following discussion is not intended to be exhaustive; it merely identifies examples of restraints, the treatment of which might differ in the United States, the EU, and Japan.

REFUSALS TO LICENSE

U.S. law provides, at a minimum, a strong presumption that an unconditional unilateral refusal to license does not violate the antitrust laws. *See Verizon Communications v.*

Law Offices of Curtis V. Trinko, 540 U.S. 398, 408 (2004) (the Court has been "very cautious" in recognizing exceptions to the general rule that the Sherman Act does not restrict the right of a company "freely to exercise [its] own independent discretion as to parties with [which it] will deal"). *Trinko* (which did not involve IP rights) has not yet been applied to a prior split among circuits as to whether the presumptive legality of an IP holder's refusal to license could be rebutted by evidence of the IP holder's anticompetitive intent. (*Compare Image Technical Services v. Eastman Kodak Co.*, 125 F.3d 1195 (9th Cir. 1997) (Kodak's termination of supply of patented and nonpatented replacement parts to independent servicers could state an antitrust claim) *with CSU, LLC v. Xerox Corp.*, 203 F.3d 1322 (Fed. Cir. 2000) (absent fraud on the patent office, tying, or sham litigation, Xerox's termination of supply of patented replacement parts to independent service organization did not state an antitrust claim).) Nevertheless, most practitioners expect that an IP holder's unilateral refusal to license its IP would rarely, if ever, violate the antitrust laws.

The U.S. Agencies acknowledge an inherent tension between the right to exclude under the patent laws and the prospect that a unilateral refusal to deal could give rise to antitrust liability, should a patent holder unilaterally refuse to license to a particular company. The Agencies have rejected the position that the 1988 amendment to the Patent Act, 35 U.S.C.A. § 271(d), creates antitrust immunity for a unilateral refusal to license a patent. The Agencies nevertheless recognize the "traditional understanding" that "a unilateral right to decline the grant of a license is a core part of the patent grant." Antitrust & IP Report at 30. The Agencies' position, therefore, is that unilateral refusals to license "will not play a meaningful part in the interface between patent rights and antitrust protection." *Id.*

EU competition law also generally regards a "mere" refusal to license as not constituting a violation. Nevertheless, EU law may regard a refusal to license intellectual property rights as an abuse of a dominant position in violation of Article 82 if: (1) the would-be licensor is dominant in the relevant market; (2) the refusal relates to IP rights that are indispensable to exercise a particular activity in a neighboring or downstream market; (3) the refusal to license excludes any effective competition in that neighboring or downstream market; (4) the would-be licensee would, if it were granted a license, offer new products or services not being offered by the would-be licensor, for which there is a potential consumer demand; and (5) the refusal to license is not objectively justified. *See* Court of First Instance, Case T-201-04, Microsoft, ¶ 331–332.

The Japan Guidelines generally accept the position that an IP holder unilaterally may refuse to license its IP, but with exceptions. The Guidelines provide that a decision by an IP holder not to grant a license is viewed "as an exercise of [the underlying IP] rights and normally constitutes no problem." Japan Guidelines ¶ III.1(1). The Guidelines, however, specify certain exceptions. For example, a company may be found to violate the Antimonopoly Act if it acquires from other holders significant IP rights that it does not plan to use itself but expects competitors to use in the future and then refuses to license that IP. *Id.* at ¶ III.1(1). Also, an IP holder may violate the Antimonopoly Act by encouraging another company to use the technology in question and then refusing to grant a license. *Id.* at ¶ IV.2(2). Thus, in Japan, while a mere unilateral refusal to grant a license normally raises no issues, the right to refuse a license is not unlimited, and a refusal to license under the circumstances described above could violate the Antimonopoly Act.

ROYALTY RATES

Under U.S. antitrust law, an IP holder generally is permitted to charge whatever royalty it wishes for a license to its intellectual property. *See Brulotte v. Thys Co.*, 379 U.S. 29, 33 (1964) ("A patent empowers the owner to exact royalties as high as he can negotiate"). (The patent misuse doctrine might apply to certain aspects of royalty arrangements, however, such as a requirement that a licensee pay royalties based on use of the technology after expiry of the patent. *Id.*; *compare* Antitrust & IP Report at 116–119, 122–123.)

