Intellectual Property Rights, And Competition Law
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Lecture - 26
IP Based Conduct Under Article 101

Hello all. In the last discussion, we discussed about the various provisions mentioned under Article 101 and Article 102 in the treaty of functioning of European Union. We looked into the provisions laid down as per this regulation. Article 101 specifically talks about the various associations amongst the undertakings which may be in terms of vertical or may be in terms of horizontal agreements which if reduces or tries to distort or tries to restrict the competition, will be considered as an anti-competitive agreement. Article 102 talked about the abuse of the dominant position.

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In this session I would like to take you through the assessment of IP based conduct under Article 101. In this section we will look into the principles for assessment under Article 101 and in particular, we will look through case laws and analyse assessment of IP licensing or agreements under Article 101.

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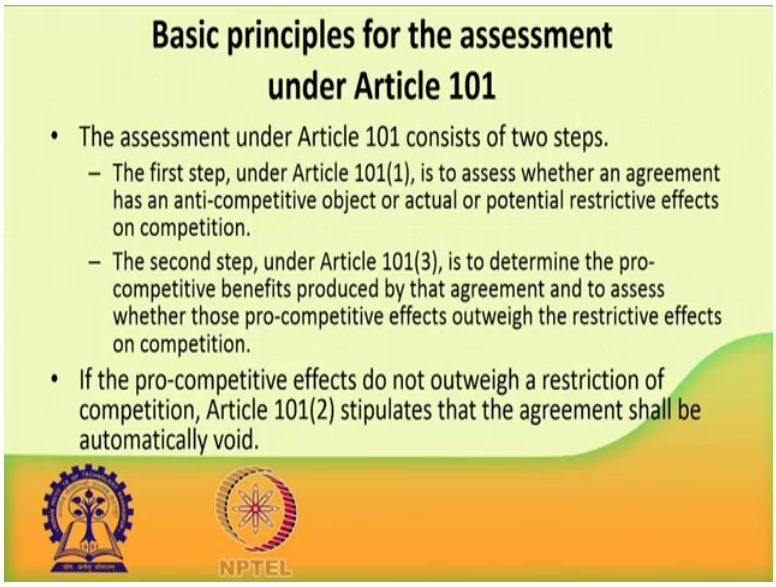

Article 101 talks about the restriction of the agreements by the undertakings, which in any way restricts, distorts or reduces the competition in the European internal market. To consider whether any agreement falls under this category of anti-competitive nature, there are two principles under which the cases are analysed. The assessment under Article 101 consists of two steps. Under Article 101 sub-section (1), the first assessment is regarding whether an agreement has an anti-competitive object or *actual or potential restrictive effect on the competition* or not. It means that, whether it is directly aimed at achieving anti-competitive object or in some way it will lead to actual or potential restrictive effect.

And in the second step, under the provision of sub-section (3) of Article 101, the European commission determines the pro-competitive benefits produced by the agreement. And then they outweigh the pro-competitive effects with the restrictive effects. If the pro-competitive effects outweigh the restrictive effects, then the agreement is not considered as anti-competitive and if the vice-versa happens, then the agreement is considered as an anti-competitive agreement.

These are the basic principles which are also mentioned in the slides. So, at first it is assessed whether the agreement is having any anti-competitive object or *actual or potential restrictive effect on competition* and in the second step, it is determined that

whether the pro-competitive effects outweigh the restrictive effects on the competition or not. And as you know in the sub-section (2) of Article 101, it has been stated that if any agreement is as per the sub-section (1) of Article 101 then, it will automatically stand void.

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Article 101 is regarding the vertical arrangements or horizontal arrangements. For example, the formation of cartels or mergers. So, cartels are a group of independent undertaking that come together by the way of agreement, they try to restrict the price or they try to share the common market, if in any way they restrict the competition; then, it is considered as an anti-competitive agreement. The Article 101 prohibits the agreements whose object or effect is to restrict competition. How is it assessed whether the agreement is having an object of restricting competition or not?

The European commission looks into the agreement and particular attentions are paid in the three aspects. First what is the content of the agreement, meaning thereby that is the agreement directly telling the restrictive nature of the agreement; second what are the objectives that agreement seeks to attain. The main objective of the agreement is analysed and third, the economic and the legal context of the agreement is looked into because when an agreement finally comes to the market, the economic activity will be

the final decisive factor to understand or analyse if the agreement is anti-competitive or not.

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For an agreement to have restrictive effects on the competition within the meaning of sub-section (1) of Article 101, it must have or is likely to have an *appreciable adverse impact* on at least one of the parameters of the competition. In what terms the appreciable adverse effect can be judged? It can be judged on the basis of certain parameters such as the competition in the market, the product pricing, the output of the agreement and the impact on the product quality, product variety or total impact on the innovation. The appreciable adverse impact may be judged on any of these parameters.

