The relationship between IP law and competition law

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1. Tensions

1.1 Introduction

Viewed from a distance, the law can give the impression of being harmonised and consistent. But if one takes a closer look, internal tensions within it swiftly become apparent; and few of these are more deeply rooted than the tension between IP law on the one hand and competition law on the other. It is not hard to see why, for the two come from very different directions. Intellectual property law, in essence, is all about restricting unauthorised trade: for example, a patented invention will entitle the patentee and its licensees to stop others from exploiting the invention without consent within the jurisdiction in which the patent has been granted. By contrast, competition law is in principle uncomfortable with trading restrictions and exclusive arrangements: it favours permitting people to trade, not restricting them from so doing. Boiling it down even further, one could say that IP law involves the erection of trading barriers, whereas competition law favours their dismantlement.

1.2 Reconciling the tensions

How are these tensions reconciled? The approach adopted by the Court of Justice of the European Union has been to draw a distinction between the existence of an intellectual property right on the one hand, and its exercise on the other.[1] The jurisprudential reasoning is that the courts will not interfere with the existence of the IP right, but that, in the interests of (for example) the internal market, they will intervene to police how that right is exercised. An analogy might be drawn here with a bi-lateral co-existence agreement, in which the two sides – despite their opposing interests – reach a modus vivendi by making reciprocal concessions. Competition law gives ground by conceding that, in certain specified circumstances, softcore IP restrictions will be deemed not to violate the prohibitions on anti-competitive agreements. And, in its turn, intellectual property law 'backs down' by accepting that certain commercial practices that (for example) promote the internal market will not constitute IP infringement – major derogations, in other words, from the exercise of IP rights. By virtue of these compromises the tensions between these two bodies of law are reduced, though they are certainly not removed altogether.

1 *Consten and Grundig v Commission* [1966] ECR 299 *et seq*.

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1.3 Examples of reconciliation

Examples are worth a thousand words of theory, and we therefore set out below an example of each of these types of concession, one by competition law and one by IP law.

A prime example of competition law giving ground is the EU's Technology Transfer Block Exemption (TTBE).[2] This important piece of legislation is a regulation, and thus (unlike directives, which are addressed to member states and which therefore have to be transposed into domestic law) is directly binding on EU citizens and businesses. It grants to certain categories of IP assignments and licences a major exemption from the prohibition in EU law on anti-competitive agreements, provided always that specified conditions are met; and it is called a "block" exemption in order to differentiate it from individual exemptions that are granted only on a case-by-case basis. (Although the TTBE is sometimes described as a "safe harbour", IP rights holders need to be alive to the fact that the harbour walls are far from all-encompassing. Thus, the exemption will not apply if specified market shares are exceeded, and in any event whole categories and sub-categories of IP rights – trade marks, for example, and non-software copyright – are not covered at all by the TTBE.)

Conversely, a classic example of a major derogation from the exercise of IP rights can be found in the law on the free movement of goods (closely related to EU competition law, for both laws are aimed ultimately at securing and upholding the internal market) in the form of the exhaustion of rights principle. This important precept holds that, once a product has been placed on the market within the European Economic Area (EEA) by an IP rights holder or with its consent, the latter's entitlement to use those rights to control how the product is subsequently distributed will expire, or will be 'exhausted', in legal parlance. This principle is enshrined not just in case law, but in national statutes: for example, the UK Trade Marks Act stipulates that (subject to certain exceptions):

> *a registered trade mark is not infringed by the use of the trade mark in relation to goods which have been put on the market in the European Economic Area under that trade mark by the proprietor or with his consent.*[3]

The objective of ensuring the internal market within the EEA thus takes such priority that it has given rise to statutory defences to infringement which have been inserted in national statutes.

From a jurisprudential standpoint, the reconciliation of divergent legal principles is a fascinating subject. But in this chapter we shall take a more pragmatic approach to the issue, and shall review how, under the law applicable in the United Kingdom, the tension between IP law and competition law is handled in practice by legislators, courts and regulators.

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2 Commission Regulation (EU) number 316/2014 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of technology transfer agreements.

3 Trade Marks Act 1994, section 12(1).

2. Red flags

2.1 Introduction

A full discussion of the complex interface between IP law and competition law is beyond the scope of this section, where the approach will be limited to discussing a list of red flags that should be waved when certain IP transactions are being contemplated. It needs to be emphasised that this list is selective and non-exhaustive, and that whether or not the red flag proves to be justified in any individual case will depend on a mixture of fact (including, for example, the respective market shares of the parties involved) and law (including, for example, whether any applicable exceptions or exemptions may be available).

