Guidelines on the Application of Articles 4 and 5 of the Act no 4054 on the Protection of Competition to Technology Transfer Agreements

I. INTRODUCTION

(1) Guidelines on the Application of articles 4 and 5 of the Act no 4054 on the Protection of Competition to Technology Transfer Agreements (the Guidelines) set out the principles for the assessment of technology transfer agreements by the Competition Board (the Board) within the scope of articles 4 and 5 of the Act no 4054 on the Protection of Competition. Technology transfer agreements are agreements where the licensor permits the licensee to exploit the licensed technology for the production of goods or services, as defined in article 4(1)(a) of the Block Exemption Communiqué no. 2008/2 on Technology Transfer Agreements (the Communiqué[1]).

(2) The purpose of these Guidelines is to provide guidance on the application of the Communiqué as well as on the application of articles 4 and 5 of the Act individually to technology transfer agreements that fall outside the scope of the Communiqué. The Communiqué and the guidelines are without prejudice to the application of article 6 of the Act to technology transfer agreements.

(3) The principles set forth in these guidelines must be applied in the light of the circumstances specific to each case on a file base. This will prevent rigid application of the Guidelines. Each case must be assessed taking into account its own facts and these Guidelines must be applied reasonably and flexibly. Examples given in the Guidelines includes explanations to guide those concerned and are not intended to be exhaustive.

GENERAL PRINCIPLES

1. Articles 4 and 5 of the Act and Intellectual Property Rights

(4) The Communiqué defines intellectual property rights as patent, utility model, industrial design, integrated circuit topography and plant breeder’s right and related applications and software rights. Legal regulations related to intellectual property rights[2] confer exclusive rights on right holders. The owner of intellectual property is entitled under the relevant legal regulations to exploit the subject of the right exclusively, to prevent illegal use of it by third parties and confer the right to use it by licensing it to third parties.

(5) The fact that legal regulations related to intellectual property grant exclusive rights of exploitation to right holders does not imply that intellectual property rights are immune from the area of application of the competition law. Articles 4, 5 and 6 of the Act is also applicable to agreements whereby the holder of intellectual property right licenses another undertaking to exploit its intellectual property rights. However, the grant of exclusive right to use to right holders does not imply that there is an absolute conflict between intellectual property rights and competition rules. Indeed, both bodies of law have the same basic objective of promoting consumer welfare and an efficient allocation of resources. As is known, innovation constitutes an essential and dynamic

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[1] See the Official Gazette dated 23/01/2008 and numbered 26765.

[2] The explanations made related to intellectual property in the Guidelines also apply for know-how.

component of an open and competitive market economy. Within this scope, while intellectual property rights promote dynamic competition by encouraging undertakings to invest in developing new or improved products and processes, competition protected by the competition law puts pressure on undertakings to innovate. Therefore, the common objective of intellectual property rights and competition is to promote innovation and ensure a competitive exploitation thereof.

(6) In the assessment of license agreements under articles 4 and 5 of the Act, it must be kept in mind that the process of creating intellectual property rights often entails substantial investment and that this is often a risky activity. In order not to reduce dynamic competition and to maintain the incentive to innovate, the innovator must not be unduly restricted in the exploitation of intellectual property rights. For these reasons, it is important that the innovator should be free to determine the remuneration for the exploitation of intellectual property rights taking failed projects into account for maintaining their investment incentives. On the other hand, technology rights licensing may also require the licensee to make significant sunk investments. Articles 4 and 5 must be applied by considering such ex ante investments made and the risks taken by the parties. Therefore, the risk facing the parties and the sunk investment that must be committed may thus constitute a reason for the relevant agreement to fall outside the prohibition in article 4 of the Act or benefit from the exemption in article 5 for the period of time required to recoup the investment.

(7) Most intellectual property rights and license agreements related to them create pro-competitive effects by leading to the dissemination of technology and promotion of innovation; thus, an automatic presumption that they are contrary to competition rules will not be true. Even in cases where license agreements restrict competition, the conditions in article 5 may be fulfilled. As a result, when articles 4 and 5 of the act are considered together, it is possible to say that most of the licensing agreements comply with competition rules.

2. The General Framework for Applying Articles 4 and 5 of the Act

(8) As is known, article 4 of the Act prohibits agreements which have as their object or effect the restriction of competition by applying both to restrictions of competition between the parties to the agreement and to restrictions of competition between any of the parties and third parties.

(9) The assessment of whether a license agreement restricts competition must be made by taking into account the context in which competition would occur in the absence of the agreement and its restrictions. In making this assessment of a license agreement under article 4 of the Act, it is necessary to take account of whether the agreement restricts inter-technology competition[3] and intra-technology competition[4] as there are not any distinctions in the Act. The following cases may be examples of factors to be considered while making such assessment.

> (a) A licensor imposes obligations on its licensees not to use competing technologies and these obligations foreclose third party technologies, therefore

[3] Competition between undertakings using the same technology

[4] Competition between undertakings using competing technologies

the agreement restricts actual or potential competition.

(b) If the licensor imposes obligations related to price, territory or customers, competition between the licensees may be restricted. However, the restraint may in certain cases not be caught by article 4 if it is objectively necessary for the conclusion of the agreement. For instance, if the territorial restrictions in a license agreement between non-competitors are objectively necessary for the licensee to enter a new market, it may not be caught by article 4 of the Act for a certain time. Similarly, imposing the licensees a ban on making sales to certain types of end users on objective grounds related to health or security due to the nature of the relevant product may not be deemed restrictive of competition.

(10) Article of the Act does not distinguish between those agreements that have a restriction of competition as their object and those that have a restriction of competition as their effect but prohibits both types.

(11) Obligations in an agreement which have restriction of competition as their object are prohibited according to article 4 of the Act irrespective of the efficiencies they create in the market and it is unlikely that the said obligations may fulfill the conditions of exemption in article 5 of the Act. The assessment of whether or not an agreement has as its object a restriction of competition requires an analysis of factors such as the content of the agreement, objective aims pursued by it, the context in which it is applied or to be applied, the actual conduct and behavior of the parties in the market and the conditions under which it is applied. Even where the agreement does not contain an express provision, the way in which an agreement is actually implemented may reveal an obligation restrictive of competition. Although the intent of the parties may be considered to show the object of restricting competition, it is not a necessary condition. It is accepted that the restrictions listed in article 6 of the Communiqué are restrictive by their object.

(12) If an agreement is not restrictive of competition by object it is necessary to examine whether it has restrictive effects on competition. In this context, account must be taken of both actual and potential effects. For license agreements to be restrictive of competition by effect, it must be likely that they will affect actual or potential competition by creating negative effects on prices, output, innovation or the variety or quality of goods and services in the relevant market.

(13) For the purposes of revealing effects restrictive of competition, it is normally necessary to define the relevant market and to examine and assess the factors such nature of the products and technologies concerned, the market position of the parties, and buyers, the existence of potential competitors and the level of entry barriers. In some cases, however, it may be possible to show anti-competitive effects directly by analyzing the conduct of the parties to the agreement on the market. Ascertaining that an agreement has led to price increases may be an example of such situations.

(14) Beside their features restrictive of competition, license agreements also have substantial pro-competitive potential. The vast majority of those agreements are indeed pro-competitive. License agreements may promote innovation by allowing innovators to earn returns to cover at least part of their research and development costs. Thus, the licensor has resource to make a new invention. License agreements also lead to a dissemination of technologies and provide benefits by reducing the production costs of the licensee or by enabling it to produce new or improved

products. Efficiencies at the level of the licensee often stem from a combination of the licensor's technology with the assets and technologies of the licensee. Such combination of complementary assets and technologies may allow a cost/output configuration that would not otherwise be possible. For instance, the combination of an improved technology of the licensor with more efficient production or distribution assets of the licensee may reduce production costs or lead to the production of a higher quality products. License agreements may also serve the pro-competitive purpose of removing obstacles to the development and exploitation of the licensees' own technologies. In particular in sectors where large numbers of patents are prevalent, license agreements are often made in order to remove the risk of infringement claims by the licensor. When the licensor agrees not to invoke its intellectual property rights to prevent the sale of the licensee's products, the license agreement in question removes the obstacles to the sale of the licensee's products and thus generally promotes competition.

(15) In cases where a license agreement is caught by article 4 of the Act, whether the conditions listed in article 5 of the Act are fulfilled must be analyzed. It should be noted that hardcore restrictions in license agreements[5] fulfill the conditions in article 5 of the Act only in exceptional circumstances. For instance, the provisions in license agreements that fix the price of the products produced under the license are among such restrictions.

3. Market Definition

(16) The Board's approach to defining the relevant market is laid down in its Guidelines on the Definition of the Relevant Market[6]. These guidelines only address aspects of market definition that are relevant in the field of technology licensing.

(17) Technology is an input, which is integrated into a product or a production process. Technology right licensing can therefore affect competition both in input markets and in output markets. For instance, an agreement between two parties which sell competing products and which also cross license technology rights relating to the production of these products may restrict competition in the market concerned. For the purposes of assessing the competitive effects of license agreements it may be necessary to define the relevant goods and services markets (product markets) as well as the relevant technology markets.

(18) Within the scope of the Communiqué and the Guidelines, the relevant product market comprises the contract products incorporating the licensed technology and products which are regarded by the buyers as interchangeable with or substitutable for the contract products, by reason of the products' characteristics, their prices and their intended use.

(19) Technology markets consist of the licensed technology rights and its substitutes, that is to say, other technologies which are regarded by the licensees as interchangeable with or substitutable for the licensed technology rights, by reason of the technologies' characteristics, their royalties and their intended use. Technology

[5] Hardcore restrictions are listed in article 6 of the Communiqué and exclude an agreement out of the scope of block exemption.
[6] See the text published on the website of the Competition Authority according to the Board Decision dated 28/01/2008 and numbered 08-04/56-M.

markets are defined following the same method as the product market. Starting from the technology which is marketed by the licensor, it is necessary to identify those other technologies to which licensees could switch in response to a small but permanent increase in relative prices, for instance in royalties. An alternative approach is to look at the market for products incorporating the licensed technology rights.

(20) Once relevant market has been defined, market shares that is an indication of the relative strength of market players are calculated. One way to calculate the market shares in technology markets is to identify each technology's share in total licensing income from royalties. In this way, it is possible to see the share of a technology in the market where competing technologies are licensed. However, calculation of market shares with this method is a theoretical and not a practical way because of lack of sufficient information on royalties, etc. Therefore, to calculate the market shares in the technology market on the basis of sales of products incorporating the licensed technology on downstream product markets, as explained in the fourth paragraph of article 5 of the Communiqué would be a more suitable approach (see paragraph 57). In this case, all sales in the relevant market will be taken into account regardless of whether the product incorporates the licensed technology. In case of technology markets, within the framework of article 5(4) of the Communiqué, it is relevant to take into account only in-house technologies as it is a good indicator of the general strength of the technology. This approach is important to consider any potential competition from undertakings that are producing with their own technology and that are likely to start licensing in the event of a small but permanent increase in the price for licenses. Secondly, even where it is unlikely that other technology owners would start licensing, the licensor does not necessarily have market power on the technology market even if it has a high share of licensing income. The fact that the downstream product market is competitive may be an effective competitive pressure on the licensor. An increase in royalties in upstream markets affects the costs of the licensee, may decrease its competitive power and thereby cause it to lose sales. A technology's market share on the product market also captures this element and is thus normally a good indicator of licensor's market power on the technology market. In cases where the block exemption does not apply, in order to assess the market power of the licensor more accurately, both approaches stated above may need to be applied as much as possible.

(21) Moreover, in cases where the block exemption does not apply, as the market share may not be a good indicator of the relative strength of existing technologies, in addition to the technologies controlled by the parties, other factors such as the number of technologies which the user may use as a substitute in return for a similar royalty and which are controlled by third parties independently of the parties will be taken into account (see paragraph 109).

Some license agreements may affect competition in innovation, in analyzing such effects, it will be sufficient to examine the impact of the agreement on competition within existing product and technology markets. Moreover, in some exceptional cases, in particular, where the agreement impacts innovation activities that aim to create new products and research and development centers can be detected at an early stage, it may be relevant to define the innovation markets.

4. The Distinction between Competitors and Non-Competitors

(23) While it is accepted that anticompetitive effects of agreements between

competitors are greater compared to agreements between non-competitors, it should be noted that intra-technology competition between licensees constitutes an important complement to inter-technology competition. For instance, intra-technology competition may lead to lower prices for the products incorporating the technology in question and also spur further competition between undertakings that use competing technologies.

(24) In order to determine the competitive relationship between the parties it is necessary to examine whether the parties are actual or potential competitors at the time of the agreement. If at the time of the agreement the parties are not actual or potential competitors in any relevant market affected by the agreement they are deemed to be non-competitors.

(25) The parties are deemed actual competitors in the relevant market if they are already active in the same relevant product or technology market without infringing other party's intellectual property rights. If the licensee is already licensing its own technology to third parties and the licensor enters the market by licensing a competing technology to the licensee, the parties are deemed actual competitors.

(26) The parties are considered to be potential competitors in the product market if it is likely that, at the absence of the agreement, they would undertake the necessary additional investments to enter the relevant market in response to a small but permanent increase in product prices, without infringing other party's intellectual property rights. In order to constitute a realistic competitive constraint entry has to be likely to occur within a short period. Normally a period of one to two years is deemed appropriate; however, in individual cases longer periods can be taken into account. The period of time needed for undertakings already active in the market to adjust their capacities can be used as a yardstick to determine this period. For instance, the parties are likely to be considered potential competitors in the product market where the licensee who produces on the basis of its own technology in one geographic market starts producing in another geographic market on the basis of a licensed competing technology because in such circumstances, the licensee will be able to enter the second geographic market on the basis of its own technology, unless entry is precluded by objective factors, such as patents blocking the use of its own technology (see paragraph 29).

(27) The parties are considered to be potential competitors if the licensee is not licensing-out its own technology but it would be likely to do so in the event of a small but permanent increase in technology prices in the technology market where it owns substitutable technologies. Potential competition in the technology market is taken into account for agreements that cannot benefit from block exemption but will not lead to the application of hardcore restrictions valid for agreements between competitors.

(28) In light of the explanations above, if the licensor is not an actual or a potential supplier of the products in the relevant market and although the licensee who is active in the product market has a competing technology and produces on the basis of that technology, it does not license the competing technology, the parties will not be deemed competitors. In some cases, the parties may become competitors as the licensee develops and uses a competing technology after the agreement is concluded. In such cases, if there is not any changes in the essence of the agreement, the hardcore competition restrictions list that is valid for agreements between competitors will not apply to this agreement. The same applies to cases

where the licensee is active in the product market before obtaining the license and the licensor enter the product market afterwards on the basis of the licensed technology or a new technology (see article 6(4) of the Communiqué).