The Japan Guidelines are silent on the issue of royalty rates. The Guidelines imply, however, that the JFTC believes a violation of competition law might arise from "the unjustifiable imposition of disadvantageous conditions on licensees . . . in a situation in which the licensor enjoys a dominant bargaining position." Japan Guidelines ¶ IV.1(3).b. Unfortunately, the Guidelines themselves contain no explanation of the meaning of "unjustifiable" or "disadvantageous conditions." The JFTC has interpreted the Guidelines as generally permitting parties to determine appropriate royalty rates but may treat excessive royalties as equivalent to a refusal to license. (The Guidelines also refer to certain specific royalty arrangements that may violate the Antimonopoly Act, such as a royalty obligation owing on technology after the IP rights in question expire or on use of technology not covered by the relevant IP rights. *Id.* ¶ IV.5(2), (3).)

The EC Guidelines provide that "parties to a license agreement are normally free to determine the royalty payable by the licensee." EC Guidelines at ¶ 156. The pregnant question is, of course, what situations do the EC authorities consider to be abnormal? Recently, the European Commission imposed a fine of €899 million (approximately US $1.35 billion) against Microsoft for violating a Commission decision requiring Microsoft to license patented and secret interoperability information on reasonable terms. (Microsoft initially charged 6.85 percent, later reduced to 1.2 percent.) Commission Decision of February 27, 2008, COMP/C-3/37.792 Microsoft. The *Microsoft* decision was unique in that the European Commission had previously found Microsoft liable for abuse of a dominant position and had ordered Microsoft to license its interoperability information on reasonable terms, and Microsoft and the European Commission had agreed upon the criteria for determining whether a royalty would be considered reasonable. Because of its specific circumstances, the *Microsoft* decision does not imply that the Commission will review the amount of royalties in most cases. Nevertheless, this decision leaves open the question of whether the European Commission may be willing, in certain circumstances, to second-guess the reasonableness of royalty rates charged by companies deemed to have a dominant market position.

UNILATERAL NONPRICE RESTRAINTS

Under U.S. law, an IP holder generally is permitted to restrict a licensee's rights to certain specific territories, uses, or customers. *See Ethyl Gasoline Corp. v. U.S.*, 309 U.S. 436, 456 (1940) (a patent holder "may grant licenses . . . restricted in point of space or time, or with any other restriction upon the exercise of the granted privilege, save only that . . . he may not enlarge his monopoly"). Any potential concern with respect to "enlarge[ing] the monopoly" is likely to depend at least as much on analysis of the scope of the patent grant and application of doctrines of patent law, such as patent exhaustion, as on antitrust law. *See*, *e.g.*, *Quanta Computer, Inc. v. LG Electronics, Inc.*, ___ U.S. ___, 128 S. Ct. 2109 (2008).

EU law imposes somewhat tighter limits on the ability of an IP holder to restrict a licensee to a particular territory or group of customers. (In contrast to the United States, where antitrust law is intended to preserve competitive conditions in an integrated economy, EU competition law originated in part as a tool to promote the integration of separate national economies. Today, EU competition law continues to scrutinize closely any restraint that may serve to perpetuate divisions between countries or regions within the EU.) EU law provides that, in a nonreciprocal agreement between competitors, an IP holder may restrict sales by the licensee in a territory reserved for itself, and vice versa. TTBER Art. 4.1(c)(iv). However, EU law would treat a restriction of one licensee's sales into a territory reserved to another licensee as a hardcore restriction if the protected licensee is a competitor of the IP holder at the time of the license. Even where the IP holder and the protected licensee do not compete, the TTBER permits restrictions on active sales only, categorizing a restraint on passive sales as a hardcore restriction. *Id*., Art. 4.1(c)(v). In agreements involving noncompetitors, an IP holder may restrict a licensee's active and (in some circumstances) passive sales to a particular territory or group of customers. TTBER Art. 4.2(b); EC Guidelines ¶¶ 98–101. Customer restrictions are treated in a similar fashion. An IP holder generally may restrict a licensee to use of the licensed technology in a particular field, unless the agreement is likely to lead the licensee to reduce output outside the licensed field of use. EC Guidelines ¶ 183.