If it is having an appreciable adverse impact, then it will be considered as anti competitive agreement under the sub-section (1) of Article 101. These agreements can have such effects by appreciably reducing the competition between the parties; meaning thereby that the agreement can be between the parties directly dealing with each other or it may be with third parties. This means that, the agreement must reduce the parties *decision making independence* i.e., if certain parties or undertakings are part of an agreement they cannot independently make any decision and all the decisions will have an adverse impact on the market in terms of pricing or product output or quality of the product or on the innovation of the product.

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As per Article 101 sub-section (1), if an agreement is found to be anti-competitive in nature; then the commission will move into sub-section (3) of the Article 101. There are certain exemptions placed by the European competition commission, for research and development or for R&D activity or specialised research, they allow certain kind of agreements between the undertakings or between the companies.

Apart from these exemptions, sub-section (3) of Article 101 is looked into and the exception rules are applied under Article 101 sub-section (3) which lays down certain exceptions. If the agreements fall under these exceptions then it may be considered as pro-competitive in nature. There are 4 cumulative conditions; 2 positive conditions and 2 negative conditions.

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What are these four conditions? First one is, the agreement must contribute in improving the production or distribution of the product or it should contribute in promotion of technical or the economical effect. We can say that there should be an efficiency gain by this agreement and the restriction placed in the agreement should be indispensable to the total process or for the efficiency gain. The third and most important is that if certain kind of restrictions are placed, then the consumers must get a benefit from these kind of agreements. They should receive a fair share of the resulting benefit.

The fair share may be through high quality of the product or product of a lower price or product with technical advancement in theoretical sense, if it is more innovative or technologically better. All these are indirect benefits for the consumer. The agreement must not afford the parties possibility for eliminating competition in respect of essential part of the products in question, i.e. it should not restrict the competition. These are the four cumulative conditions which must be judged under sub-section (3) of Article 101 before deciding whether agreement is pro-competitive in nature or not.

As I told you earlier, now it must be weighed against the anti-competitive or the restrictive conditions as per the Article 101. If the pro-competitive aspects are heavier or weighs higher than the anti-competitive or the restrictive effects, then the agreement will

not be considered as anti-competitive in nature and it will be considered as a normal agreement in the market.

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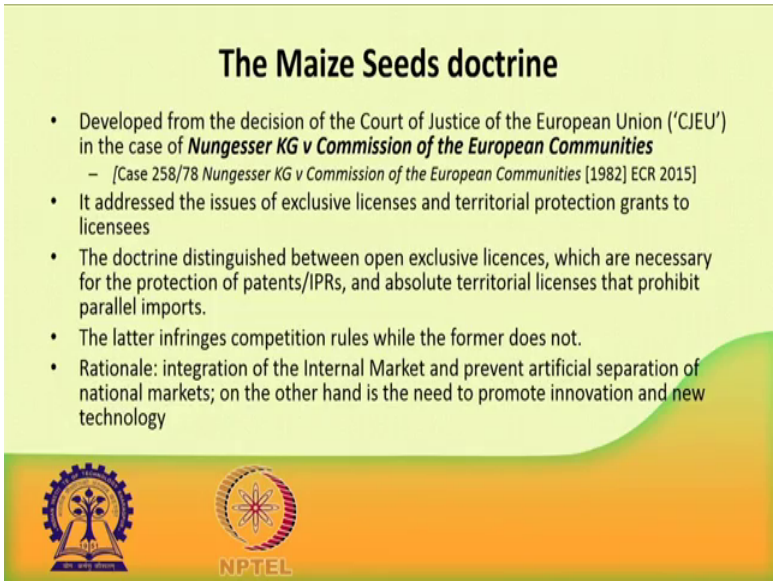

Under Article 101 several cases have been decided or assessed, whether the agreements are anti-competitive or not. Now, let us discuss some of these cases which involve intellectual property rights. There are certain case laws through which doctrines have evolved. You know that there are various forms of intellectual property rights, such as patents which are more technical in nature; designs which are different from the patents in that they do not involve any technical advancement; only the exterior shape or configuration is being protected.

Then, there are trademarks which are not true form of invention like patents, but are also very important for any company or enterprise. There are plant variety protection, there are geographical indication. So, there are different forms of IP. Each of these cases involved different forms of IP that have their own merits and the cases were decided based on the facts associated with the IPR. There is a general trend or general overview over how the cases are being dealt in the European Union.