(29) The parties are not considered competitors if the subject of technologies are in a blocking position. They may be in a one-way or two-way blocking position. A one-way blocking position exists where a technology cannot be exploited without infringing upon another valid technology rights, while a two-way blocking position exists where neither technology can be exploited without infringing upon the other valid technology right.

(30) In some cases it may also be possible to conclude that while the licensor and the licensee produce competing products, they are non-competitors in the relevant product and technology market. The fact that the licensed technology represents such a drastic innovation that the technology of the licensee has become obsolete or uncompetitive may be an example of such cases. It is often not possible to foresee such circumstances at the time the agreement is concluded but they become apparent after the technology in question or the products incorporating it are put on the market. For instance, when CD technology was developed and players and discs were put on the market, it was not obvious that this new technology would replace LP technology. It became apparent after some years later that LP technology would yielded to this technology. Within this framework, if it is not obvious at the time the agreement is concluded that the licensee's technology is obsolete or uncompetitive, the parties are deemed competitors; however the relationship of competitors between the parties will change if the licensee's technology becomes obsolete or uncompetitive in the market.

III. APPLICATION OF THE COMMUNIQUÉ

1. The Effects of the Communiqué

(31) Technology transfer agreements that fulfill the conditions set out in the Communiqué are block exempted from the prohibition in article 4 of the Act. Such agreements can only be prohibited for the future and upon withdrawal of the block exemption by the Board.

(32) Block exemption of technology transfer agreements is based on the presumption that if they are caught by article 4 of the Act, those agreements fulfill the four conditions laid down in article 5 of the Act.

(33) For the agreements outside the scope of the block exemption, it is relevant to examine whether the agreement in question is caught by article 4 of the Act and if so, whether the conditions of article 5 are satisfied. In particular, if the market shares of the parties to a technology transfer agreement exceed the market share thresholds set out in the Communiqué, a detailed analysis is necessary to show whether the said agreement is under article 4 of the Act and whether it fulfills the conditions for exemption laid down in article 5. While making the necessary analysis, all legal and economic aspects related to the agreements, especially the structure of the relevant technology and product market should be taken into account. However, it can be presumed that agreements containing the hardcore restrictions listed in article 6 of the Communiqué are subject to the prohibition in article 4.

2. Scope and Duration of the Communiqué

2.1. Agreements between Two Parties

(34) According to article 5, paragraph one, the Communiqué only covers technology transfer agreements ‘between two undertakings’, technology transfer agreements between more than two undertakings are not covered by the Communiqué. Such agreements concluded by two undertakings fall within the scope of the Communiqué even if they include conditions for more than one level of trade such as production and distribution because the Communiqué applies to license agreements concerning not only the production stage but also provisions regarding the distribution stage such as the obligations that the licensee must or may impose on resellers of the products produced under the license.

(35) License agreements concluded between more than two undertakings are often of similar nature as license agreements concluded between two undertakings; thus, in an individual assessment of such agreements, the principles set out in the Communiqué will be applied.

2.2. Agreements Concerning Production

(36) According to articles 2 and 5 of the Communiqué, for license agreements to be covered by it they must be related to "the production of contract products". In other words, the licensee must use the licensed technology in the production of goods or provision of services. The Communiqué does not apply to technology pools where two or more parties agrees to assemble their technologies and create pool and license them as a package. The concept of technology pool also covers arrangements whereby two or more parties agree to license the package of technologies in question to a third party and empower that party to license the package.

(37) Provided that the production of the contract products constitute the main purpose of the agreement, agreements allowing the licensee to sub-license[7] the licensed technology to third parties are covered by the Communiqué. However, the Communiqué does not apply to agreements whose main purpose is to sub-license. However, the principles set out in the Communiqué and Guidelines will be applied to such "master licensing" agreements between the licensor and the licensee by analogy. Agreements between the licensee and sub-licensees are covered by the Communiqué.

(38) The term "contract products" encompasses goods and services produced with the licensed technology. This is the case where the licensed technology is used in the production process and where it is incorporated into the product itself. The Communiqué applies in all cases where technology licenses are granted for the purposes of producing goods and services.

(39) Moreover, agreements where the licensor allows the licensee to make production for instance under a patent and will not use its patent-based rights (non-challenge agreements) as well as settlement agreements are under the scope of the Communiqué.

[7] Sub-licensing means the grant of the license by the licensee to third parties.

(40) The Communiqué covers subcontracting agreements whereby the licensee undertakes to produce products with the licensed technology exclusively for the licensor. In order for subcontracting agreements involving the supply of equipment necessary for production by the licensor to the licensee to be assessed within the scope of the Communiqué, the main purpose of the agreement must be the licensed technology. On the other hand, subcontracting is also covered by the Guidelines on Certain Subcontracting Agreements between Non-Competitors[8]. According to those Guidelines, while subcontracting agreements whereby the subcontractor undertakes to produce certain products exclusively for the contractor generally fall outside article 4 of the Act, some restrictions imposed on the subcontractor such as the obligation not to conduct or exploit its own research and development may be caught by article 4[9].

(41) The Communiqué also applies to agreements whereby the licensee must carry out development work before obtaining a product or a process that is ready for commercial exploitation, provided that a contract product has been identified because even if such further work and investment is required, the object of the agreement is the production of an identified product. The Communiqué and these Guidelines do not cover agreements whereby technology is licensed for the purpose of enabling the licensee to carry out further research and development in various fields. For instance, this is the case where the licensee obtains a license for a technological research tool for further research activity. To apply the Communiqué and the Guidelines, there should be a direct connection between the licensed technology and an identified contract product. Where there is no such connection, it will not be relevant to apply the Communiqué and the Guidelines as the main objective of the agreement is research and development activity rather than the launch of a new product. The Communiqué and the Guidelines do not cover research and development sub-contracting whereby the licensee undertakes to carry out research and development in the field of the licensed technology and to hand back the improved technology package to the licensor. The main object of such agreements is the provision of research and development services aimed at improving the technology as opposed to the production of goods and services on the basis of the licensed technology.

2.3. The Concept of Technology Transfer Agreements

(42) The Communiqué and these guidelines cover agreements for the transfer of technology. According to subparagraphs (a) and (d) of article 4(1) of the Communiqué, the concept of ‘technology’ covers patents, utility models, industrial design, integrated circuit topography, plant breeder's rights and related applications and software rights as well as know-how. In this sense, the licensed technology should allow the licensee, with or without other input, to produce the contract products.

(43) According to article 4(1)(d) of the Communiqué, know-how means a confidential, substantial and identified package of knowledge resulting from experience and testing. 'Confidential' in this definition means that know-how is not known or easily accessible as a whole or when pieced together and combined completely. 'Substantial' means that know-how encompasses significant and useful knowledge for

[8] See the text published on the website of the Competition Authority according to the Board Decision dated 10/01/2008 and numbered 08-04/55-M.
[9] See paragraph 8 of the said Guidelines.

the production of the products or application of the process under the license agreement. In other words, the information must significantly contribute to or facilitate the production of the contract products. In cases where the licensed know-how relates to a product as opposed to a process, this condition implies that the know-how is useful for the production of the contract product. This condition is not satisfied where the contract product can be produced on the basis of freely available technology. However, the condition does not require that the contract product is of higher value than products produced with freely available technology. In the case of process technologies, this condition implies that the know-how is useful in the sense that it can reasonably be expected at the date of conclusion of the agreement to be capable of significantly improving the competitive position of the licensee, for instance by reducing its production costs. 'Identified' means that it is possible to verify that the licensed know-how fulfills the criteria of secrecy and substantiality. This condition is satisfied where the licensed know-how is described in manuals or other written form; however in some cases this may not be reasonably possible. For instance the licensed know-how may consist of secret and substantial practical knowledge which is possessed by the licensor's employees and passed on to the licensee in the form of training of the licensee's employees. In such cases it is sufficient to describe in the agreement the general nature of the know-how and to list the employees that will be or have been involved in passing it on to the licensee.

(44) The Communiqué applies to the agreements whose main objective is to transfer technology as defined in the Communiqué. On the other hand, agreements the main objective of which is the purchase of goods or services or licensing types of intellectual property rights other than those listed in the Communiqué are not covered. Agreements including provisions relating to the purchase and sale of products are only covered by the Communiqué if those provisions do not constitute the main objective of the agreement and relate directly to the application of the licensed technology. This may be the case where tied products are the input of the equipment or process specially prepared for efficient exploitation of the licensed technology. On the other hand, if the product in question is only another input for the final product, whether the licensed technology constitute the main objective of the agreement should be analyzed carefully. For instance, in case the licensee is already producing a final product on the basis of another technology, the license should lead to an important improvement more valuable than the product purchased from the licensor in the production process of the licensee. The requirement that the tied products should be related to the licensing of the technology shows that the purchase of the products that are not related to the products incorporating the licensed technology are not covered by the Communiqué. For instance, this applies to cases where the tied product does not mean to be used with the licensed product but relates to an activity in a different product market.

(45) The Communiqué covers licenses related to intellectual property rights other than those defined therein provided that they are directly related to the exploitation of the licensed technology and do not constitute the main objective of the agreement. This condition ensures that the said rights are block exempted to the extent that they enable the licensee to better exploit the licensed technology. For instance, a licensor may authorize a licensee to use its trademark on the products incorporating the licensed technology, as this trademark allows consumers to make an immediate link between the product and the characteristics imputed to it by the licensed technology. However, if the value of the licensed technology is limited because the licensee already uses the same or similar technology and the main objective of the agreement is the trademark, the Communiqué will not apply.

2.4. Duration

(46) The block exemption granted by the Communiqué applies for as long as the licensed property right has not lapsed, expired or been declared invalid. In the case of know-how, the block exemption applies as long as the licensed know-how remains secret. However if the know-how becomes publicly known as a result of action by the licensee, the exemption applies for the duration of the agreement.

(47) In case of an agreement where the relevant intellectual property rights and know-how are licensed in combination, the block exemption applies to each licensed intellectual property right and know-how covered by the agreement and ceases to apply on the date of expiry, invalidity or the coming into the public domain of the last technology right within the meaning of the Communiqué.

2.5. Relationship with Other Block Exemption Regulations

(48) If the licensed technology is the subject of other types of agreements such as research and development or the products produced with the licensed technology are distributed within the framework of a vertical agreement, it is necessary to address the relationship between the Communiqué and other Communiqués adopted by the Board.

2.5.1. Block Exemption Communiqué No 2003/2 on Research and Development Agreements

(49) Block Exemption Communiqué No 2003/2 on research and development agreements (the Communiqué no 2003/2)[10] covers agreements whereby two or more undertakings agree to jointly carry out research and development and to jointly exploit the results thereof. According to last paragraph of article 3 of the Communiqué no 2003/2, it is deemed that research and development is carried out by parties together, or its results are utilized jointly where research and development studies are carried out by a team, an organization or an undertaking set up together or via a third undertaking appointed together, or there is a division of labor between parties through specialization in the areas of research, development, production or distribution; the parties make cooperation about the transfer of intellectual rights or the passing of know-how.

(50) Accordingly, agreements licensing between the parties and by the parties to a joint legal entity with respect to research and development should be addressed within the framework of the Communiqué no 2003/2. In the context of such agreements the parties can also determine the conditions for licensing the fruits of research and development to third parties. In that case, as third party licensees are not party to the research and development agreement, license agreements concluded with third parties is not covered by the Communiqué no 2003/2. However such license agreements may benefit from the block exemption in the Communiqué no 2008/2 if the conditions are fulfilled.

2.5.2. Block Exemption Communiqué no 2002/2 on Vertical Agreements

[10] See the Official Gazette dated 27/08/2003 and numbered 25212.

The Communiqué no 2002/2 on vertical agreements (the Communiqué no 2002/2)[11] covers agreements entered into between two or more undertakings each operating, for the purposes of the agreement, at different levels of the production or distribution chain, and relating to the purchase, sale or resale of certain goods or services.

(51) Given that the Communiqué no 2008/2 only covers agreements between two parties and that a licensee, selling products incorporating the licensed technology, is a supplier within the scope of the Communiqué no 2002/2, those two block exemption regulations are applied simultaneously. In this case, the agreement between licensor and licensee is subject to the Communiqué no 2008/2 whereas agreements concluded between a licensee and its buyers are subject to the Communiqué no 2002/2.

(53) License agreements where the agreement imposes obligations on the licensee as to the way in which it must sell the products incorporating the licensed technology may benefit from block exemption under the Communiqué no 2008/2. In particular, in cases where the licensee is obliged to establish a certain type of distribution system such as exclusive distribution or selective distribution according to the license agreement, distribution agreements concluded for the purposes of implementing such obligations must, in order to be covered by a block exemption, comply with the Communiqué no 2002/2.

(54) Under the Communiqué no 2002/2, since each licensee is deemed as a separate supplier, distributors must in principle be free to sell both actively and passively into territories covered by the distribution systems of other licensees producing their own products on the basis of the licensed technology rights. However, restrictions allowed according to the Communiqué no 2002/2 may also apply to the distribution systems of the licensees where the products incorporating the licensed technology are sold under a common brand belonging to the licensor because for a common brand identity to exist, the products must be sold and marketed under a common brand for conveying quality and other relevant information to the consumer. However, it does not suffice that in addition to the licensees' brands the product carries the licensor's brand, which identifies it as the source of the licensed technology.

3. Exemption Protection Granted by the Communiqué

(55) According to article 5 of the Communiqué, the block exemption of restrictive agreements is subject to market share thresholds and it is presumed that agreements under those thresholds satisfy the conditions laid down in article 5 of the Communiqué. If the market share thresholds are exceeded, individual exemption assessment is required. However, it should be noted that the fact that market share thresholds are exceeded does not give rise to any presumption that the agreement is caught by article 4 of the Act or that the agreement does not fulfill the conditions of article 5. Such license agreements may benefit from individual exemption provided that they do not contain hardcore restrictions.

(56) The market share threshold is defined separately for the agreements between competitors and the agreements between non-competitors.[12] If the parties to the

[11] See the Official Gazette dated 14/07/2002 and numbered 24815.

[12] For the explanations related to competitors and non-competitors, see paragraphs 23-30

license agreement are not competitors, the agreement benefits from block exemption provided that the market share of each party does not exceed 40% in the affected relevant technology and product markets. If the parties to the license agreement are competitors, the agreement benefits from block exemption provided that the total market share of the parties do not exceed 30% in the affected relevant technology and product markets. The market share thresholds apply both to technology markets and markets of products incorporating the licensed technology. If the market share threshold is exceeded in one of the affected markets, the block exemption does not apply to the agreement for that relevant market. For instance, if the license agreement concerns two separate product markets or two separate geographic markets, the block exemption applies to one of the markets and not to the other.

