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DISTRIBUTION AND LICENSING CLIENT ALERT

CHANGES IN EU COMPETITION LAW AND

THE EFFECT ON TECHNOLOGY LICENSING IN THE EUROPEAN UNION

EXECUTIVE SUMMARY

A new European Union Technology Transfer Block Exemption is scheduled to take effect on **May 1, 2004**. Except for agreements between parent companies and their subsidiaries, *any patent or technology license agreement entered into on or after this date that may affect trade in the EU or in the European Economic Area must comply with the new regulations*. In addition, existing agreements must be brought into compliance by **November 1, 2005**.

These changes in the EU Technology Transfer Block Exemption regulations are a fresh reminder that transnational distribution and licensing agreements must always take into account the possibility that provisions which are often found in U.S. agreements may be inadequate or unenforceable abroad. Such provisions may even invalidate the entire agreement or result in fines or liability to third parties.

The European Commission is empowered to impose fines of up to 10% of the worldwide turnover of an offending enterprise. This power will remain under the new regulations. The fine of €497 million just levied against Microsoft underscores the magnitude of potential liability in Europe. Other recent cases have resulted in fines of €462 million (Hoffman-la Roche), €188

million (Degussa), and €149 million (Nintendo).

BACKGROUND

The European Union's competition law, like U.S. anti-trust law, puts limits on the control that manufacturers and licensors may exert on their independent distributors and licensees. Some types of control, like price fixing and tie-ins, are prohibited outright, as in the U.S. Other types of control, however, must be judged by their overall effect on competition, and thus, may be deemed either competitive or anti-competitive, depending on the circumstances. Since the inclusion of anti-competitive provisions in an agreement could render the entire agreement unenforceable and, in some cases, even result in liability for the manufacturer or licensor, the competition law creates a substantial risk in EU-related distribution and licensing arrangements, which originally could only be resolved by obtaining either approval or a "no action" comfort letter from the European Commission.

To eliminate this risk while avoiding an administrative logjam at the European Commission, the EU in the mid-80's adopted a "safe harbor" regulation exempting patent and know-how licenses containing certain types of provisions from the requirement of pre-approval that would otherwise apply. These

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regulations were combined and replaced in 1996 by the Technology Transfer Block Exemption.

A PREVIEW OF THE NEW REGULATIONS

Although the new regulations are not yet in final form, they are expected to include the following changes:

- > The regulations will extend the protection of the Technology Transfer Block Exemption to include **software** and other copyright licenses in addition to patent and know-how licenses.
- > The new Technology Transfer Block Exemption will not be available if (a) the parties to the agreement are competitors or potential competitors whose **combined market share** is **over 20%** of the relevant technology or product market, or (b) the parties are non-competing and **either party's market share** is **over 30%**. Previously, there were no market share thresholds placed on the exemption, although one of the stated grounds on which the European Commission could withdraw the exemption was the existence of a licensee market share of more than 40%. If the new thresholds are not raised in the final regulations, many agreements that previously qualified for the Technology Transfer Block Exemption will require clearance from the European Commission.
- > In addition to the possible revocation of the Technology Transfer Block Exemption in particular cases by the European Commission, based on a finding of an actual anticompetitive effect in the EU, it will now be possible for an **individual member state** of the EU to find an anticompetitive effect in its own territory. In such case, the member state may remove the agreement from the protection of the new

Technology Transfer Block Exemption in its own territory.

POTENTIAL PITFALLS

Depending upon the particular circumstances, any of the following provisions could create difficulties for transnational distribution and licensing agreements oriented around U.S. parameters. U.S. agreements should be reviewed to ensure that they are valid and enforceable in the EU and will not result in fines or liability to third parties.

- > A licensor may not require its licensee to grant back exclusive rights (either by assignment or license) to improvements in the technology that are made by the licensee.
- > A licensor may generally not prohibit its licensee from making "passive sales" to customers outside the licensed territory. This restriction has been interpreted to invalidate efforts by the licensor to restrict the languages that its licensee uses in advertising on its website.
- > A licensor may not contractually restrict its licensee's ability to challenge the licensor's rights in the licensed intellectual property. The licensor may, however, retain the contractual right to terminate the agreement in the event such a challenge.

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**FOR FURTHER INFORMATION,
PLEASE CONTACT:**

If you have any questions about the application of EU regulations to your European licenses or would like further information about technology licensing generally, please contact:

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