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CJEU Confirms EU Competition Law Does Not Prevent Royalties for Revoked Patent Licences

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On 7 July 2016, the Court of Justice of the European Union (CJEU) ruled that, provided that a licensee is free to terminate a licence agreement on reasonable notice, it can be obliged to pay royalties even after the patent protecting the licensed technology has been deemed invalid.

In particular, the CJEU rejected the argument that a licensee being required to pay royalties for licensed technology that others could use for free (as a result of the patent being invalidated) did not amount to an anti-competitive agreement in breach of EU competition law or unlawfully place the licensee at a competitive disadvantage to its competitors.

This decision will come as a relief to licensors of patented technology, and a disappointment to licensees, as it confirms that a licensee that has agreed to pay a royalty for patented technology cannot later try to rely on EU competition law to escape paying the royalty if the patent is deemed invalid.

Background

The CJEU's decision is the culmination of an extended dispute between Genentech Inc. and the pharmaceutical company Sanofi, a subsidiary of which granted Genentech a non-exclusive licence in 1992 to use certain DNA sequences, known as "enhancers", that were the subject of a European patent and two U.S. patents. Under the licence agreement, Genentech agreed to pay (among other fees) "running royalties" on the sale of finished products incorporating the licensed technology. The enhancer was later used by Genentech to manufacture a successful cancer drug called Rituxan and other drugs.

In 1999, the European version of the patent was revoked by the European Patent Office.

In 2008, Sanofi, believing that Genentech had used the patented technology in the production of Rituxan and other drugs without paying the running royalties on the sale of those drugs, and thus alleging that Genentech had infringed the licence agreement, demanded payment from Genentech, triggering litigation in the U.S. and Europe.

EU arbitration

In October 2008, Sanofi lodged an application for arbitration against Genentech with the International Court of Arbitration of the International Chamber of Commerce ('ICC') in Paris. The arbitrator held that Genentech had benefited from the commercial purpose for the licence agreement, namely to avert all patent litigation in relation to validity of the patents.

As a result, the arbitrator held that any payments made under the licence agreement could not be reclaimed, and payments due by Genentech thereunder remained due, despite the subsequent revocation of the European patent, since the commercial purpose of the agreement had been fulfilled. In February 2013, the arbitrator ordered Genentech to pay Sanofi damages and costs.

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Genentech appealed the arbitrator's ruling to the Court of Appeal in Paris, arguing that forcing it to pay royalties for use of a revoked patent breached Article 101 on the Treaty on the Functioning of the EU ("TFEU"), which prohibits anti-competitive agreements. Genentech submitted that requiring it to pay for the use of a technology that its competitors could use for free exposed it to additional costs of approximately EUR169 million as compared with its competitors.

The Paris Appeals Court referred the question of whether competition law was breached to the CJEU.

CJEU decision

The CJEU interpreted the question before it as asking whether Article 101 TFEU precludes the imposition on a licensee of an obligation to pay a royalty for the use of a patented technology for the entire period that a licence agreement is in force, in the event of the revocation or non-infringement of the patents protecting the licensed technology.

Agreeing with the opinion of the Advocate General issued earlier this year and considered by us here, the CJEU concluded that Article 101 TFEU did not preclude such an imposition of an obligation to pay a royalty, provided that the licensee was able freely to terminate that agreement by giving reasonable notice.

The CJEU noted that it was not for it, in the context of the preliminary ruling procedure, to review the findings of the arbitrator or his interpretation of the licence agreement carried out in the light of German law.

It then went on to rely on its previous "Ottung" ruling, in which it had held that an obligation to pay royalties was not necessarily connected to the existence of a patent, but rather could reflect a commercial assessment of the value of exploitation granted by the licence agreement itself. Such a royalty obligation may breach Article 101 TFEU where the licence agreement either does not grant the licensee the right to terminate the agreement by giving reasonable notice or it seeks to restrict the licensee's freedom of action after termination. However, in the context of an exclusive licence, the obligation to pay a royalty -even after the expiry of the period of validity of the licensed patent- will not breach Article 101 TFEU if the licensee can freely terminate the agreement by giving reasonable notice (and thus discharge the royalty obligation).

The CJEU applied a similar assessment in this case, finding that a royalty is the price to be paid for commercial exploitation of the licensed technology with the guarantee that the licensor will not exercise its industrial-property rights. It held that as long as the licence agreement at issue is still valid and can be freely terminated by the licensee, the royalty payment is due, even if the industrial-property rights derived from patents cannot be used against the licensee due to the fact that the period of their validity has expired.

As the licence could be freely terminated by Genentech, the CJEU rejected the contention that the payment of a royalty undermined competition by restricting Genentech's freedom of action or by causing market foreclosure effects, since Genentech could have been in the same position as its competitors by simply terminating the agreement.

Key practicality ignored by CJEU decision

Unfortunately the CJEU's ruling fails to address a practical reality, namely the implications where an agreement involves a larger bundle of patents and geographies, and only one or a small number of those patents is revoked. In our experience, the licensor will generally try to negotiate the same royalty with or without the revoked

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patents. In addition, the licensee faces significant risk if it chooses to terminate the agreement due to one invalid patent, but it is still selling products incorporating technology for which the patents remain valid. Guidance from the European Commission or the CJEU in this regard would therefore be welcomed.

Practical Implication

This decision does provide some comfort to EU patent holders that, provided licence agreements contain reasonable termination provisions, they can continue to request agreed royalties from licensees, despite some question over the validity of their patents. However, to avoid the risk of challenge on competition grounds, it may be helpful for patent owners who wish to charge royalties extending beyond a patent's life to consider including in the agreement a provision explaining the commercial reasoning for doing so.

In addition, although the decision implicitly appears to accept in principle the practice of "back-loading" payments in licence agreements (which to date has often been a feature of licences given the uncertainty regarding whether future new technologies will be successful); patent holders may wish to negotiate larger upfront royalty payments, to minimise the risk of losing out on royalties if the licensee later terminates due to revocation of the patent.

Conversely, licensees should ensure that the licence agreement is clear regarding a potential invalidation or expiry of the patent. In particular, they may wish to include in the agreement an explicit clause stipulating that they will be released from their obligation to pay royalties in the event of a subsequent invalidation, or expiry of the patent. Alternatively, they may wish to stay alert as to matters regarding the validity of the patents protecting the technology they have licensed, to ensure they terminate or renegotiate agreements if these are invalidated and they do not inadvertently remain liable for royalties when they can use these for free outside of the agreement. Licensees may also be able to use this decision to negotiate more favourable termination provisions (e.g. shorter notice periods), on the basis that unreasonable terms may be regarded as anti-competitive.

Finally, in light of the practical concerns identified above, licensees of a bundle of patents may wish to insert contractual mechanisms by which royalties can be lowered in the event of a subsequent revocation of one or more of the bundle, or perhaps consider separate licence agreements for each patent.

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