How these transactions involving intellectual property rights or agreement's involving intellectual property rights are considered should be looked through the eyes of

competition policy in the European Union. In this direction, we will discuss certain cases which would shed light on how the IPR and competition law are associated and how they establish the complementarity nature which we discussed in the earlier module. One of the landmark cases with respect to intellectual property rights was *Maize Seed Case* or the *Nungesser versus Commission of the European community*. This case is one of the landmark cases, where the issue of exclusive licenses and territorial protection in conjunction with intellectual property rights were dealt with.

The facts of the case are, the French agriculture research institute INRA developed a specialized hybrid maize seed. They had plant variety rights or the breeders right. They transferred all the rights to the seed distributor company in the France *the Nungesser*. Nungesser got the exclusive license with territorial protection to take this brand as well as to sell the seed and cultivate the seed exclusively in Germany and no third party including the INRA was allowed to cultivate or sell the seed in the German territory.

It excluded all the third parties including itself. In Germany, Nungesser was the only company who was supplying the seeds and cultivating the seeds. The prices were higher. Since it did not allow any third parties, the European commission looked into this case as a violation of the competition law and violation of Article 101 of the treaty on functioning of European Union and this case was registered. Aggrieved by this decision of European commission, *Nungesser* approach the European court of justice. The European court of justice partly allowed the decision. The issue here was the exclusive license and territorial protection.

As you know intellectual property rights gives us the right of exclusivity. In any of the intellectual property, the inventor invests money, resources in the research and development of it, also a long period of time is invested. To gain benefits, it is essential to provide the inventor with certain exclusivity or certain benefits because he has to recur the cost which he has invested in the research. The inventor wants some profit out of his invention, for which some exclusivity, is granted to the inventor as per the norms of the intellectual property rights.

But, the competition law looks into the static dimension: for example the lower pricing and availability to the consumer, equal competition between the market players. With this context, in this case, the European Court of Justice looked into the aspect of open exclusive license and exclusive license with closed territoriality.

Through this case, a doctrine has developed which is popularly known as *the maize seed doctrine*. The doctrine distinguishes between open exclusive license, which are necessary for the protection of patents or any other IPR per se, and absolute territorial license that prohibits parallel import. As per the European court of justice, the exclusive license with absolute territorial protection infringes the competition rules; whereas, open exclusive license does not infringe the competition rules.

They looked into the case with two rationals. First: whether there is an integration of the integral market or not; whether the clauses are creating an artificial separation in the national markets and whether the aim, which both competition law and the intellectual property law share is to promote innovation and technology, is being satisfied or not. With these two rationals, the European court of justice has looked into this case.

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The European court of justice stated that in an open exclusive license, the licensor merely undertakes not to grant other license in respect of the same territory and that he

will not compete with the licensee in that territory. However, it does not restrict any third party in selling or importing the seed or exporting the seed from that territory. It is the contract between the licensee and the licensor and no third party is involved. But when there is an exclusive agreement with territoriality, the way it was in this case, then third parties are also prevented from exporting or importing the seed or selling the seed in the German territory.

The court held that open licenses were necessary for dissemination of the new technologies and to encourage acquisition. Open license emanates from the contractual relationship between the parties. As long as they do not affect the position of the third parties, they do not interfere with the Article 101 sub-section (1).

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On the other hand, the exclusive licenses with absolute territoriality infringe the Article 101 sub-section (1) because they extend the provision of exclusivity to the third parties who are not bound by the contract itself. Thereby any agreement which prevents parallel imports or which results in a creation of an artificial market or the separation of the internal market will be considered as violation of Article 101. This case settled that any agreement that prohibits or limits parallel trade will infringe the Article 101 sub-section (1).

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This is one of the important decision in the history of the European competition policy. The court looked at IPR on one hand, the inventor should enjoy the monopoly and he should gain the benefits or profit because he has invested money and time in the invention, on the other hand; it should not prevent any third party; it should not include other parties from selling or getting benefit from that invention.

On similar lines, the next doctrine is the *exhaustion of rights doctrine*.

As you know, the intellectual property rights are given for a limited period of time like any other IPR right. In line with the competition policy, the exhaustion of right doctrine has evolved through this classic case of *Consten and Grundig versus the Commission.* Grundig was a German distributor of electronic goods. He chose *Consten* to distribute the electronic goods in France and *Consten* was chosen as an exclusive distributor in France and no third party were allowed to distribute this electronic good. Grundig had transferred all the trade name and brand of the electronic good to *Consten*.

But, there was another company which started parallel importation of the goods from Germany and started selling it in the France. Consten and Grundig together complained about this third company to the commission. However, the commission said that the agreement between *Consten* and Grundig is in violation of Article 101. Through this case

the court of justice has come out with this doctrine known as *the exhaustion of right doctrine*.