However, before listing these red flags we need to outline the prohibitions that the red flags are designed to highlight. The best starting point is the Competition Act 1998, which, in admirably concise language, outlaws two main categories of anti-competitive behaviour under UK law. The first of these categories is the subject of what is known as the Chapter I Prohibition,[4] which (unless they fall within one or more of the various statutory exceptions) forbids agreements between undertakings, decisions by associations of undertakings and concerted practices that may affect trade within the United Kingdom, and that have as their object or effect the appreciable[5] prevention, restriction or distortion of competition within the United Kingdom. The second category is dealt with by the Chapter II Prohibition,[6] which outlaws any conduct on the part of one or more undertakings that amounts to the abuse of a dominant position in a market if it may affect trade within the United Kingdom. Essentially, therefore, the first prohibition is aimed at contracts and arrangements, whereas the second is aimed at conduct. Of the two, the second prohibition is arguably the more dangerous: for, unlike the first prohibition, it can be infringed by purely unilateral behaviour, and there are hardly any exceptions to it.

The Chapter I and II Prohibitions faithfully reflect those that are enshrined in Articles 101 and 102 respectively of the Treaty on the Functioning of the European Union (TFEU), the language of which is indeed used almost verbatim in the British statute. It is therefore very helpful that, unlike the position with mergers and acquisitions (where there is clear blue water between UK law and EU law), the prohibitions in the Competition Act harmonise with those in the TFEU.

2.2 Anti-competitive agreements

Below we outline categories of contractual provisions that may cause the IP transactions in which they feature to suffer adverse attention from competition law regulators.

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4 Competition Act 1998, section 2.

5 Although the word "appreciable" does not appear in the relevant wording of the statute, the Chapter I Prohibition is interpreted by the courts and the regulators as meaning that, unless so-called "hardcore" restrictions are involved, the effect of agreements between parties with small market shares that fall below specified levels is considered to be insufficient to constitute an infringement of the Chapter I Prohibition.

6 Competition Act 1998, section 18.

(a) The cartel offence

There is little doubt that the reddest of the red flags needs to be waved whenever there is a bilateral or multi-lateral arrangement that, if operated in the United Kingdom as the parties intend, would:

- directly or indirectly fix a price for the supply of a product or service to a third party;
- limit or prevent the supply of a product or service;
- limit or prevent production of a product;
- divide up between the parties the supply of a product or service to a customer or customers; and/or
- divide up between the parties customers for the supply of a product or service.

The reason why these types of arrangement are potentially so heinous is that, in addition to the risk of civil liability under the Chapter I Prohibition and/or Article 101, they may also incur criminal liability on the part of an individual who made the agreement by virtue of constituting the so-called 'cartel offence',[7] which, in addition to the fines that may be imposed, is punishable on summary conviction by up to six months' imprisonment, and on indictment by up to five years' imprisonment. It is sometimes forgotten that people have already been not only convicted but sent to prison in this country for having committed this offence: thus, in the infamous *Marine Hose* case,[8] the defendants were convicted of having dishonestly engaged in price fixing, bid rigging, the allocation of markets and the restriction of supplies, and were given sentences of imprisonment of up to three years, although these were subsequently reduced by the Court of Appeal. And the risk of such liability has increased since April 2014, when the previous requirement of "dishonesty" was removed from the offence,[9] thus making it easier for the prosecution to prove.

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(b) Resale price maintenance

But even if it does not constitute a criminal offence, an IP transaction can still be regarded as going against the principles of competition law. A classic example is resale price maintenance which, though it falls outside the parameters of the cartel offence, will nevertheless be very likely to violate the prohibitions on anti-competitive behaviour. So if, for example, the royalty rates that I have set in my patent licence have the object or effect of fixing the price at which the patented products are resold by the licensee, there would be a clear risk of the licence infringing the prohibitions under Chapter I and/or Article 101. Indeed, "the restriction of a party's ability to determine its prices when selling products to third parties" is at the very top of the list of "hardcore restrictions" contained in the TTBE, which will automatically disallow the applicability of the exemption where the parties are competing undertakings.[10] And, even where I have merely recommended

7 Enterprise Act 2002, section 188.
8 *R v Whittle et al* [2008] EWCA Crim 2560.
9 Pursuant to the Enterprise and Regulatory Reform Act 2013.
10 TTBE, Article 4.1(a).

resale prices to my licensee, that can still be regarded by the competition law regulators as offensive if I have pressured the licensee to accede to my recommendation, or offered it incentives to do so.