(57) In case of technology markets, the licensor's market share is to be calculated on the basis of the sales of the licensor and all its licensees of products incorporating the licensed technology for each of the relevant markets. If the parties are competitors, the sale of the licensee of the products incorporating its technology and the sale of the products incorporating the licensed technology should be combined. In case the products incorporating the technology are not launched, the market share is calculated as zero. The market share of the technology will be visible once the products are launched.

(58) In case of product markets, the licensee's market share is to be calculated on the basis of the licensee's sales of products incorporating the licensor's technology and competing products, that is to say, the total sales of the licensee in the product market in question. Where the licensor is a supplier of products in the relevant market, the licensor's sales in the product market in question must also be taken into account. In the calculation of market shares for product markets, however, sales made by other licensees are not taken into account when calculating the licensee's and/or licensor's market share.

(59) Market shares should be calculated on the basis of sales value data of the where such data are available. However, where value based data are not available, estimates based on other reliable market information may be used, including market sales volume data.

The principles set out above can be illustrated by the following examples:

License agreements between non-competitors

<u>Example 1</u>

Company A is specialized in developing bio-technological products and techniques and has developed a new product Proxsus; however, it is not an active producer of Proxus. Company B is a company producing competing products with freely available non-proprietary technologies. In the first year, B sold TL 25 million worth of products produced with those technologies. In the second year, A gives a license to B to produce Proxsus. In that year B sells TL 15 million worth of products produced with the help of the freely available technologies and TL 15 million worth of Proxsus. In the third year and the following years B produces and sells only Proxsus, worth TL 40 million annually. In addition in the second year, A also licenses to C, which was not active on that product market before. C produces and sells only Proxsus, TL 10 million in the second year and TL 15 million in the third year and thereafter. It is established that the total market of Proxsus and its substitutes where B and C are active is worth TL 200 million in each year.

In the second year when the license agreements are concluded, A does not have any shares on the technology market as its market share has to be calculated on the basis of the total sales of Proxsus in the preceding year. In the third year, A's market share on the technology market is 12,5 %, taking into account the value of Proxsus produced by B and C in the second year. In the fourth year and thereafter A's market share on the technology market is 27,5 %, reflecting the value of Proxsus produced by B and C in the preceding year.

In the second year, B's market share on the product market is 12,5 %, reflecting B's TL 25 million sales in the first year. In the third year B's market share is 15 % because its sales have increased to TL 30 million in the second year. In the fourth year and thereafter B's market share is 20 % as its sales are TL 40 million annually. C's market share on the product market is 0 % in year the first and second year, 5 % in the third year and 7,5 % thereafter.

As the license agreements are concluded between non-competitors and the individual market shares of A, B and C are below 40 % each year, agreements may benefit from the block exemption provided by the communiqué.

<u>Example 2</u>

Let's assume that other conditions are the same as in Example 1, however now B and C are operating in different geographic markets. It is established that the total market of Proxsus and its substitutes is worth TL 75 million annually in each geographic market.

In this case, A's market share on the technology markets has to be calculated for of each of the two geographic product markets. In the market where B is active A's market share depends on the sale of Proxsus by B. As in this example the total market is assumed to be TL 75 million, the market share of A is 0 % in the second year, 18,75 % in the third year and 50 % thereafter. B's market share is 31,5 % in the second year, 37,5 % in the third year and 50 % thereafter. In the second year and third year both A's and B's market share does not exceed the 40 % threshold. The threshold in this example is exceeded from the fourth year; therefore, in line with article 9(4) of the Communiqué, the license agreement between A and B can no longer benefit from block exemption after the sixth year and will be subject to individual exemption.

In the market where C is active A's market share depends on the sale of Proxsus by C. A's market share on the technology market, based on C's sales in the previous year, is therefore 0 % in the second year, 12,5 % in the third year and 18,75 % thereafter. C's market share on the product market is 0 % in year the first and second year, 5 % in the third year and 18,75 % thereafter. The license agreement between A and C therefore benefits from the block exemption for the whole period.

License agreements between competitors

Example 3

Companies A and B are active on the same relevant product and geographic market for a certain chemical product. They also each own a patent on different technologies used to produce this product. In the first year A and B sign a cross license agreement licensing each other to use their respective technologies. In the first year, A and B produce only with their own technology and A sells TL 15 million of the product and B sells TL 20 million of the product. After the second year, they both use their own and the other's technology.

From that year onward A sells TL 10 million of the product produced with its own technology and TL 10 million of the product produced with B's technology. After the second year B sells TL 15 million of the product produced with its own technology and TL 10 million of the product produced with A's technology. The total market of the product and its substitutes is worth TL 100 million in each year.

To assess the license agreement under the Communiqué, the market shares of A and B have to be calculated both on the technology market and the product market. The market share of A on the technology market depends on the amount of the product sold in the preceding year, which was produced, by both A and B, with A's technology. In the second year, the market share of A on the technology market is therefore 15 %, reflecting its own production and sales of TL 15 million in the first year. From the third year, A's market share on the technology market is 20 %, reflecting the TL 20 million sale of the product produced with A's technology and produced and sold by A and B (TL 10 million each). Similarly, in the second year B's market share on the technology market is 20 % and thereafter 25 %.

The market shares of A and B on the product market depend on their respective sales of the product in the previous year, irrespective of the technology used. The market share of A on the product market is 15 % in the second year and 20 % thereafter. The market share of B on the product market is 20 % in the second year and 25 % thereafter.

As the agreement is between competitors, their combined market share, both on the technology and on the product market, has to be below the 30 % market share threshold in order to benefit from the block exemption. It is clear that this is not the case here. The combined market share on the technology market and on the product market is 35 % in year 2 and 45 % thereafter. Thus, this agreement between competitors will have to be subject to individual exemption assessment.

4. Hardcore Restrictions of Competition under the Block Exemption Communiqué

4.1. General Principles

(60) Article 6 of the Communiqué contains a list of hardcore restrictions of competition. The classification of a restraint as a hardcore restriction of competition is based on the nature of the restriction and experience showing that such restrictions are almost always anti-competitive. The restraint classified as a hardcore restriction of competition may stem not only from the objective of the agreement but also from the conditions where the agreement is implemented (See paragraph 11).

(61) When a technology transfer agreement contains a hardcore restriction of

competition, the agreement as a whole falls outside the scope of the block exemption according to article 6 of the Act. For the purposes of the Communiqué, it is accepted that hardcore restrictions cannot be separated from the rest of the agreement. It should be noted that an agreement that cannot benefit from block exemption due to hardcore restrictions can fulfill the conditions of individual exemption only in exceptional circumstances (see paragraph 15).

4.2. Agreements between Competitors

(62) The second paragraph of article 6 of the Communiqué lists the hardcore restrictions for license agreements between competitors. Accordingly, the agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object any of the following cannot benefit from block exemption:

a) The restriction of a party's ability to determine its prices

b) The limitation of production and sales amount of contract goods.

c) The allocation of markets or customers except:

1) The obligation on the licensor and/or the licensee to produce or not to produce with the licensed technology in one or more technical area of use, product market or territory

2) The obligation on the licensor not to grant a license to a third party and not to use the subject of the license in a certain territory.

3) The restriction of active sales by the licensor and/or the licensee into the territory or to the customer group reserved for the other party. However, sales by the parties to third parties in their territory who will make sales to other territories or customer groups within the country cannot be restricted directly or indirectly.

4) The restriction of active sales by the licensee into the territory or to the customer group allocated by the licensor to another licensee. However, sales by the parties to third parties in their territory who will make sales to another territory or customer group within the country cannot be restricted directly or indirectly.

5) The obligation on the licensee to produce the contract products only for its own use. However, the licensee cannot be restricted in selling the contract products actively and passively as spare parts for its own products.

6) The obligation on the licensee to produce the contract products only for a particular customer, where the license was granted in order to create an alternative source of supply for that customer

d) The restriction of the licensee's ability to exploit its own technology or the restriction of the ability of any of the parties to the agreement to carry out research and development, unless it is indispensable to prevent the disclosure of the licensed know-how to third parties.

(63) The list in article 6(2)(a) of the Communiqué concerns agreements between competitors that have as their object the fixing of prices for products sold to third parties, including the products incorporating the licensed technology. It is known that such price fixing agreements between competitors constitute a restriction of competition by its very object. In this context, price fixing can take the form of charging an exact price or a price list with certain allowed maximum rebates. It is immaterial whether the agreement concerns fixed, minimum, maximum or recommended prices. Price fixing can also be implemented indirectly by applying disincentives to deviate from an agreed price level, for example, by agreeing that the royalty rate will increase if product prices are reduced below a certain level. However, an obligation on the licensee to pay a certain minimum royalty does not amount to price fixing alone.

(64) Royalties that are calculated on the basis of each product sold directly affect the marginal cost of the product and thus product prices. Competitors can therefore use cross licensing where parties pay royalties reciprocally as a means of coordinating and/or increasing prices on downstream product markets[13]. If it is established that such an agreement does not create any competitive benefits and is a sham license agreement without any valid justification made by the parties to hide a price fixing agreement, an assessment will be made according to article 4.

(65) The hardcore restriction contained in article 6(2)(a) of the Communiqué also covers agreements whereby royalties are calculated on the basis of all product sales irrespective of whether the licensed technology is being used. Moreover, such agreements are also caught by article 6(2)(d) according to which the licensee must not be restricted in its ability to use its own technology rights (see paragraph 76). In general such agreements restrict competition since the agreement raises the cost of using the licensee's own competing technology and restricts competition that existed at the time of the agreement. Exceptionally, however, an agreement whereby royalties are calculated on the basis of all product sales may fulfill the conditions individual exemption if the restriction is objectively indispensable to obtain a pro-competitive result. For instance, this may be the case where in the absence of the restraint it would be impossible or unduly difficult to calculate and monitor the royalty payable by the licensee because the licensor's technology leaves no visible trace on the final product and practicable alternative monitoring methods are unavailable.

(66) The hardcore restriction of competition set out in article 6(2)(b) of the Communiqué concerns reciprocal output and sale restrictions on the parties. For instance, when competitors agree to impose reciprocal output or sale limitations, the object and likely effect of the agreement is to reduce output in the market. Another example is the case where an obligation on the parties to make payments reciprocally if a certain level of output is exceeded, as it creates the same effect.

(67) Article 6(2)(c) prohibits allocation of markets or customers unless an exceptional situation occurs. Before moving on to the explanations about exceptional cases, it should be noted that generally article 4 of the Act is not applicable to the said exceptions given the nature of intellectual property rights and the legislation regulating those rights.

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[13] This also applies to the cases where a party grants a license to the other party and accepts physical input from the licensee. Purchasing price does the same function as royalty.

The provision in article 6(2)(c) applies irrespective of whether the licensee is free to use its own technology. Once the licensee has made the necessary preparations to use the licensor's technology to produce a given product, it may be costly to maintain a separate production line using another technology in order to serve customers covered by the restrictions. Therefore, the said costs may be a barrier for the licensee to use another technology. It is highly unlikely that such license agreements create pro-competitive effects.

(69) Under article 6(2)(c)(i) of the Communiqué, it is not a hardcore restriction for the licensor to grant the licensee an exclusive license to produce in a particular territory and thus agree not to produce itself the contract products in or provide the contract products from that territory. Such exclusive licenses are block exempted irrespective of the scope of the territory. Similarly, the block exemption also applies if the license is limited to one or more technical areas of use or one or more product markets. In fact, as the purpose of such agreements may be to give licensee an incentive to invest in and develop the licensed technology, it is not possible to say that the object of the agreement is necessarily to share markets. However, in order to benefit from this exemption, the restrictions on area of use must not exceed the scope of the licensed technology and the licensees must not be restricted in using their own technologies (See article 6 (1)(d) of the Communiqué) because in cases where the licensees are restricted to use their own technologies, it is possible to establish that there is an agreement to share markets between the parties.

(70) According to the second subparagraph of article 6(2)(c), block exemption can be granted in cases where the licensor allocates a particular territory for the licensee and agrees that it will not give a license to a third party and use the subject of the license on that particular territory. Additionally, it is not a hardcore restriction for the licensor to reserve its right to use the subject of the license in the territory allocated to the licensee.

(71) According to the third subparagraph of article 6(2)(c) of the Communiqué, the restriction of the active sales by one of the parties into the territory or the customer group reserved for the other party is not a hardcore restriction of competition. However, sales by the parties to third parties in their territory who will make sales to other territories or customer groups within the country cannot be restricted directly or indirectly so that an absolute territorial protection is not made.

(72) According to the fourth subparagraph of article 6(2)(c) of the Communique, the restriction of active sales by the licensee into a territory or a customer group allocated by the licensor to another licensee does not prevent the implementation of block exemption as an exception of market and customer allocation. However, in order to avoid absolute territorial protection, preventing the licensees from making sales to customers in their territories, who want to obtain products from the licensor to sell in another territory or to another customer groups cannot benefit from the block exemption. On the other hand, if the licensees agree on not making active or passive sales to specific territories or customer groups, the agreement would mean that there is a cartel between the licensees. Such agreements are not covered by the Communiqué since they do not encompass any technology transfers.

(73) According to the fifth subparagraph of article 6(2)(c) of the Communiqué, a restriction on the licensee to produce the contract products only for its own use benefits from block exemption. However, if the contract product is a component

produced to be combined with another product, the licensee may be imposed an obligation to produce that component only to use in its own products and not to sell it to another producers. However the licensee must be able to sell those products as spare parts for its own products and supply them to third parties who render after-sales services.

(74) The last restriction covered by the block exemption as per the sixth subparagraph of article 6(2)(c) of the Communiqué is the obligation on the licensee to produce the contract products for a specific customer in order to create an alternative source of supply for that customer. Within the scope of this provision, while it is necessary that the license is limited to creating an alternative source of supply for that particular customer, it is not a condition that only one such license is granted in order to benefit from the block exemption. It is possible to benefit from the block exemption in case more than one undertaking is licensed to supply the same specified customer.

(75) Article 6(2)(d) includes a provision to protect the parties' ability to carry out research and development. As a rule, provisions restricting any of the parties' ability to carry out research and development cannot benefit from the block exemption. This rule applies irrespective of whether the restriction applies to a field covered by the license or to other fields. However, the fact that the parties agree to provide each other with future improvements of their respective technologies does not amount to a restriction on independent research and development. Such restrictions must be assessed on an individual basis. Restrictions on a party to carry out research and development with third parties will not be assessed under this sub-paragraph, where such restriction is necessary to protect the licensor's know-how against disclosure. However, in order to be covered by the exception, such restrictions must be necessary and proportionate to ensure the protection of the licensor's know-how against disclosure. For instance, where particular employees of the licensee are designated to be trained in and responsible for the use of the licensed know-how, those employees may not be allowed be involved in research and development with third parties.