Although the Japan Guidelines are unclear, under certain circumstances they appear to be even more limiting with respect to nonprice restraints on licensees. The Guidelines provide that a restriction on the scope of use of a technology is "generally recognizable as an exercise of rights and in principle it does not constitute unfair trade practices," but they add that "in some cases [such a restriction] cannot be recognized substantially as an exercise of rights." Japan Guidelines ¶ IV.3. Accordingly, for example, a restriction on the territory where a licensee may manufacture or sell licensed products generally is considered to be an exercise of IP rights. However, an IP holder may violate the Antimonopoly Act if it licenses multiple licensees and controls their activities by restricting the scope of use or imposing certain licensing terms. *Id*. ¶ III.1(2), (3). Similarly, an IP holder may unreasonably restrain trade if it licenses multiple licensees and the licensor and licensees collectively implicitly agree to restrictions on the scope of use in a manner that "substantially restricts competition in the market associated with the product." *Id*. at ¶ III.2(2). While it remains to be seen how these provisions will be applied, it appears that the Japan Guidelines are far more concerned with protecting potential competition among an IP holder's licensees than is U.S. law or even the TTBER.

TYING AND BUNDLING

Tying and bundling involving intellectual property take many forms. Various patents may be tied or bundled together, requiring a licensee to accept a package license. Alternatively, a product containing a patented technology may be tied to or bundled with one or more other patented or nonpatented products. A product tie or bundle of this sort may be accomplished technologically, by combining products physically or producing them so that they are compatible only with one another, or contractually, by requiring a customer to purchase one or more less desirable products or technologies in order to obtain a more desirable product or technology. Important factors with respect to bundled licensing include whether a bundle includes both essential and nonessential IP and whether the patents or other IP in question are also available separately at reasonable cost.

While U.S. law generally has treated tying by a company with a significant market share as per se unlawful, recent precedent indicates that U.S. courts are likely to apply a rule of reason analysis to package licensing of intellectual property, including a package containing both essential and nonessential patents. Courts are likely to look favorably on the potential procompetitive benefits of a package or bundled IP license. *See U.S. Philips Corp. v. ITC*, 424 F.3d 1179 (Fed. Cir. 2005) (Philips' package license of patents for recordable and rewritable compact discs was not per se unlawful and could involve significant efficiencies); *see also* 35 U.S.C.A. § 271(d)(5). The U.S. Agencies have stated that they are unlikely to challenge a tying or bundling arrangement unless (1) the patent holder has market power, (2) the tying or bundling arrangement has an adverse effect on competition, and (3) efficiency justifications do not outweigh the anticompetitive effects. Antitrust & IP Report at 110 (quoting the IP Licensing Guidelines § 5.3). The Agencies acknowledge that, in most instances, such practices are not anticompetitive. Antitrust & IP Report at 114.

The EC Guidelines also apply the equivalent of a rule of reason approach; they recognize the potential procompetitive benefits of package licensing and state that a package license is likely to violate Article 81 only in rare circumstances and, at a minimum, only if it covers a significant share of a relevant market. EC Guidelines ¶¶ 191–195. Thus, it would appear that, at a minimum, a finding of some degree of market power would be necessary to find a violation under EU law. The European Commission has challenged product ties in situations where a company has a dominant position, thus raising the distinct possibility that it might also challenge a package license that covers a significant part of a market.