(c) Restrictions on the licensee's use of its own technology

What if I have included in my licence an obligation on the licensee to assign to me – or to license to me exclusively – the improvements that it has made to my patent? Again, that will definitely warrant a red flag, for the obligation is specifically listed by the TTBE as having the effect of disallowing its exemption.[11] Indeed, any restriction of the licensee from exploiting its own technology rights or (unless it is indispensable to prevent the disclosure of licensed know-how) from carrying out research and development would be risky.[12]

(d) Post-expiry restrictions

Another danger area is where restrictions imposed on a licensee purport to endure after the expiry of the licensed IP rights. For example, if I oblige my licensee to continue to pay me royalties on its use of my patent not only during its term but after its expiry date, I could be skating on very thin ice indeed.

(e) Output restrictions

There are certain commercial situations where the contractual imposition of output restrictions in an IP licence may be justifiable, if not pro-competitive. For example, output restrictions could be necessary for the licensor to disseminate its technology as widely as possible; and, unless it is permitted to limit the licence to a particular production site with a specific capacity, the licensor might be reluctant to license its technology to its competitors at all, which would thus have a negative effect on competition.[13] Nevertheless, it needs to be remembered that the limitation of output features prominently on the TTBE's list of hardcore restrictions[14] and should therefore be treated with great caution.

(f) Territorial exclusivity

The question of territorial exclusivity for IP licences is an especially tricky area, which is unfortunate to say the least, as it repeatedly arises in practice. It is, after all, very normal for IP licensors to wish to grant exclusive rights in a particular territory to one (and only one) licensee; yet such an arrangement can all too easily run the risk of contravening competition law, which often views territorial exclusivity with suspicion, namely as a means of dividing up markets and erecting unjustified barriers to trade. This is therefore a classic example of the tension between IP law and competition law referred to in section 1.

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11 TTBE, Article 5.1(a).

12 TTBE, Articles 4.1(d) and 5.2.

13 See further the Guidelines on the application of Article 101 on the Treaty on the Functioning of the European Union to Technology Transfer Agreements: Commission Communication 2014/C89/03 (the Commission Guidelines) at section 4.2.3.

14 TTBE, Article 4.1(b).

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Whether in any particular case a clause in an IP licence granting territorial exclusivity will contravene competition law will depend on a range of factors, including (*inter alia*) the parties' respective market shares, whether they are actual or potential competitors, whether the contract includes reciprocal licences, and whether a selective distribution system is in place. For the purposes of this short section, therefore, the most that can be done is to refer to a general rule of thumb: regulators traditionally distinguish between prohibitions imposed in an exclusive licence on active sales (ie, sales made pursuant to an active marketing policy outside the exclusive territory) on the one hand and passive sales (ie, the sales made in response to unsolicited orders emanating from outside the exclusive territory) on the other. A ban by the licensor on the former will tend to be regarded more benevolently by the regulators than a ban on the latter. So, for example, if I purport to impose an absolute export ban on my Hungarian copyright licensee from selling its licensed products to any other member state, or to prohibit it from selling the products online,[15] the red flag will need to be waved vigorously; if, by contrast, I merely prohibit it from (for example) establishing a sales branch or distribution depot in another member state in which I have granted exclusive rights to another licensee, the risk should be considerably lower.

(g) Settlement agreements

The use of compromise agreements, co-existence contracts, non-assertion agreements and other types of settlement are obviously a frequent and familiar way of resolving IP disputes, since they avoid the expense – and risk – of a trial. But in the heat of negotiating and drafting such instruments, it can often be forgotten that competition law has decidedly mixed feelings about them.

On the one hand, competition law acknowledges that a settlement is in principle a bona fide way of finding a mutually acceptable compromise to a legal dispute, and can indeed promote the public interest by saving courts and other tribunals the burden of trying and judging them. On the other hand, IP settlements usually involve arrangements between actual or potential competitors that incorporate restrictions on trading, which is precisely the sort of situation where red flags need to be waved from the competition law standpoint.

Patent settlements: A clear indication of how seriously the regulators view this issue is the fact that the European Commission has to date published no fewer than five successive reports on its monitoring of patent settlements in the pharmaceutical sector. The most recent of them[16] provides a useful insight into the Commission's approach to the subject. Firstly, it divides pharmaceutical patent settlement agreements into two broad categories: namely, Category A, which comprises those that permit the generic company to enter the market and compete freely, or that do not oblige it to leave the market; and Category B, which comprises those settlements that impede or ban the generic company from entering the market with its own

15 Case C-439/09: *Pierre Fabre Dermo-Cosmétique SAS v Président de l'Autorité de la Concurrence et al.*

16 *Fifth Report on the Monitoring of Patent Settlements*: 5 December 2014: Competition DG.

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product. The difference between the two from a competition law viewpoint is that the former agreements are generally unobjectionable, whereas the latter are potentially problematic.