(76) Another restriction that article 6(2)(d) excludes out of the scope of the block exemption is the restrictions on the licensee to use its own competing technology. The licensee must also be unrestricted in the use of its own competing technology rights provided that in doing so it does not make use of the technology rights licensed from the licensor. The licensee must be able to use its own technology without being subject to limitations in terms of where it produces, how much it produces or the price at which it sells. The licensee must also not be obliged to pay royalties on products produced on the basis of its own technology rights (see paragraph 65). Moreover, the licensee must not be restricted in licensing its own technology to third parties. When restrictions are imposed on the licensee's use of its own technology or its right to carry out research and development, the competitiveness of the licensee's technology is reduced. The most important effect of this is to reduce competition on existing product and technology markets and to reduce the licensee's incentive to invest in the development and improvement of its technology.

4.3. Agreements between Non-Competitors

(77) Article 6(3) of the Communiqué lists the restrictions which excludes as a group technology transfer agreements between non-competitors out of the scope of the block exemption. According to the said subparagraph, the exemption provided by the Communiqué does not cover agreements which, directly or indirectly, in isolation or in

combination with other factors under the control of the parties, have as their object any of the following:

a) The restriction of a party's ability to determine its prices. However, it is possible to impose a maximum sale price or recommend a sale price, provided that it does not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties.

b) The restriction of the territory into which, or of the customers to whom, the licensee may passively sell the contract products, except:

1) The restriction of passive sales into an exclusive territory or to an exclusive customer group reserved for the licensor

2) The restriction of passive sales into an exclusive territory or to an exclusive customer group allocated to another licensee during the first two years that this other person is selling the contract products in that territory or to that customer group

3) The obligation on the licensee to produce the contract products only for its own use. However, the licensee cannot be restricted in selling the contract products actively and passively as spare parts for its own products

4) The obligation on the licensee to produce the contract products only for a particular customer, where the license was granted in order to create an alternative source of supply for that customer

5) The restriction of active sales to end users by a licensee carrying out activities at the wholesale level

6) The restriction of sales by members of a selective distribution system to unauthorized distributors.

c) Restriction of active or passive sales to end users by a licensee carrying out activities at the retail level without prejudice to the right to prohibit a member of a selective distribution system from carrying out activities at an unauthorized place.

(78) Article 6(3)(a) concerns the restriction of the ability of a party to determine its selling prices. That is to say, as per this article, the agreement must not include any restrictions which have as their direct or indirect object the establishment of a fixed or a minimum selling price or a fixed or minimum price level to be observed by the licensor or the licensee when selling products to third parties.

Accordingly, not only the agreements that directly establish the selling price but also agreements that indirectly determine the selling price - for instance fixing margins, fixing the maximum level of discounts, linking the sales price to the sales prices of competitors, ensuring the observance of the established prices by means of threats, or warnings or contract terminations in case of deviations from a given price level - fall outside the scope of the exemption.

Direct or indirect price fixing can be made more effective when combined with measures to detect price reductions, such as using a price monitoring system, obligations on the licensees to inform about price deviations or to apply a most-favored-customer clause[14]. However, the provision of a list of recommended prices to or the imposition of a maximum price by the licensor is not considered in itself as a restriction rendering the agreement outside the scope of the block exemption provided that it does not turn into a fixed or a minimum price.

(79) Article 6(3)(b) of the Communiqué concerns the passive sales by the licensee. Accordingly, agreements or concerted practices that have as their direct or indirect object the restriction of passive sales by licensees of products incorporating the licensed technology is out of the scope of the exemption provided for by the Communiqué as a whole, apart from the exceptions listed in the same article.

Passive sales restrictions on the licensee may be in the form of direct obligations, such as the obligation not to sell to certain customers or to customers in certain territories or the obligation to refer orders from these customers to other licensees or in the form of indirect measures inducing the licensee to refrain from making such sales, such as financial incentives and the implementation of a monitoring system aimed at verifying the effective destination of the licensed products.
Although quantity limitations do not serve for this objective as such, they may be an indirect means to restrict passive sales. In cases such as the adjustment of quantities over time to cover only local demand, the combination of quantity limitations and an obligation to sell minimum quantities in the territory, as well as minimum royalty obligations linked to sales in the territory, differentiated royalty rates depending on the destination of the products and the monitoring of the destination of products sold by individual licensees, it is possible to assume restriction of passive sales as quantity limitations may be used to implement an underlying market partitioning agreement.

(80) First of all, it should be noted that article 6(3)(b) does not cover sales restrictions on the licensor. Therefore, all sales restrictions on the licensor are block exempted up to the market share threshold of 40 %. The same applies to all restrictions on active sales by the licensee, with the exception of what is said on active selling in point (105). It should be emphasized that generally it is not possible to apply article 4 of the Act to the restrictions imposed on the licensees with respect to active sales, given the nature of intellectual property rights and the legislation regulating those rights. Indeed from a competitive perspective, it is possible to say that such restrictions promote investments, non-price competition and improvements in the quality of services provided by the licensees by solving free rider problems and hold-up problems.

(81) Provisions restricting active and passive sales by the licensee into an exclusive territory or to an exclusive customer group reserved for the licensor in technology transfer agreements do not render the agreement out of the scope of the exemption provided by the Communiqué. In another words, such restrictions benefit from the exemption provided by the Communiqué as long as the market share threshold is not exceeded because it is presumed that as long as the market share threshold is not exceeded such restraints promote pro-competitive dissemination of technology and integration of such technology into the production assets of the licensee although they restrict competition. For a territory or customer group to be reserved for the licensor,

[14] Most-favored-customer clause means an obligation to grant another customer the favorable terms given to a customer.

the licensor does not actually have to be producing with the licensed technology in the territory or for the customer group in question, it is possible that the licensor can also reserve them for later exploitation.

(82) According to the second subparagraph of article 6(3)(b) the restriction of passive sales by a licensee into an exclusive territory or to an exclusive customer group allocated to another licensee during the first two years that this other person is selling the contract products in that territory or to that customer group benefits from block exemption.

The licensee often has to incur significant investments in production assets as well as advertisement and marketing in order to start operating in a new territory and develop its activities there. The licensee that starts to operate in a new region is faced with substantial risks as the expenses for advertisement and marketing and investments to produce on the basis of a particular technology are often sunk. In such cases, licensees do not want to obtain a license unless (active and) passive sales into their territory or to their customer groups by other licensees are restricted for a certain period of time. Therefore, restrictions of passive sales by other licensees into the exclusive territory reserved for the licensee benefits from the block exemption provided by the Communiqué for two years as explained above. However, after the two-year period expires, the said restriction will not benefit from the exemption provided by the Communiqué. It is often not possible that such restriction benefits from individual exemption under article 5 of the Act.

(83) According to the third subparagraph of article 6(3)(b) of the Communiqué, a restriction on the licensee to produce the contract products only for its own use benefits from block exemption. However, if the contract product is a component produced to be combined with another product, the licensee may be imposed an obligation to produce that component only to use in its own products and not to sell it to another producers. However the licensee must be able to sell actively or passively those products as spare parts for its own products and supply them to third parties who render after-sales services.

(84) Another restriction covered by the block exemption as per the fourth subparagraph of article 6(3)(b) of the Communiqué is the obligation on the licensee to produce the contract products for a specific customer in order to create an alternative source of supply for that customer. In fact, such provisions in agreements between non-competitors rarely fall under article 4 of the Act.

(85) As per the fifth subparagraph of article 6(3)(b), the restriction of sales to end users by a licensee carrying out activities at the wholesale level and imposing an obligation to make sales only to retailers is under the scope of block exemption. Such obligation allows the licensor to transfer its wholesale distribution function to the licensee and normally is out of the scope of article 4 of the Act.

(86) Lastly, if a selective distribution system is established, restrictions of the sales by the licensee to unauthorized distributors is under the scope of block exemption according to subparagraph six of article 6(3)(b). However, according to article 6(3)(c) of the Communiqué, the licensee must be allowed to make sales to end users both actively and passively, without prejudice to fifth subparagraph of article 6(3)(b).

5. Restrictions That Cannot Benefit From the Block Exemption

(87) Article 7 of the Communiqué lists the restrictions that cannot from block exemption and therefore require individual exemption assessment. According to article 7, where a technology transfer agreement contains any of the restrictions laid down in that article and the related restriction is separable from the rest of the agreement, only that restriction shall not benefit from and the rest of the agreement shall continue to be covered by the block exemption. In case any of the restrictions laid down in this article cannot be separated from the rest of the agreement, the whole agreement shall not benefit from the block exemption.

(88) The exemption provided for in this Communiqué shall not apply to the following restrictions as per article 7 of the Communiqué:

a) Any direct or indirect obligation on the licensee to grant an exclusive license to the licensor or a third party designated by the licensor in respect of its own severable improvements on or new applications of the licensed technology,

b) Any direct or indirect obligation on the licensee to assign, partly or completely, to the licensor or a third party designated by the licensor the rights related to its own severable improvements on or new applications of the licensed technology,

c) The obligation on the licensee not to challenge the validity of the related intellectual property rights that the licensor owns in Turkey. However, the right of the licensor to terminate the technology transfer agreement in case the licensee challenges the validity of one or more of the related licensed intellectual property rights is reserved.

(89) Subparagraphs (a) and (b) of article 7(2) of the Communiqué is about exclusive grant back or transfer to the licensor of severable improvements on or new applications of the licensed technology. In this sense, an improvement is deemed severable if it can be used without breaching the rights on the licensed technology. The obligations listed in the said subparagraphs are likely to reduce the licensee's incentive to innovate since it hinders the licensee from exploiting its improvements. This is the case both where the severable improvement has the same application as the licensed technology and where the licensee develops new applications of the licensed technology.

However, non-exclusive grant back obligations for severable improvements are covered by the block exemption. Even if the grant back obligation is non-reciprocal, that is to say, it is only imposed on the licensee, and where under the agreement the licensor is entitled to transfer the severable improvements to other licensees, the block exemption is applicable. Within this framework a non-reciprocal grant back obligation may promote the dissemination of innovation and new technology by permitting the licensor to freely determine whether and to what extent to pass on its own improvements to its licensees. In this way, such transfer clause may promote the dissemination of technology as each licensee knows at the time of contracting that it will be on an equal footing with other licensees in terms of the technology on the basis of which it is producing.

On the other hand, as the licensee cannot exploit the non-severable improvements without the permission of the licensor, exclusive grant back and transfer obligations on the licensee are not evaluated within the framework of article 4 of the Act.

(90) The application of Article 7(2)(a) and (b) does not depend on whether or not the licensor pays consideration in return for acquiring the improvement or for obtaining an exclusive license. However, the existence and level of such consideration may be important in the context of an individual assessment under article 5 of the Act. When grant backs are made against consideration it is less likely that the grant back obligation creates a disincentive for the licensee to innovate.

On the other hand, in the assessment of exclusive grant backs outside the scope of the block exemption, the market position of the licensor on the technology market is also an important factor. The stronger the position of the licensor, the more likely it is that exclusive grant back obligations will have restrictive effects on competition in innovation. Also, the stronger the position of the licensor's technology, the more likely it is that the licensee can become an important source of innovation and future competition.

The negative impact of grant back obligations can also be increased in case of parallel networks of license agreements containing such obligations.

When available technologies are controlled by a limited number of licensors that impose exclusive grant back obligations on licensees, the risk of anti-competitive effects is greater than where there are a number of technologies only some of which are licensed on exclusive grant back terms.

(91) In the case of cross licensing between competitors, where a grant back obligation on both parties is combined with an obligation on both parties to share improvements of its own technology with the other party, it is more likely that there will be negative effects on innovation because the sharing of all improvements between competitors may prevent each competitor from gaining a lead over the other (see paragraph 180).

However, the parties are unlikely to be prevented from gaining a lead over each other where the purpose of the license is to permit them to develop their respective technologies and where the license does not lead them to use the same technological base in the design of their products. This is the case where the purpose of the license is to create freedom rather than to improve the technological base of the licensee.

(92) Article 7(2)(c) of the Communiqué concerns obligations not to challenge the validity of the licensor's intellectual property.

The reason for excluding non-challenge clauses from the scope of the block exemption is the fact that licensees are normally in the best position to determine whether or not an intellectual property right is invalid.

In fact, the rules related to intellectual property rights and the purpose of competition law do not allow the protection of invalid intellectual property rights since the protection of intellectual property rights that should normally be invalid stifles innovation rather than promoting it.

Non-challenge clauses may be assessed under article 4 of the Act where the licensed technology is valuable and therefore creates a competitive disadvantage for undertakings that are prevented from using it or are only able to use it against payment of royalties. In such cases the conditions of article 5 of the Act are unlikely to be fulfilled.

On the other hand, a more favorable view will be taken for non-challenge clauses relating to know-how where the recovery of the licensed know-how is likely to be impossible or very difficult once it is disclosed. In such cases, an obligation on the licensee not to challenge the licensed know-how will protect in particular weaker licensors against a challenge once the know-how has been absorbed by stronger licensees and promotes dissemination of new technology by allowing the week licensor to grant a license.

(93) Article 7(2)(c) of the Communiqué allows the licensor to terminate the license agreement in the event that the validity of the licensed technology is challenged. Accordingly, the licensor is not forced to continue its agreement with a licensee that challenges the very subject matter of the license agreement. Thus, if the licensee continues to use the technology it challenges, it will have to bear the relevant risks. The purpose of article 7(2)(c) of the Communiqué is primarily to prevent the inclusion of clauses that prevent the licensee from challenging the licensed technology as the licensor may sue the licensee on the grounds that the agreement is violated depending on such clauses if the licensee challenges the technology and thus deter the licensee from challenging the technology of the licensor. As a result, article 7(2)(c) of the Communiqué ensures that the licensee is at the same position as third parties with respect to challenging the validity of intellectual property rights.

(94) Article 7(3) of the Communiqué excludes from the scope of the block exemption any direct or indirect obligation limiting the licensee's ability to exploit its own technology rights or limiting the ability of the parties to the agreement to carry out research and development in case of agreements between non-competitors, unless that restriction is indispensable to prevent the disclosure of licensed know-how to third parties.

The content of article 7(3) of the Communiqué is the same as that of article 6(2)(d) concerning agreements between competitors, which is dealt with in paragraphs 75 and 76. However, in the case of agreements between non-competitors, such restrictions should be subject to individual assessment taking into account that such restrictions generally do not have negative effects on competition or may satisfy the conditions listed in article 5 of the Act.