As per this doctrine the exclusive right cannot be used to artificially split up the common market along the national borders. Therefore, the holder of an IPR in a member state cannot oppose the import of a product protected by an IPR into that member state. Even though, you have an IPR associated with some product and you already have a channel to sell that product in a market, you cannot oppose the import of that product from other market into that market because you are selling in that market.

It is applicable throughout the European Union and it plays a significant role in protecting the free movements of the good. As per this doctrine, once you have sold the article you do not share any other right with that product. So, now, the third party is free to sell that product or use that product in any way. This is exhaustion of right doctrine. This is in line with the competition policy.

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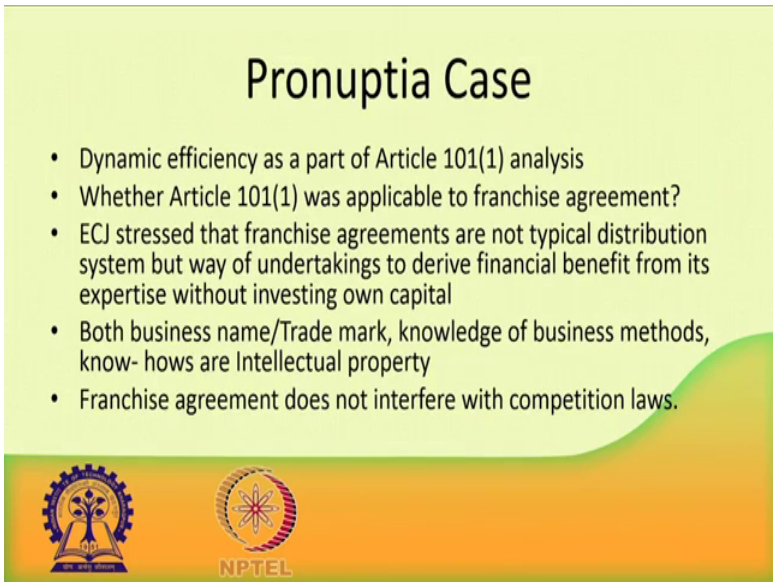

Another important case is Pronuptia case, where the court has analysed whether the franchise agreement can be judged on the basis of Article 101 sub-section (1) or not.

In a franchise agreement, the business name, trademarks, know-how, etcetera are transferred to the franchisee and the franchisee is supposed to maintain the trademark in

such a way that there should not be any compromise on the quality or brand name of the franchise and also there should not be any leakage of the know-how or other secrets which are being transferred through this agreement. In this case, the European court of justice, stressed that the franchise agreements are not a typical distribution system, but it is a way by which the undertakings derive financial benefit from their expertise without investing their own capital.

Even though in a franchise agreement, the business transfers its trademark, which is a kind of intellectual property, but it should not interfere with the competition law. In some of the franchise agreement there are terms: such as the franchisee cannot start his own business until certain period of time, yet these clauses, in general, do not interfere with the competition laws. As I mentioned earlier, the cases are looked from different angles, depending upon the nature of intellectual property right involved, when we talk about the competition law or competition policy in the European Union.

I also mentioned earlier that there is a complementarity between the intellectual property law and the competition law in the fact that they share common goal of consumer benefit and promotion of innovation and technical know-hows. But still there is a difference, difference in the sense that the competition law generally looks at the agreements in terms of static benefit i.e. whether there is equal competition amongst the competitors or not; whether the consumers are getting the product on a lower price or not. But when we look at the cases from the angle of intellectual property right, we generally think about the benefit for the inventor, along with the consumer, in the sense that the consumer is getting a new product, better quality product with technical advancement and it also promotes innovation.

IPR focuses on dynamic innovations or dynamic efficiency; whereas, the competition law focuses on the static efficiency. So, depending on the merit of the case, it is static efficiency versus the dynamic efficiency. In case of agreements which involve the intellectual property right, equal weightage should be given to the static efficiency as well as the dynamic efficiency i.e. whether there is a technical advancement or not; whether the inventor or the proprietor of the intellectual property right is getting due benefit or not, should be taken into consideration. And as we know that it is a kind of an

exclusive right, so in the agreements, there is a certain chance that restrictions may be put in place, but as mentioned in Article 101 sub-section (1) and sub-section (3), they should be judged on a case to case basis.

Through these cases, we now have a brief idea about how Article 101 is assessed in case of dealings involving intellectual property right. In continuation to this, we will discuss the assessment of Article 102 with respect to various intellectual property right agreements in the next section.

Thank you.