Category B agreements are therefore subdivided depending on whether or not they contain a transfer of value from the originator company to the generic company. Those that do not (Category BI) will be unlikely to encounter problems with the regulators unless exceptional circumstances apply; but those that do (Category BII), on the other hand, are clearly at risk of attracting adverse regulatory attention. Indeed, in the years 2013–14 alone the European Commission imposed fines of almost €0.6 billion on parties to arrangements that delayed generic entry on to the market.[17] The rule of thumb, therefore, is that a large red flag must definitely be waved whenever "pay-for-restriction" or "pay-for-delay" provisions feature in a patent settlement agreement.

Other types of IP settlement agreements: Even if your compromise agreement is careful to avoid any restriction of generic entry, it can still run into competition law problems. For example, a settlement deal whereby the parties agree to cross-license each other and to accept restrictions on the use of their respective technologies could well be risky, especially where the parties have a significant degree of market power, and/or where the deal has the effect of preventing them from gaining a competitive lead over the other or reducing their incentive to innovate.[18]

Another type of provision often encountered in IP settlements (including, in particular, trade mark co-existence agreements) is the delimitation of territorial markets. Such provisions need to be drafted with great care, especially if they are combined with restrictions on the use of the intellectual property after the expiry of the applicable licence: the Chiquita/Fyffes case[19] is a good example of how such a combination can incur the wrath of competition law regulators.

Finally, no-challenge clauses are often encountered in IP settlement agreements. These are discussed in section 3.1 below.

(h) Joint ventures

Joint venture arrangements are often used as vehicles for the collaborative exploitation of IP rights. But the range of different commercial operations that describe themselves as joint ventures means that they can be treated in a bewildering variety of ways by competition law: for example, the establishment of a cross-border jointly owned company might fall to be assessed under the Merger Control Regulation,[20] whereas a purely domestic research and development collaboration might fall to be considered by reference to the Chapter I Prohibition. Distinguishing which regime (if any) will apply will depend on (*inter alia*) whether or not the joint

17 For example, Cases T-460/467/470/471/472/13 (the *Lundbeck* cases) and Cases T-677/679/680/684/691/701/705/14 (the *Servier* cases), although all these cases are subject to appeal at the time of writing.

18 Commission Guidelines, paragraphs 240–241.

19 Commission Press Release IP/92/461, 4 June 1992.

20 Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings.

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venture is full-function, whether it has a cooperative or concentrative element, and whether a community dimension is present. In a chapter of this length, there is insufficient space to explore these criteria; suffice it to say therefore that this is a complicated area of law where the potential applicability of competition law is very often present, and where it is prudent to tread carefully. With specific reference to IP joint ventures, those that involve the assignment or licensing of IP rights may often be able to avail themselves of the TTBE, and those that involve joint research and development might find that the EU research and development block exemption regulation[21] can be helpful.

2.3 Abuse of a dominant position

In the preceding section we have outlined a range of commercial situations in which IP transactions can all too easily contravene the prohibition of anti-competitive agreements under Chapter I and/or Article 101. We now turn to consider a different set of red flags that may need to be hoisted, namely where the exercise of IP rights may amount to the abuse of a dominant position contrary to Chapter II and/or Article 102.

It is important for IP rights holders to understand that, in certain circumstances, their rights may directly or indirectly cause them to occupy a dominant position under one or more of the relevant markets. For the purposes of EU jurisprudence a 'dominant position' is taken to mean:

> *a position of economic strength enjoyed by an undertaking which enables it to hinder the maintenance of effective competition on the relevant market by allowing it to behave to an appreciable extent independently of its competitors and customers and ultimately of consumers.*[22]

While the occupation of a dominant position on the relevant market or markets does not itself contravene Chapter II or Article 102, the abuse of that position certainly can do; and we set out below a number of such situations with particular reference to intellectual property.

(a) Refusal to license

Few, if any, commercial situations highlight the tension between IP and competition laws more starkly than where the refusal by a rights holder to license its IP rights causes it to be accused of abusing a dominant position. From the IP viewpoint, a rights holder should obviously be free to choose whether (and, if so, how and to whom) to license its IP rights. But from a competition law standpoint the proprietorship of IP rights may in certain circumstances amount to a dominant position on the relevant market, and an arbitrary refusal to license them can – exceptionally – be abusive and thereby unlawful.

A good example from UK case law is the Court of Appeal's decision in *Intel v Via Technologies*,[23] in which the court held that, in exceptional circumstances, a refusal to

21 Commission Regulation (EU) No 1217/2010 of 14 December 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of research and development agreements.

22 *Nederlandsche Banden Industrie Michelin v Commission* [1983] ECR 3461.

23 *Intel Corporation v Via Technologies Inc. et al* [2002] EWCA Civ 1905.

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