(95) In the case of agreements between non-competitors, the licensee normally does not own a competing technology. However, there may be cases where for the purposes of the block exemption the parties are considered non-competitors despite the fact that the licensee does own a competing technology. For instance in cases where the licensee owns a technology but does not license it and the licensor is not an actual or potential supplier on the product market, they are not considered competitors in the technology or product market according to the Communiqué. In such circumstances, it is important to ensure that the licensee is not restricted in its ability to exploit its own technology and further develop it as the relevant technology constitutes a competitive constraint in the market. Therefore, in such a situation restrictions on the licensee's use of its own technology rights or on research and development are normally considered to be restrictive of competition and not to satisfy the conditions of article 5 of the Act. For instance, an obligation on the licensee to pay royalties not only on the basis of products it produces with the licensed technology but also on the basis of products it produces only with its own technology will generally limit the ability of the licensee to exploit its own technology and thus must be excluded

from the scope of the block exemption.

In cases where the licensee does not own a competing technology or is not already developing such a technology, a restriction on the ability of the parties to carry out independent research and development may be restrictive of competition where only a few technologies are available. In particular if the parties possess the necessary assets and skills to carry out further research and development, they may be important (potential) source of innovation. In that case the conditions of article 5 of the Act are unlikely to be fulfilled. In other cases where a number of technologies are available and where the parties do not possess special assets or skills, the restriction on research and development is likely either to fall outside article 4 or to satisfy the conditions of article 5 for lack of an appreciable restrictive effect. The restraint may promote the dissemination of new technology by assuring the licensor that the license does not create a new competitor and by inducing the licensee to focus on the exploitation and development of the licensed technology. Moreover, article 4 of the Act only applies where the agreement reduces the licensee's incentive to improve and exploit its own technology. Article 4 may not apply to cases where the licensor is entitled to terminate the license agreement once the licensee commences to produce on the basis of its own competing technology. Such a right does not reduce the licensee's incentive to innovate, since the agreement can only be terminated when a commercially viable technology has been developed and products produced on the basis thereof are ready to be put on the market.

6. Withdrawal of the Block Exemption

(97) According to article 8(1) of the Communiqué, the Board may withdraw the benefit of the block exemption in respect of a technology transfer agreement in case it is established that the agreement does not fulfill the conditions of article 5 of the Act.

(98) As the fulfillment of all of the four conditions of article 5 is required for the exemption to be applicable, the block exemption can therefore be withdrawn where an agreement fails to fulfill even one of the four conditions.

(99) For the withdrawal procedure, the Board bears the burden of proving that the agreement does not satisfy the conditions of article 5. Moreover, the Board takes the written and/or oral opinion of the parties before making its final decision about the withdrawal of the exemption.

(100) According to article 6 of the Communiqué, withdrawal may in particular be warranted particularly in case access of third parties' technologies to the market is restricted. Access of third parties' technologies to the market may be prevented by the cumulative effect of networks of agreements encompassing similar restrictions prohibiting licensees from using third parties' technologies.

(101) Article 6 of the Communiqué on restrictions that render technology transfer agreements out of the scope of the block exemption and article 7 on restrictions that cannot benefit from the block exemption aim at ensuring that block exempted agreements do not reduce the incentive to innovate, do not delay the dissemination of technology, and do not unduly restrict competition between the licensor and licensee or between licensees.

However, the restrictions listed in those articles do not take into account all the possible impacts of license agreements.

In particular, the cumulative effect of networks of license agreements containing similar restrictions is ignored. However, license agreements may lead to foreclosure of the market for instance to third party licensors. Foreclosure of the market to other licensors may stem from the cumulative effect of networks of agreements prohibiting the licensees from exploiting competing technologies, preventing them from making agreements with other (potential) licensors.

(102) Withdrawal of the exemption may be realized both by an individual Board decision and a communiqué that covers all the undertakings in a market. Article 8(2) of the Communiqué provides for that where parallel networks created by similar technology transfer agreements cover more than 50% of the relevant market, the Competition Board may, by a communiqué which it shall further issue, exclude agreements containing particular restrictions out of the scope the exemption provided for in the Communiqué.

(103) For the purpose of calculating the 50% market coverage ratio, account must be taken of each individual network of agreements containing restraints producing similar effects on the market.

(104) Article 8(2) of the Communiqué does not mean that the Board will withdraw the block exemption in each case where 50% ratio is exceeded. The application of this paragraph is appropriate when it is likely that access to the relevant market or competition in that market is appreciably restricted. Before applying article 8(2) of the Communiqué, the Board will consider whether withdrawal would be a more appropriate remedy by taking into account the factors such as the number of competing undertakings contributing to a cumulative effect on a market.

(105) The scope of any communiqué adopted under article 8(2) of the Communiqué must be clear. In another words, the Board will define the relevant product and geographic market and identify the type of restraint in respect of which the block exemption will no longer apply. While identifying the type of the restraint in question, the Board may amend the scope of the communiqué in line with the competition concern to be solved. For instance, the Board may limit the scope of the communiqué about withdrawal of the exemption to non-compete obligations exceeding a certain period. Thus, agreements of a shorter duration or of a less restrictive nature which have a lesser degree of foreclosure effects on the market may continue to benefit from the block exemption.

Where appropriate, the Board may specify the minimum market share level which, in the specific market context, an undertaking must have for being regarded as having a significant responsibility in the cumulative effect. When the market share of the products incorporating a technology does not exceed 5%, the agreement or network of agreements covering that technology is generally not considered to have a significant share in the cumulative foreclosure effect.

(106) According to article 8(2) of the Communiqué, the Board will give sufficient time to the parties concerned in case it decides to exclude agreements containing certain restraints out of the scope of the block exemption by a communiqué.

(107) Withdrawal of exemption according to article 8 of the Communiqué is not

retrospective. Thus, the agreement or agreements in question would have benefited from the exemption during the period until a decision is taken.

Application of Article 4 and 5 of the Act to Agreements outside the Scope of the Communiqué

1. General Principles

(108) For agreements that fall outside the block exemption, individual assessment is necessary. Agreements that either do not restrict competition within the meaning of article 4 of the Act or which fulfill the conditions of article 5 are considered valid and enforceable. It is recalled that there is no presumption of illegality of agreements that fall outside the scope of the block exemption provided that they do not contain hardcore restrictions of competition. In particular, there is no presumption that an agreement falls under the scope of article 4 of the Act merely because the market share thresholds are exceeded. Individual assessment based on the principles described in these guidelines is required.

(109) In order to promote predictability for the agreements outside scope of the block exemption and to confine the analysis to cases that are more likely to restrict competition, it can be said that it is unlikely that concerns will arise with respect to articles 4 and 5 of the Act where there are four or more independently controlled technologies in addition to the those of the parties that are substitutable. In assessing whether the technologies are sufficiently substitutable, the relative commercial strength of the technologies in question must be taken into account. The competitive constraint imposed by a technology is limited if it does not constitute a commercially viable alternative to the licensed technology. For instance, if due to network effects in the market consumers have a strong preference for products incorporating the licensed technology, other technologies already on the market or likely to come to the market within a reasonable period of time may not constitute a real alternative and may therefore impose only a limited competitive constraint. In a case where the conditions listed in this paragraph do not exist, it cannot be presumed that the agreement is caught by article 4 of the Act and the conditions of article 5 are not satisfied.

1.1. The Relevant Factors to Be Taken Into Account for the Assessment

(110) While individual assessment is made for a technology transfer agreement that cannot benefit from the block exemption, it is necessary to take account of the way in which competition operates in the market in question. The following factors should particularly be paid attention in this respect:

(a) The nature of the agreement;

(b) The market position of the parties;

(c) The market position of competitors;

(d) The market position of buyers on the relevant markets;

(e) Entry barriers

(f) Maturity of the market and

(g) Other factors.

The importance of individual factors to be taken into account may vary in each case and assessed with other factors. For instance, a high market share of the parties is usually a good indicator of market power, but in the case of low entry barriers it may not be indicative of market power of the parties. It is therefore not possible to provide firm rules on the importance of the individual factors.

(111) Technology transfer agreements can take many forms. It is therefore important to analyze the nature of the agreement in terms of the competitive relationship between the parties and the restraints that it contains. Moreover, while analyzing the restraints that the agreement contains, it is necessary to go beyond the express terms of the agreement. The way in which the agreement has been implemented by the parties and from the incentives that they face may show the existence of implicit restraints that cannot be seen by looking at the terms of the agreement.

(112) The market position of the parties provides an indication of the degree of market power, if any, possessed by the licensor, the licensee or both. The higher their market share the greater their market power is likely to be. This is particularly so where the market share reflects cost advantages or other competitive advantages vis-à-vis competitors. Being a first mover in the market, holding essential patents or superior technology may be examples of such competitive advantages.

(113) While examining the competitive relationship between the parties, an analysis beyond the points stated under the section "Market Definition" between paragraphs 16-22 and the section "The Distinction between Competitors and Non-competitors" between 23-30 is needed. Even in cases where the licensor is not an actual or a potential supplier in the product market and the licensee is not an actual or a potential competitor in the technology market, whether the licensee has a competing technology which it does not license must be analyzed. If the licensee has a strong position in the product market, granting the licensee an exclusive license for a competing technology may significantly restrict competition when compared to the circumstances where the licensor does not grant an exclusive license or any licenses to other undertakings.

(114) Market shares and possible competitive advantages and disadvantages are also used to assess the market position of competitors. The stronger the actual competitors and the greater their number the less risk there is that the parties will be able to exercise market power individually. However, if the number of competitors is rather small and their market position (size, costs, R&D potential, etc.) is rather similar, this market structure may increase the risk of collusion.

(115) The market position of buyers provides an indication of whether or not one or more buyers possess buyer power. The first indicator of buyer power is the market share of the buyer on the purchase market and this share reflects the importance of its demand for possible suppliers. Characteristics such as the number and geographic spread of outlets and the brand image amongst final consumers are used to assess the position of the buyer on the resale market. In some circumstances buyer power may prevent the licensor and/or the licensee from exercising market power on the market and thereby prevent competition problems that would otherwise have existed. This is particularly the case where strong buyers have the capacity and the incentive to bring new sources of supply on to the market in the case of a small but permanent

increase in relative prices. Where the power of the buyers allow them only to extract favorable terms from the supplier or simply pass on any price increase to their customers, the position of the buyers does not prevent the exercise of market power by the licensee on the product market and therefore do not solve the competition problem on that market.

(116) Entry barriers are measured by the extent to which incumbent companies can increase their price above the competitive level without attracting new entry. In the absence of entry barriers, easy and quick entry would render price increases unprofitable. When effective entry, preventing or eroding the exercise of market power, is likely to occur within one or two years, entry barriers can be said to be low. Entry barriers may result from a wide variety of factors such as economies of scale and scope, government regulations, especially where they establish exclusive rights, state aid, import tariffs, intellectual property rights, ownership of resources where the supply is limited due to for instance natural limitations, essential facilities, a first mover advantage or brand loyalty. Restrictive agreements entered into by undertakings may also work as an entry barrier by making access more difficult and foreclosing (potential) competitors. Entry barriers may be present at the stage of the research and development and at various stages of production and distribution chain. The question whether certain of these factors should be described as entry barriers depends particularly on whether they entail sunk costs. Sunk costs are those costs which have to be incurred to enter or be active on a market but which are lost when the market is exited. While high sunk costs increase the risk assessment of new entrants, they also increase the possibility of incumbents to apply more aggressive policies against new entrants as the costs of exiting from the market will be higher. As entry requires sunk costs, sometimes minor and sometimes major, actual competition in the market is more important in the assessment than potential competition.

(117) A mature market is a market that has existed for a long time, where the technology used is well known and widespread and not changing very much and in which demand is relatively stable or declining. In such a market, restrictions of competition are more likely to have negative effects than in more dynamic markets.

(118) It should be noted that in the assessment of particular restraints other factors may have to be taken into account. Such factors include the coverage of the market by similar agreements, the duration of the agreements, the regulatory rules and behavior that may facilitate anticompetitive behavior such as price leadership, pre-announced price changes and discussions on the ‘right’ price, price rigidity in response to excess capacity, price discrimination and past collusive behavior.

1.2. Negative Effects of Restrictive License Agreements

(119) The negative effects that may result from restrictive technology transfer agreements can be listed as follows:

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

3. Reduction of intra-technology competition

(120) Technology transfer agreements may reduce inter-technology competition. This is particularly the case where reciprocal obligations are imposed. For instance, where competitors transfer competing technologies to each other and impose a reciprocal obligation to provide each other with future improvements and where this agreement prevents either competitor from gaining a technological lead over the other, competition in innovation between the parties is restricted (see paragraph 180).

(121) Licensing between competitors may also facilitate collusion. The risk of collusion is particularly high in concentrated markets. Collusion requires that the undertakings concerned have similar views on what is in their common interest and on how their coordination functions. For collusion to work the undertakings must be able to monitor each other's market behavior and there must be deterrent factors to ensure that they do not depart from the common policy on the market. On the other hand, entry barriers are needed to prevent or limit entry for collusion to be successful. Agreements can facilitate collusion by increasing transparency, by controlling certain behavior and by raising barriers to entry. Collusion can also exceptionally be facilitated by licensing agreements that lead to a high degree of commonality of costs, because undertakings that have similar costs are more likely to have similar views on the terms of coordination.

(122) License agreements may also affect inter-technology competition by creating barriers to entry for and expansion by competitors. Such foreclosure effects may stem from restraints that prevent licensees from licensing from third parties or create disincentives for them to do so. For instance, third parties may be foreclosed where incumbent licensors impose non-compete obligations on licensees to such an extent that an insufficient number of licensees are available to third parties and where entry at the level of licensees is difficult. Suppliers of substitutable technologies may also be foreclosed where a licensor with a sufficient degree of market power ties together various parts of a technology and licenses them together as a package while only part of the package is essential to produce a certain product.

(123) License agreements may also reduce intra-technology competition, that is to say, competition between undertakings that produce on the basis of the same technology. An agreement imposing territorial restraints on licensees, preventing them from selling into each other's territory reduces competition between them. License agreements may also reduce intra-technology competition by facilitating collusion between licensees. Moreover, license agreements that reduce intra-technology competition may facilitate collusion between owners of competing technologies or reduce inter-technology competition by raising barriers to entry.

1.3. **Positive Effects of Restrictive License Agreements and the Framework for Analyzing Such Effects**

(124) Even restrictive license agreements also produce pro-competitive effects often in the form of efficiencies, which may outweigh their anti-competitive effects. As such assessment takes place within the framework of article 5 of the Act, all of the conditions therein must be fulfilled.