Japanese treatment of tying and bundling is less clear. The Japan Guidelines provide that a bundled license is lawful if it is "essential to obtain the effect of the technology sought by the licensee or is otherwise recognized as reasonable to some extent." Japan Guidelines ¶ IV.5(4). Otherwise, it "constitutes [an] unfair trade practice[] if it tends to impede fair competition." *Id*. Because of the lack of precedent on this issue, it remains unclear whether the JFTC might take the position that tying or bundling generally deprives a customer of the right to select products or services and thus harms competition, or whether it would challenge tying or bundling only if the IP holder has market power or there is an actual effect on competition. *See*, *e.g.*, JFTC Recommendation Decision, Microsoft (Dec. 14, 1998) (issuance of cease-and-desist order with respect to tying of Excel and Word apparently based in part on market power).

CROSS-LICENSES

Depending on the specific terms, cross-licenses may give rise to greater potential for anticompetitive harm and therefore may draw closer scrutiny under U.S. law. Nevertheless, U.S. courts have recognized that they are likely to involve procompetitive benefits, and therefore a rule of reason analysis is usually appropriate. The U.S. Agencies recognize that "most . . . non-exclusive [portfolio] cross-license agreements . . . generally do not raise competition concerns." Antitrust & IP Report at 62.

Rather than applying a general analysis, as is the case under U.S. law, EU law applies a number of specific, rigid provisions. For example, a territorial restriction in a cross-license between competitors may be treated as a hardcore restraint regardless of whether the agreement is exclusive or nonexclusive, whether the provision is limited to competition involving the licensed IP only, and regardless of whether the parties have any degree of market power. *See* TTBER Art. 4.1(c); EC Guidelines ¶¶ 84–85 ("It is a hardcore restriction where competitors in a reciprocal agreement agree . . . not to sell actively and/or passively into certain territories . . . reserved for the other party. . . . [It is a hardcore restriction] irrespective of whether the licensee remains free to use his own technology"). Thus, under EU law, it is necessary to analyze each of the specific provisions of a cross-license agreement with care.

Analysis of cross-license agreements under Japanese law is unsettled, to say the least. The Japan Guidelines provide that various restraints in a cross-license, such as price restrictions or allocation of customers, constitute unreasonable restraints of trade "where the participating parties collectively hold a high market share of a particular product market" and if they "substantially restrain[] competition in the field of trade of the product in question." Japan Guidelines ¶ III.2(3).b. The Guidelines also provide, however, that a price restriction in a one-way license agreement "is as a rule recognized to constitute an unfair trade practice" without regard to the market share of the participants and apparently without regard to existence or absence of anticompetitive effects. Japan Guidelines ¶ IV.4(3). The Guidelines provide no explanation for this inconsistency in treatment of a price restraint in one-way licenses and cross-licenses. Clarification may come only when the Guidelines' provisions are actually applied in specific cases.

CONCLUSION

For many years, the United States was the sole country with a significant body of law addressing the interplay between antitrust and intellectual property law. In recent years, this topic has attracted increasing attention in certain other jurisdictions. The adoption of the TTBER and the issuance of the EC Guidelines and the Japan Guidelines confirm that a number of key principles are common to the analysis in the United States, the EU, and Japan. In particular, there is growing consensus that the IP right itself permits certain restraints, such as (in most cases) the right to refuse to license, and that most restraints should be governed by a factual, rule of reason-type analysis.

Nevertheless, important differences remain. As examples, territorial restraints require careful attention in the EU, and restraints on competition among licensees appear to be an issue of particular concern to the JFTC. In most cases, despite these differences, it is possible to accomplish the parties' legitimate objectives in an IP licensing agreement, but it is important that the agreement be structured appropriately for each relevant jurisdiction.

In future years, the global landscape is likely to become more complicated. A number of countries, such as South Korea, have been fairly active in applying their competition laws and are likely to start facing issues at the intersection of competition and intellectual property law more frequently. And two very important countries—China and India—are just at the point of beginning to implement competition laws. Article 55 of the new China Antimonopoly Act in particular expressly recognizes that "abuses" of IP rights may violate this new competition law, but it does not define what constitutes an "abuse." It remains to be seen how these countries will apply their respective laws to IP licensing issues. The increasing complexity of this area of law makes it all the more important for IP holders to consider potential implications in all relevant jurisdictions at the time IP licenses are being planned.

ENDNOTES

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