(125) The assessment of restrictive agreements under article 5 of the Act is made by taking into account the conditions both at the time of the conclusion of the agreement

and the assessment. Material changes in the facts should be considered while making the assessment. The exemption will apply as long as the conditions in article 5 of the Act are fulfilled. However, while evaluating whether exemption conditions are fulfilled, it is necessary to take into account the initial sunk investments made by any of the parties and the time needed and the restraints required to commit and recoup an efficiency enhancing investment. articles 4 and 5 of the Act must be applied by considering such ex ante investments made and the risks taken by the parties. Therefore, the risk facing the parties and the sunk investment that must be committed may thus ensure that the relevant agreement fall outside the prohibition in article 4 of the Act or benefit from the exemption in article 5 for the period of time required to recoup the investment.

(126) The first condition of article 5 of the Act requires an assessment of the objective benefits produced by the agreement. In this respect, license agreements have the potential of bringing together complementary technologies and other assets allowing new or improved products to be put on the market or existing products to be produced at lower cost. Apart from hardcore cartels, license agreements are often made because it is more efficient for the licensor to exploit the technology itself. This may particularly be the case where the licensee already has access to the necessary production assets. The agreement allows the licensee to gain access to a technology that can be combined with those assets, allowing it to exploit new or improved technologies. Another example of potentially efficiency enhancing licensing is where the licensee already has a technology and the combination of this technology and the licensor's technology gives rise to synergies. When the two technologies are combined the licensee may be able to attain a cost/output configuration that would not otherwise be possible. License agreements may also give rise to efficiencies at the distribution stage in the same way as vertical distribution agreements. Such efficiencies can take the form of cost savings or the provision of valuable services to consumers. A further example of possible efficiency gains is the agreements whereby technology owners assemble a technology package for licensing to third parties. Such pooling arrangements may in particular reduce transaction costs, as licensees do not have to conclude separate license agreements with each licensor. Pro-competitive licensing may also occur to ensure design freedom. In sectors where large numbers of intellectual property rights exist and where products may infringe upon a number of existing and future property rights, license agreements whereby the parties agree not to assert their property rights against each other are often pro-competitive because they allow the parties to develop their respective technologies without the risk of subsequent infringement claims.

(127) Within the scope of the last condition in article 5 of the Act, whether the competition restriction is indispensable, whether it makes it possible to perform the activity in question more efficiently than would have been the case in the absence of the restriction concerned will be assessed. In making this assessment the market conditions and the conditions facing the parties must be taken into account. With respect to this condition, the parties have to prove why a less restrictive alternative was not chosen, if any. If the application of what appears to be a commercially realistic and less restrictive alternative would lead to a significant loss of efficiencies, the restriction in question is considered indispensable. Moreover, in some cases, it may also be necessary to examine whether the agreement as such is indispensable to achieve the efficiencies. This may for example be so in the case of technology pools that include complementary but non-essential technologies. In that case, it must be examined to what extent the inclusion of those technologies gives rise to particular

efficiencies or whether, without a significant loss of efficiencies, the pool could be limited to technologies for which there are no substitutes. In the case of simple licensing between two parties, it is generally not necessary to go beyond an examination of whether individual restraints are indispensable; normally there is no less restrictive alternative to the license agreement.

(128) Within the framework of the second condition of article 5 of the Act, the condition that consumers must receive a fair share of the benefits, implies that consumers of the products produced under the license must at least be compensated for the negative effects of the agreement. This means that the efficiency gains must fully off-set the likely negative impact on prices, output and other relevant factors caused by the agreement. This may be possible by changing the cost structure of the undertakings concerned, giving them an incentive to reduce price, or by allowing consumers to gain access to new or improved products and thus any likely price increase could be compensated.

(129) According to the last condition of article 5, the agreement must not eliminate competition in a significant part of the market. This condition presupposes an analysis of competitive pressures on the market and the impact of the agreement on sources of competition. It should be noted that the application of this condition do not prevent the application of article 6 of the Act. As articles 4 and 5 of the Act both are imposed for the aim of maintaining effective competition in the market, exemption cannot be granted to the restrictions that can be regarded as abuse of dominant position.

(130) The fact that the agreement substantially reduces one dimension of competition does not necessarily mean that competition is eliminated within the meaning of article 5. A technology pool, for instance, can result in an industry standard, leading to a situation in which there is little competition in terms of the technological format. If the main players in the market adopt a certain format, network effects may make it very difficult for alternative formats to survive. However, that the creation of a de facto industry standard does not mean that competition is eliminated within the meaning of the third condition of article 5 of the Act. Within the said standard, suppliers may compete on price, quality and product features. However, in order for the agreement to comply with article 5 of the Act, it must be ensured that the agreement does not unduly restrict competition and future innovation.

2. Application of Articles 4 and 5 of the Act to Various Types of Restraints in License Agreements

(131) The aim of this section is to show how several types of restrictions included in license agreements between both competitors and non-competitors outside the scope of the block exemption granted by the Communiqué will be assessed.

(132) This section does not cover obligations in license agreements that are generally not restrictive of competition within the meaning of article 4 of the Act, examples of which are listed above:

(a) Confidentiality obligations;

(b) Obligations on licensees not to sub-license;

(c) Obligations not to use the licensed technology rights after the expiry of the agreement, provided that the licensed technology rights remain valid;

(d) Obligations to assist the licensor in enforcing the licensed intellectual property rights;

(e) Obligations to pay minimum royalties or to produce a minimum quantity of products incorporating the licensed technology and

(f) Obligations to use the licensor's trade mark or indicate the name of the licensor on the product.

2.1. Royalty Obligations

(133) With respect to both agreements between competitors and agreements between non-competitors, the parties to a license agreement are normally free to determine the royalty payable by the licensee and its mode of payment without being caught by article 4 of the Act. Royalty obligations may for instance take the form of lump sum payments, a percentage of the selling price or a fixed amount for each product incorporating the licensed technology. In cases where the licensed technology relates to an input which is incorporated into a final product, it is not restrictive of competition that royalties are calculated on the basis of the price of the final product, provided that it incorporates the licensed technology. In the case of software licensing royalties based on the number of users and royalties calculated on a per machine basis are generally compatible with article 4 of the Act.

(134) In the case of license agreements between competitors it should be noted that royalty obligations may amount to price fixing, which is considered a hardcore restriction and exclude the agreement out of the scope of the block exemption (see article 6(2)(a) of the Communiqué). It is a hardcore restriction under article 6(2)(a) if competitors provide for reciprocal running royalties in circumstances where the license is a sham, in that its purpose is not to allow an integration of complementary technologies or to achieve another pro-competitive aim. It is considered as a hardcore restriction under article 6(2)(a) and 6(2)(d) if royalties extend to products produced solely with the licensee's own technology rights.

(135) Other types of royalty arrangements between competitors are block exempted up to the market share threshold of 30% even if they restrict competition. In cases outside the scope of the block exemption, article 4 of the Act may be applicable where competitors cross license and impose running royalties that are disproportionate compared to the market value of the license and where such royalties have a significant impact on market prices. In assessing whether the royalties are disproportionate compared to the market value of the license, it is necessary to examine the royalties paid by other licensees on the product market for the same or substitute technologies. In such cases the conditions of article 5 of the Act are unlikely to be fulfilled. article 4 of the Act may be applicable in cases where royalties to be paid per unit increase with the increase in the amount of production. If the parties have significant market power, such royalties may have impacts that limit the amount of production.

(136) Although the block exemption only applies as long as the technology rights are valid and in force, the parties can normally extend royalty obligations beyond the period of validity of the licensed intellectual property rights without falling foul of article 4 of the Act. Once these rights expire, third parties can legally exploit the technology

in question and compete with the parties to the agreement thus such actual and potential competition will normally be sufficient to ensure that the obligation in question does not have appreciable anti-competitive effects.

(137) In the case of agreements between non-competitors the block exemption covers agreements whereby royalties are calculated on the basis of both products produced with the licensed technology and products produced with technologies licensed from third parties. Such arrangements may facilitate the calculation of royalties. However, those arrangements may also lead to foreclosure by increasing the cost of using third party inputs and may thus have effects similar to those of a non-compete obligation. If royalties are paid not just on products produced with the licensed technology but also on products produced with third party technology, then the royalties will increase the cost of the latter products and reduce demand for third party technology. Therefore, outside the scope of the block exemption the question whether the restriction has foreclosure effects must also be considered. For that purpose it is appropriate to use the analytical framework set out in section 168-175 titled "Non-compete Obligations" below. In the case of appreciable foreclosure effects, such agreements are caught by article 4 of the Act and unlikely to fulfill the conditions of article 5 of the Act, unless there is no other practical way of calculating and monitoring royalty payments.

2.2. Exclusive License Agreements and Sales Restrictions

(138) For the purpose of the explanations made under this section, it is useful to distinguish between restrictions as to production within a given territory (exclusive or sole licenses) and restrictions on the sale of products incorporating the licensed technology into a given territory and to a given customer group (sales restrictions).

2.2.1. Exclusive and Sole Licenses

(139) The license is considered an exclusive license if the licensee is the only person permitted to produce on the basis of the licensed technology in a particular territory. Therefore, the licensor undertakes not to produce itself or license others to produce within a given territory. Where the licensor undertakes only not to license third parties to produce within a given territory, the license is a sole license. The difference between exclusive license and sole license is that with exclusive license only the licensee can produce in a given territory while with sole license the licensor may also produce in addition to the licensee. Exclusive or sole licensing is often accompanied by sales restrictions that limit the parties as to where they may sell products incorporating the licensed technology.

(140) Given the nature of intellectual property rights and the legislation regulating those rights, it is not possible to apply article 4 of the Act to exclusive license agreements where the license is granted to a single licensee and the licensor will not use the subject of the license because exclusive licensing between non-competitors is generally necessary in order to induce the licensee to invest in the licensed technology and to bring the products to market in a timely manner. This is in particular the case where the licensee must make large investments in further developing the licensed technology.

(141) While there are not any rules preventing dominant undertakings from making license agreements, if a licensee in a dominant position obtains exclusive licenses for one or more competing technologies, foreclosure of the market for third parties to

prevent them from obtaining licenses for the said technologies and therefore restriction of competition will be possible.

In case the package of technologies resulting from the cross licenses creates a de facto industry standard to which third parties must have access in order to compete effectively on the market, agreements whereby two or more parties cross license each other and undertake not to license third parties give rise to particular concerns such as exclusion of certain undertakings. In such cases the agreement creates a closed standard reserved for the parties. Such arrangements should be assessed according to the same principles as those applied to technology pools (see paragraphs 182-207, the section on "Technology Pools"). Normally, if technologies which support such a standard is licensed to third parties on fair, reasonable and non-discriminatory terms, it is unlikely that competition concerns will occur.

2.2.2. Sales Restrictions

(143) As regards sales restrictions a distinction should be made between licensing between competitors and between non-competitors.

(144) Restrictions on active and passive sales by one or both parties in agreements between competitors are hardcore restrictions of competition under article 6(2)(c) of the Communiqué. Restrictions on passive sales in such agreements are unlikely to fulfill the exemption conditions of article 5 of the Act because such restrictions do not fulfill the condition of not restricting competition more than necessary to obtain the benefits expected from license agreements.

(145) As article 4 of the Act does not apply given the nature of intellectual property rights and the legislation regulating those rights, with respect to agreements between competitors, the restriction of the active sales by the licensor and/or the licensee into the territory or the customer group reserved for the other party does not constitute a barrier for the relevant agreement to benefit from exemption, irrespective of the market share threshold (see the third sub-paragraph of article 6(2)(c) of the Communiqué). The same applies to the restriction of active sales by the licensee into the territory or to the customer group allocated by the licensor to another licensee (see the fourth subparagraph of article 6(2)(c)). However, restrictions on passive sales by the licensee or the licensor into the exclusive territory or to the exclusive customer group reserved for the other party as well as on passive sales by the licensees to the exclusive territory reserved by the licensor to another licensee exclude the relevant agreement out of the scope of the block exemption according to article 6(2)(c).

(146) In the case of agreements between non-competitors sales restrictions between the licensor and a licensee are block exempted up to the market share threshold of 40%. Above the market share threshold restrictions on active and passive sales by licensees to territories or customer groups reserved exclusively for the licensor may benefit from exemption within the framework of article 5 of the Act on objective grounds for instance the said restrictions are indispensable for the grant of the license. In other cases, for the assessment of sales restrictions on the licensee within the scope of article 5 of the Act, the degree of market power held by the licensor alone and also the cumulative effect of similar agreements concluded by licensors which together hold a strong position in the market.

(147) Sales restrictions on the licensor, when caught by article 4 of the Act, are likely

to fulfill the conditions of article 5 unless there are no alternatives to the licensor's technology on the market or such alternatives are not licensed by the licensee from third parties. Such restrictions may be indispensable within the meaning of article 5 of the Act in order to induce the licensee to invest in the production, marketing and sale of the products incorporating the licensed technology.

(148) As regards agreements between non-competitors, the Communiqué block exempts restrictions on active sales by licensees into each other's territories or customer groups. Above the market share thresholds restrictions on active sales between licensees' territories and customer groups limit intra-technology competition; however, article 4 of the Act does not apply to the said agreements given the nature of intellectual property rights and the legislation regulating those rights. If the restrictions of passive sales exceed two years as of the date when the licensee benefiting from those restrictions first launches the product incorporating the licensed technology in its exclusive territory, they will be regarded as hardcore restrictions according to the second subparagraph of article 6(3)(b). It is not possible for passive sale restrictions to fulfill the conditions in article 5 of the Act.

2.3. Output Restrictions

(146) Output restrictions in license agreements between competitors prevent the agreement from being covered by the block exemption as set out in article 6(2)(b) of the Communiqué (see paragraph 66). While assessing output restrictions in license agreements as per article 5 of the Act, the degree of the market power held by the parties is very important. Within this scope another point that must also be taken into account is whether such restrictions may be necessary in order to induce the licensor to disseminate its technology as widely as possible. For instance, a licensor may be reluctant to license its competitors if it cannot limit the license to a particular production site with a specific capacity (a site license). Where the license agreement leads to a real integration of complementary assets, output restrictions on the licensee may therefore fulfill the conditions of article 5. However, it is unlikely that the conditions of article 5 will be fulfilled if the parties have substantial market power.

(150) Output restrictions in license agreements between non-competitors are block exempted up to the market share threshold of 40%. The main anti-competitive risk flowing from output restrictions on licensees in agreements between non-competitors is reduced intra-technology competition between licensees. The significance of such anti-competitive effects depends on the market position of the licensor and the licensees and the extent to which the output limitation prevents the licensee from satisfying demand for the products incorporating the licensed technology.

(151) Output limitations imposed on the licensee in agreements between non-competitors may also have pro-competitive effects by promoting the dissemination of technology. As a supplier of technology, the licensor should normally be free to determine the output produced with the licensed technology by the licensee. If the licensor is not free to determine the output/sales amount of the licensee, certain license agreements might not be concluded, which would have a negative impact on the dissemination of new technology. This is particularly likely to be the case where the licensor is also a producer since in such case the licensee's output/sales amount may find its way back into the licensor's main area of operation and thus have a direct impact on those activities. On the other hand, it is less likely that output restrictions are necessary in order to ensure dissemination of the licensor's technology when they are combined with sales restrictions on the licensee prohibiting it from selling into a

territory or customer group reserved for the licensor. Combination of these two types of restrictions will increase the possibility that the relevant agreement will cause market sharing.

2.4. Field of Use Restrictions

(152) Under a field of use restriction the license is either limited to one or more technical fields of application or one or more product markets or industrial sectors. There are many cases in which the same technology can be used to make different products or can be incorporated into products belonging to different product markets. A new molding technology may for instance be used to make plastic bottles and plastic glasses. Moreover, a single product market may encompass several technical fields of use. For instance a new engine technology may be employed in four cylinder engines and six cylinder engines. Similarly, a technology to make chipsets may be used to produce chipsets with up to four CPUs and more than four CPUs. A license limiting the use of the licensed technology to produce say four cylinder engines and chipsets with up to four CPUs constitutes a technical field of use restriction.

(153) Given that field of use restrictions do not hinder the relevant agreement from being covered by the block exemption and that certain customer restrictions are hardcore restrictions under articles 6(2)(c) and 6(3)(b) of the Communiqué, it is important to distinguish the two categories of restrictions. According to a customer restriction, specific customer groups are identified and the parties are restricted in selling to such identified groups. The fact that a technical field of use restriction may correspond to certain groups of customers within a product market does not imply that the restraint is to be classified as a customer restriction. For instance, the fact that certain customers buy predominantly or exclusively chipsets with more than four CPUs does not imply that a license which is limited to chipsets with up to four CPUs constitutes a customer restriction. However, the field of use must be defined objectively by reference to identified and meaningful technical characteristics of the contract product.

(154) A field of use restriction limits the exploitation of the licensed technology by the licensee to one or more particular fields of use without limiting the licensor's ability to exploit the licensed technology. In addition, with respect to territories, these fields of use can be allocated to the licensee under an exclusive or sole license. Field of use restrictions combined with an exclusive or sole license also restrict the licensor's ability to exploit its own technology, by preventing it from exploiting it itself, including by way of licensing to others. In the case of a sole license only licensing to third parties is restricted. Field of use restrictions combined with exclusive and sole licenses are treated in the same way as the exclusive and sole licenses dealt with in the section "Exclusive and Sole Licenses" between paragraphs 139-142 above.

(155) Field of use restrictions may have pro-competitive effects by encouraging the licensor to license its technology for applications that fall outside its main area of focus. If the licensor could not prevent licensees from operating in fields where it exploits the technology itself or in fields where the value of the technology is not yet well established, it would be likely to create a disincentive for the licensor to license or would lead it to charge a higher royalty. The fact that in certain sectors licensing often occurs to ensure freedom of movement by preventing infringement claims must also be taken into account. In such cases, within the scope of the license the licensee is able to develop its own technology without fearing infringement claims by the licensor.

(156) Field of use restrictions on licensee and licensor in agreements between both non-competitors and competitors do not hinder the relevant agreement from being covered by the block exemption. Field of use restrictions in agreements between non-competitors whereby the licensor reserves one or more product markets or technical fields of use for itself are generally either non-restrictive of competition or efficiency enhancing. Such restrictions promote dissemination of new technology by giving the licensor an incentive to license for exploitation in fields in which it does not want to exploit the technology itself. If the licensor could not prevent licensees from operating in fields where the licensor exploits the technology itself, it would be likely to create a disincentive for the licensor to license.

(157) In agreements between non-competitors the licensor is normally also entitled to grant sole or exclusive licenses to different licensees limited to one or more fields of use. Such restrictions are assessed in the same way as exclusive licensing (See the section "Exclusive and Sole Licenses" between paragraphs 139-142)

2.5. Captive Use Restrictions

(158) A captive use restriction can be defined as an obligation on the licensee to limit its production of the licensed product to the quantities required for the production of its own products and for the maintenance and repair of its own products. In other words, this type of use restriction takes the form of an obligation on the licensee to use the products incorporating the licensed technology only as an input for incorporation into its own production; it does not cover the sale of the licensed product for incorporation into the products of other producers.

(159) In the case of license agreements between competitors a restriction that imposes on the licensee to produce under the license only for incorporation into its own products prevents it from supplying components to third party producers. If prior to the conclusion of the agreement, the licensee was not an actual or likely potential supplier of components to other producers, the captive use restriction does not change anything compared to the pre-existing situation. In those circumstances the restriction is assessed in the same way as in the case of agreements between non-competitors. If, on the other hand, the licensee is an actual or likely supplier of components, it is necessary to examine what is the impact of the agreement on that activity. If by making the necessary arrangements to use the licensor's technology the licensee ceases to use its own technology on a stand-alone basis and thus to be a component supplier, the agreement restricts competition that existed prior to the agreement. It may result in serious negative market effects when the licensor has a significant degree of market power on the component market.

(160) In the case of license agreements between non-competitors there are two main competitive risks stemming from captive use restrictions. These are (a) a restriction of intra-technology competition on the market for the supply of inputs and (b) an exclusion of arbitrage between licensees enhancing the possibility for the licensor to impose discriminatory royalties on licensees.

(161) Captive use restrictions, however, may also promote pro-competitive licensing. If the licensor is a supplier of original components, the restraint may be necessary in order for the dissemination of technology between non-competitors to occur. In the absence of the restraint the licensor may not grant the license or may do so only

against higher royalties because otherwise it would create a possibility for the licensee to directly compete with itself on the component market. In such cases a captive use restriction normally does not create competition concerns. Indeed article 4 of the Act does not apply to said restrictions given the nature of intellectual property rights and the legislation regulating those rights. However, the licensee cannot be restricted in selling the licensed products as spare parts for its own products. The licensee must be able to serve the after-market for its own products, including independent service organizations that service and repair the products produced by it.

(162) Where the licensor is not an original component supplier on the relevant product market, the opinion that imposing captive use restrictions is necessary for the dissemination of technology does not apply. In such cases a captive use restriction may in principle promote the dissemination of technology by ensuring that licensees do not sell to producers that compete with the licensor on other product markets. However, a restriction on the licensee not to sell into certain customer groups reserved for the licensor normally constitutes a less restrictive alternative. Consequently, in such cases a captive use restriction is normally not necessary for the dissemination of technology to take place.

2.6. Tying and Bundling

(163) In the context of technology licensing tying occurs when the licensor makes the licensing of one technology (the tying product) conditional upon the licensee taking a license for another technology or purchasing a product from the licensor or someone designated by it (the tied product). Bundling occurs where two technologies or a technology and a product are only sold together as a bundle. In both cases, however, it is a condition that the products and technologies involved are distinct in the sense that there is distinct demand for each of the products and technologies forming part of the tie or the bundle. This is normally not the case where the technologies or products are by necessity linked in such a way that the licensed technology cannot be exploited without the tied product or both parts of the bundle cannot be exploited without the other. In the following the term ‘tying’ is used to cover both tying and bundling.

(164) According to article 5 of the Communiqué, which limits the application of the block exemption by market share thresholds, tying and bundling are not block exempted above the market share thresholds of 30 % in the case of agreements between competitors and 40 % in the case of agreements between non-competitors. The market share thresholds in the communiqué apply to any relevant technology or product market affected by the license agreement, including the market for the tied product. Above the market share thresholds it is necessary to balance the anti-competitive and pro-competitive effects of tying.

(165) The main restrictive effect of tying is foreclosure of competing suppliers of the tied product. Tying may also allow the licensor to maintain market power in the market for the tying product by raising barriers to entry since it may force new entrants to enter several markets at the same time. Moreover, tying may allow the licensor to increase royalties, in particular when the tying product and the tied product are partly substitutable and the two products are not used in fixed proportion. Tying prevents the licensee from switching to substitute inputs in the face of increased royalties for the tying product. These competition concerns are independent of whether the parties to the agreement are competitors or not. For tying to produce likely anti-competitive effects the licensor must have a significant degree of market power in the tying

product so as to restrict competition in the tied product. In the absence of market power in the tying product the licensor cannot use its technology for the anti-competitive purpose of foreclosing suppliers of the tied product. Furthermore, as in the case of non-compete obligations, tying must cover a certain proportion of the market for the tied product for appreciable foreclosure effects to occur. In cases where the licensor has market power on the market for the tied product rather than on the market for the tying product, the restraint is analyzed as a non-compete clause or quantity forcing. This shows that any competition problem has its origin on the market for the 'tied' product and not on the market for the 'tying' product[15].

(166) Tying can also give rise to efficiency gains. This is for instance the case where the tied product is necessary for a technically satisfactory exploitation of the licensed technology or for ensuring that production under the license conforms to quality standards respected by the licensor and other licensees. In such cases tying is normally either not restrictive of competition or covered by article 5 of the Act. Where the licensees use the licensor's trademark or brand name or where it is otherwise obvious to consumers that there is a link between the product incorporating the licensed technology and the licensor, the licensor has a legitimate interest in ensuring that the quality of the products is such that it does not undermine the value of its technology or its reputation as an economic actor. Moreover, where it is known to consumers that the licensees (and the licensor) produce on the basis of the same technology it is unlikely that licensees would be willing to take a license unless the technology is exploited by all in a technically satisfactory way.

(167) Tying is also likely to be pro-competitive where the tied product allows the licensee to exploit the licensed technology significantly more efficiently. For instance, where the licensor licenses a particular process technology, the parties can also agree that the licensee buys a catalyst from the licensor which is developed for use with the licensed technology and which allows the technology to be exploited more efficiently than in the case of other catalysts. Where in such cases the restriction is caught by article 4 of the Act, the conditions of article 5 may be fulfilled even above the market share thresholds.

2.7. Non-compete Obligations

(168) Non-compete obligations in the context of technology licensing take the form of an obligation on the licensee not to use third party technologies which compete with the licensed technology. To the extent that a non-compete obligation covers a product or an additional technology supplied by the licensor the obligation is dealt with in the previous section on tying.

(169) According to the Communiqué, non-compete obligations are exempted in the case of agreements between competitors and in the case of agreements between non-competitors up to the market share thresholds of 30% and 40% respectively.

(170) The main competitive risk presented by non-compete obligations is foreclosure of third party technologies. Non-compete obligations may also facilitate collusion between licensors when other licensors also use it. Foreclosure of competing

[15] See the section "Non-Compete Obligations" between 168 and 175 for the applicable analytical framework.

technologies reduces competitive pressure on royalties charged by the licensor and reduces competition between the incumbent technologies by limiting the possibilities for licensees to substitute between competing technologies. As in both cases the main problem is foreclosure, the analysis can in general be the same in the case of agreements between competitors and agreements between non-competitors.

(171) Foreclosure may arise where a substantial proportion of potential licensees are already tied to one or, in the case of cumulative effects, more sources of technology and are prevented from exploiting competing technologies. Foreclosure effects may result from agreements concluded by a single licensor with a significant degree of market power or from the cumulative effect of agreements concluded by several licensors. It is possible that each individual agreement or network of agreements is covered by the Communiqué. However, a serious cumulative effect is unlikely to arise as long as less than 50% of the market is tied. Above that threshold significant foreclosure is likely to occur when there are relatively high barriers to entry for new licensees. If barriers to entry are low, new licensees are able to enter the market and exploit commercially attractive technologies held by third parties and thus represent a real alternative to incumbent licensees. In order to determine the real possibility for entry and expansion by third parties it is also necessary to take account of the extent to which distributors are tied to licensees by non-compete obligations. Third party technologies only have a real possibility of entry if they have access to the necessary production and distribution assets. In other words, the ease of entry depends not only on the availability of licensees but also the extent to which they have access to distribution.

(172) When the licensor has a significant degree of market power, obligations on licensees to obtain the technology only from the licensor can lead to significant foreclosure effects. The stronger the market position of the licensor the higher the risk of foreclosing competing technologies. For appreciable foreclosure effects to occur the non-compete obligations do not necessarily have to cover a substantial part of the market. Even if the non-compete obligations do not cover a substantial part of the market, appreciable foreclosure effects may occur where non-compete obligations are targeted at undertakings that are the most likely to license competing technologies. The risk of foreclosure is particularly high where there is only a limited number of potential licensees and the license agreement concerns a technology which is used by the licensees to make an input for their own use. In such cases the entry barriers for a new licensor are likely to be high. Foreclosure may be less likely in cases where the technology is used to make a product that is sold to third parties. Although in this case the restriction also ties production capacity for the input in question, it does not tie demand for the product incorporating the input produced with the licensed technology. To enter the market when the demand for the product incorporating the input is not tied, licensors only need access to one or more licensee(s) that have suitable production capacity. Unless only few undertakings possess or are able to obtain the assets required to take a license, it is unlikely that by imposing non-compete obligations on its licensees the licensor is able to deny competitors access to efficient licensees.

(173) Non-compete obligations may also produce pro-competitive effects. First, such obligations may promote dissemination of technology by reducing the risk of misappropriation of the licensed technology, in particular know-how. If a licensee is entitled to license competing technologies from third parties, there is a risk that particularly licensed know-how would be used in the exploitation of competing

technologies and thus benefit competitors. When a licensee also exploits competing technologies, it normally also makes monitoring of royalty payments more difficult, which may act as a disincentive to licensing.

(174) Second, non-compete obligations possibly in combination with an exclusive territory may be necessary to ensure that the licensee has an incentive to invest in and exploit the licensed technology effectively. In cases where the agreement has an appreciable foreclosure effect, it may be necessary in order to benefit from article 5 of the Act to choose a less restrictive alternative, for instance to impose minimum output or royalty obligations, which normally have less potential to foreclose competing technologies.

(175) Third, in cases where the licensor undertakes to make significant licensee specific investments for instance in training and tailoring of the licensed technology, non-compete obligations or alternatively minimum output or minimum royalty obligations may be necessary to induce the licensor to make the investment and to avoid hold-up problems. However, normally the licensor will be able to charge directly for such investments by way of a lump sum payment, implying that less restrictive alternatives are available.

3. Settlement and Non-challenge Agreements

(176) Licensing may serve as a means of settling disputes or avoiding that one party exercises its intellectual property rights to prevent the other party from exploiting its own technology rights. Licensing, including cross licensing, in the context of settlement and non-challenge agreements is generally not as such restrictive of competition since it allows the parties to exploit their technologies after the agreement is concluded. However, some of the terms and conditions of such agreements may be caught by article 4 of the Act. Licensing in the context of settlement agreements is treated in the same way as other license agreements. Therefore, in case there are technically substitute technologies, to what extend those technologies are in a one-way or two-way blocking position should be analyzed (see paragraph 29). If a blocking position exists, the parties will not be considered competitors.

(177) The block exemption applies as long as the agreement does not include the hardcore competition restrictions listed in article 6 of the Communiqué. The hardcore competition restrictions list in article 6(2) of the Communiqué will apply to cases where the parties clearly know that there is not a blocking position between their technologies and as a result they are competitors. In such cases, settlement is a means to restrict the competition present at the time of the conclusion of the agreement.

(178) If the license will be excluded from the market unless it obtains a license, the agreement is generally pro-competitive. Restrictions on intra-technology competition between the licensor and the licensee are generally covered by article 4 of the Act, however, they are able to fulfill the conditions of exemption in article 5 of the Act (See the section "Application of articles 4 and 5 of the Act to Various Types of Restraints in License Agreements" between paragraphs 131-175).

(179) Settlement agreements whereby the parties cross license each other and impose restrictions on the use of their technologies, including restrictions on the licensing to third parties, may be caught by article 4 of the Agreement. Where the

parties have a significant degree of market power and the agreement imposes restrictions that go beyond what is required in order to unblock, the agreement is likely to be caught by article 4 of the Act even if a mutual blocking position exists.

(180) Where under the agreement the parties are entitled to use each other's technology and the agreement extends to future developments, it is necessary to assess what the impact of the agreement on the parties' incentive to innovate is. In cases where the parties have a significant degree of market power, the agreement may be caught by article 4 of the Act where the agreement prevents the parties from gaining a competitive lead over each other. Agreements that eliminate or substantially reduce the possibilities of one party to gain a competitive lead over the other reduce the incentive to innovate and thus adversely affect an essential part of the competitive process. Moreover such agreements are unlikely to satisfy the conditions of article 5 of the Act. In this context, it is particularly unlikely that the restriction does not restrict competition more than necessary within the meaning of the last condition of article 5 of the Act. The achievement of the objective of the agreement, namely to ensure that the parties can continue to exploit their own technology without being blocked by the other party, does not require that the parties agree to share future innovations. However, the parties are unlikely to be prevented from gaining a competitive lead over each other where the purpose of the license is to allow the parties to develop their respective technologies and where the license does not lead them to use the same technological solutions. Such agreements merely create freedom of movement by preventing future infringement claims by the other party.

(181) In the context of a settlement and non-challenge agreements, non-challenge clauses are generally considered to fall outside article 4 of the Act. The characteristic of those agreements is that the parties agree not to challenge ex post the intellectual property rights which are covered by the agreement. Indeed, the purpose of the agreement is to settle existing disputes and/or to avoid future disputes.

4. Technology Pools

(182) Technology pools are agreements whereby two or more parties assemble a package of technology which is licensed not only to contributors to the pool but also to third parties. In terms of their structure technology pools can take the form of simple arrangements between a limited number of parties or of elaborate organizational arrangements whereby the organization of the licensing of the pooled technologies is entrusted to a separate entity. In both cases the pool may allow licensees to operate on the market on the basis of a single license.

(183) There is no inherent link between technology pools and standards, but the technologies in the pool often support (in whole or in part) a de facto or de jure industry standard. Technology pools does not necessarily support a single industrial standard. Different technology pools may support competing standards[16].

(184) Agreements establishing technology pools and setting out the terms and conditions for their operation are not — irrespective of the number of parties — covered by the block exemption (See the section "Agreements concerning

[16] See in this respect the Commission's press release IP/02/1651 concerning the licensing of patents for third generation (3G) mobile services. This case involved five technology pools creating five different technologies, each of which could be used to produce 3G equipment.

Production" between 26 and 41). Such agreements are addressed only by these guidelines. Pooling arrangements give rise to a number of particular issues regarding the selection of the included technologies and the operation of the pool, which do not arise in the context of other types of licensing. However, the licenses granted by the pool to third party licensees will be treated in the same way as other license agreements covered by block exemption when the conditions in the Communiqué, including article 6 which covers hardcore competition restrictions list.

(185) Technology pools may restrict competition. The creation of a technology pool necessarily implies joint selling of the pooled technologies, which in the case of pools composed solely or predominantly of substitute technologies amounts to a price fixing cartel. Moreover, in addition to reducing competition between the parties, technology pools may also, in particular when they support an industry standard or establish a de facto industry standard, result in a reduction of innovation by foreclosing alternative technologies. The existence of the standard and a related technology pool may make it more difficult for new and improved technologies to enter the market.

(186) Technology pools can produce pro-competitive effects, in particular by reducing transaction costs and by setting a limit on cumulative royalties to avoid double marginalization. The creation of a pool allows for getting the license of the technologies covered by the pool from a single point. This is particularly important in sectors where intellectual property rights are prevalent and licenses need to be obtained from a significant number of licensors in order to operate on the market. In cases where licensees receive on-going services concerning the application of the licensed technology, joint licensing and servicing can lead to further cost reductions.

4.1. Nature of the Pooled Technologies

(187) The competitive risks and the efficiency enhancing potential of technology pools depend to a large extent on the relationship between the pooled technologies and their relationship with technologies outside the pool. Two basic distinctions must be made, namely (a) between technological complements and technological substitutes and (b) between essential and non-essential technologies.

(188) Two technologies are complements when they are both required to produce the product or carry out the process to which the technologies relate[17]. Conversely, two technologies are substitutes when either technology allows the holder to produce the product or carry out the process to which the technologies relate. A technology is essential if there is no substitute for it outside the pool and it forms necessary part of the technology pool to produce a particular product/products or carry out a particular process/processes to which the pools relate. A technology without substitutes remains essential as long as it is covered by at least one valid intellectual property right. Technologies that are essential are by necessity also complements.

(189) When technologies in a pool are substitutes, royalties are likely to be higher than they would otherwise be because licensees do not benefit from rivalry between the technologies in question. When the technologies in the pool are complements, the technology pool reduces transaction costs and may lead to lower overall royalties because the parties will fix a common royalty for the package in the technology pool

[17] The term technology is not limited to only patents, it also covers patent applications and other intellectual property rights.

as opposed to each party fixing a royalty for its own technology without taking into account the royalties fixed by others.

(190) The distinction between complementary and substitute technologies is not clear-cut in all cases, since technologies may be substitutes in part and complements in part. When due to efficiencies stemming from the integration of two technologies licensees are likely to demand both technologies, the technologies are treated as complements, even if they are partly substitutable. In such cases it is likely that in the absence of the pool licensees would want to license both technologies due to the additional economic benefit of using both technologies as opposed to using only one of them.

(191) The inclusion of substitute technologies in the pool generally restricts inter-technology competition and amounts to collective bundling. Moreover, it leads to price fixing between competitors if there are mainly substitute technologies. As a general rule, the inclusion of significant substitute technologies in the pool constitutes a violation of article 4 of the Act and it is unlikely that the conditions of article 5 will be fulfilled in the case of pools comprising to a significant extent substitute technologies. Given that the technologies in question are alternatives, no transaction cost savings accrue from including both technologies in the pool. In the absence of the pool licensees would not have demanded both technologies. It is not sufficient that the parties remain free to license independently. This is because the parties are likely to have little incentive to license independently in order not to undermine the pool's licensing activity, as the pool allows them to jointly exercise market power.

(192) If the pool consists of only essential and thus absolutely complementary technologies, creation of such a pool per se generally falls outside of article 4 of the Act, irrespective of its position in the market. However, provisions of license agreements may be caught by article 4 of the Act.

(193) Where complementary but non-essential patents are included in the pool there is a risk of foreclosure of third party technologies. Once a technology is included in the pool and is licensed as part of the package, licensees are likely to have little incentive to license a competing technology when the royalty paid for the package already covers a substitute technology. Moreover, the inclusion of technologies which are not necessary for the purposes of producing the product(s) or carrying out the process(es) to which the technology pool relates forces licensees to pay for technology that they may not need. The inclusion of such complementary technology thus amounts to collective bundling. Where a pool encompasses non-essential technologies, the agreement is likely to be caught by article 4 of the Act where the pool has a significant position on any relevant market.

(194) Given that substitute and complementary technologies may be developed after the creation of the pool, the need to assess essentiality of the relevant technologies is an on-going process. Therefore a technology may become non-essential after the creation of the pool due to the emergence of new third party technologies. One of the ways to avoid foreclosure of the market to third parties is the exclusion of the technologies that are no longer essential out of the pool. However, there may be other ways to ensure that the market is not foreclosed to third parties. In the assessment of technology pools comprising non-essential technologies such as technologies which have substitutes outside or which are not necessary for the purposes of producing the one or more products to which the technology pool relates, the following factors will

be taken into account:

(a) Whether there are any pro-competitive reasons for including the non-essential technologies in the pool,

(b) whether the licensors remain free to license their respective technologies independently of the pool. Where the pool is composed of a limited number of technologies and there are substitute technologies outside the pool, licensees may want to put together their own technological package composed partly of technology forming part of the pool and partly of technology owned by third parties;

(c) Whether, in cases where the pooled technologies have different applications some of which do not require use of all of the pooled technologies, the pool offers the technologies only as a single package or whether it offers separate packages for distinct applications. In cases where separate packages are offered, technologies which are not essential to a particular product or process are not tied to essential technologies;

(d) Whether the pooled technologies are available only as a single package or whether licensees have the possibility of obtaining a license for only part of the package with a corresponding reduction of royalties. The possibility to obtain a license for only part of the package may reduce the risk of foreclosure of third party technologies outside the pool, in particular where the licensee obtains a corresponding reduction in royalties. This requires that a share of the overall royalty has been assigned to each technology in the pool. Where the license agreements concluded between the pool and individual licensees are of relatively long duration and the pooled technology supports a de facto industry standard, the fact that the pool may foreclose access to the market of new substitute technologies must also be taken into account. In assessing the risk of foreclosure in such cases it is relevant to take into account whether or not licensees can terminate at reasonable notice part of the license and obtain a corresponding reduction of royalties.

4.2. Assessment of Individual Restraints

(195) The purpose of this section is to address a certain number of restraints that are found in technology pools and which need to be assessed in the overall context of the pool. In paragraph 184 above it is stated that the Communiqué applies to the agreements between the pool and third party licensees. This section therefore deals with the assessment of licensing issues that are particular to licensing in the context of technology pools.

(196) In making an assessment the following main principles will be taken into account:

1. The stronger the market position of the pool the greater the risk of anti-competitive effects

2. Pools with a strong position in the market should be open and far from being discriminatory.

3. Pools should not unduly foreclose third party technologies or limit the creation of alternative pools.

(197) Undertakings setting up a technology pool that is compatible with articles 4 and 5 of the Act, are normally free to fix royalties for the technology package and each technology's share of the royalties either before or after the standard is set. Such agreement is inherent in the establishment of the pool and cannot in itself be considered restrictive of competition and in certain circumstances it may be more efficient. In certain circumstances, it may be more efficient if the royalties of the pool are agreed before the standard is chosen, to avoid that the choice of the standard confers a significant degree of market power on one or more essential technologies. However, licensees must remain free to determine the price of products produced under the license. The selection of technologies to be included in the pool is carried out by an independent expert may also further competition between available technological solutions.

(198) Where the pool has a dominant position on the market, royalties and other licensing terms should be fair and non-discriminatory. These requirements are necessary to ensure that the pool is open and does not lead to foreclosure and other anti-competitive effects on down-stream markets. However, it should be noted that these requirements do not preclude charging different royalty rates for different uses of the technologies in the pool. It is in general not considered restrictive of competition to apply different royalty rates to different product markets, whereas there should be no discrimination within product markets. In particular, the treatment of licensees of the pool should not depend on whether or not they are also licensors. Therefore whether licensors and licensees are subject to the same royalty obligations should be taken into account.

(199) Licensors and licensees should be free to develop competing products and standards and to grant and obtain licenses outside the pool. These requirements are necessary in order to limit the risk of foreclosure of third party technologies and ensure that the pool does not limit innovation and does not preclude the creation of competing technological solutions. Where pooled technology is included in a (de facto) industry standard and where the parties are subject to non-compete obligations, the pool creates a particular risk of preventing the development of new and improved technologies and standards.

(200) Grant back obligations should be non-exclusive and limited to developments that are essential or important to the use of the pooled technology. This allows the pool to feed on and benefit from improvements to the pooled technology. The parties' attitude towards not preventing licensees already having or obtaining essential patents should not be deemed anti-competitive.

(201) One of the problems with regard to technology pools is the risk that they may shield invalid patents. Pooling may raise the costs/risks for a successful challenge, because the challenge might fail if only one patent in the pool is valid. The shielding of invalid patents by means of the pool may oblige licensees to pay higher royalties and may also prevent innovation in the field covered by an invalid patent. In order to reduce such risk, a right to terminate a license should be limited to the technologies owned by the licensor challenged and not extend to technologies owned by other licensors in the pool.

4.3. Institutional Framework of the Pool Management

The way in which a pool is formed, organized and operated can reduce the risk of it having the object or effect of restricting competition and provide assurances to the effect that the arrangement is pro-competitive.

(203) When participation in a standard and pool creation process is open to all parties representing different interests it is more likely that technologies for inclusion into the pool are selected on the basis of price/quality considerations than when the pool is set up by a limited group of technology owners. Similarly, if the relevant organs of the pool is consisted of persons representing different interest, it is more likely that conditions for licensing including royalties are open, non-discriminatory and reflect the value of the licensed technology than when the pool is controlled by the representatives of the licensors.

(204) Another relevant factor is the extent to which independent experts are involved in the creation and operation of the pool. For instance, the assessment of whether or not a technology is essential to a standard supported by a pool is often a complex matter that requires special expertise. The involvement in the selection process of independent experts may be very beneficial in ensuring that a commitment to include only essential technologies is implemented in practice.

(205) The assessment in this context will take into account how experts are selected and the functions that they are to perform. Experts should be independent from the undertakings that have formed the pool. If experts are connected to the licensors or otherwise depend on them, the involvement of the expert will be less important. Experts must also have the necessary technical expertise to perform the various functions with which they have been entrusted. The functions of independent experts may include, in particular, an assessment of whether or not technologies put forward for inclusion into the pool are valid and whether or not they are essential.

(206) It is also relevant to consider the arrangements for exchanging sensitive information between the parties. In oligopolistic markets, exchanges of sensitive information such as pricing and output data may facilitate collusion. In such cases to what extent precautions have been put in place, which ensure that sensitive information is not exchanged. An independent expert or licensing body may play an important role in this respect by ensuring that output and sales data, which may be necessary for the purposes of calculating and verifying royalties is not disclosed to undertakings that compete on affected markets.

(207) Finally, any dispute resolution mechanisms foreseen in the documents setting up the pool are relevant and should be taken into account. The more dispute resolution is entrusted to bodies or persons that are independent of the pool and its members, the more likely it is that the dispute resolution will operate in a neutral way.