

# Royalty disputes: lessons from litigation

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# LESSONS FROM LITIGATION

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## LESSONS FROM LITIGATION IN RELATION TO ROYALTIES

Competition law issues may occur in the event of:

- an obligation to pay royalties beyond the duration of the life of the licensed IP;

In that context it also occurs that **further risks are posed by:**

- exclusive agreements,
- that run for either a long period of time or for an indefinite period of time; and
- which do not impose recurring obligations upon the parties (example a one-off royalty payment)

One must avoid creation of agreements that may be interpreted as an assignment of rights.

## Main legal framework – starting point

Article 101 TFEU:

Prohibited - as incompatible with the internal market – are **all agreements** between undertakings (...) which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market

Any agreements or decisions prohibited pursuant to this article shall be automatically void. That includes License Agreements.

The provisions of paragraph 1 may, however, be declared inapplicable in the case of an agreement, decision or a concerted practice which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

- (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
- (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

# Duration of obligation to pay royalties

History: CJEU, C-320/87, 12 May 1989: Ottung (matter cited in Genentech). The CJEU held that:

- a contractual obligation under which a licensee for a patented invention is required to pay royalties for an indefinite period - and thus after the expiry of the patent - does not in itself constitute a restriction of competition within the meaning of article 85(1) of the Treaty where the agreement was entered into **after the patent application was submitted and immediately before the grant of the patent.**
- requirement: the freedom of the licensee to terminate the agreement (para. 13).



[judged against the predecessor of art 101 TFEU]

# Duration of obligation to pay royalties

## Genentech, CJEU C-567/14, 7 July 2016 (facts)

On 6 August 1992, Behringwerke (later Hoechst) granted a worldwide non-exclusive licence to Genentech for the use of a human cytomegalovirus (HCMV) enhancer (making it possible to improve the effectiveness of the cellular process used for the production of proteins).

This technology was the subject of US Patents and a European Patent. On 12 January 1999, the European Patent Office (EPO) revoked patent EP 177.

Under the licence agreement, Genentech undertook to pay:

- a one-off fee of around EUR 10K for the costs of issuing the licence;
- a fixed annual research fee of around EUR 10K; and
- a 'running' royalty of 0.5% levied on the amount of sales of 'finished products' .

Genentech

SANOFI 

# Duration of obligation to pay royalties

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European Court of Justice, 7 July 2016, Genentech

## Question referring court

Must the provisions of Article 101 TFEU be interpreted as precluding effect being given - where patents are revoked - to a licence agreement which requires the licensee to pay royalties for the sole use of the rights attached to the licensed patent?'

Genentech

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# Duration of obligation to pay royalties

## Opinion AG Whatelet, *Genentech v Hoechst, Sanofi-Aventis* (elements that may determine the legitimacy)

- Genentech submitted that the judgment in *Windsurfing International v Commission* (193/83, EU:C:1986:75) demonstrates that Article 101(1) TFEU is infringed if the holder of a patent licence is required to pay royalties for a product which is not covered by a patent.
- In the *Windsurfing* judgment though, the patent holder had **made the conclusion of the agreement conditional on the acceptance of supplementary obligations which, by their nature or according to commercial usage, had no connection with the subject matter of the agreement.**
- In the *Genentech* proceedings, there is no evidence of the licensor imposing obligations on Genentech which would have had no connection with the subject matter of the licence agreement.

Consequently, the AG considered that Article 101 TFEU does not preclude effect being given, in the event of revocation or non-infringement of patents protecting a technology, to a licence agreement which requires the licensee to pay royalties for the sole use of the rights attached to the licensed patents where, **first, the commercial purpose of the agreement is to enable the licensee to use the technology at issue while averting patent litigation** and, **secondly, the licensee may terminate the licence agreement by giving reasonable notice, even in the event of revocation or non-infringement.**

# Duration of obligation to pay royalties

## Opinion AG Whatelet, Genentech v Hoechst, Sanofi-Aventis

- the obligation to pay royalties post expiration may infringe article 101(1) TFEU where the licence agreement either does not grant the licensee **the right to terminate the agreement by giving reasonable notice** or **seeks to restrict the licensee's freedom of action after termination** (Opinion Whatelet in Genentech, para. 88 by reference to Ottung, C-320/87, para 13);

The obligation to pay royalties was stipulated to last only for the duration of the validity of the licence agreement and Genentech was freely able to terminate it by giving very **short notice of two months**. As soon as the licence agreement was terminated, Genentech was therefore in exactly the same position as all other users of the enhancer at issue.

**Genentech's freedom of action was not restricted in any way during the period after termination** and it was **not subject to any clause preventing it from challenging the validity or the infringement of the patents at issue**. Indeed, following the termination of the licence agreement, Genentech brought proceedings to revoke the patents before the United States District Court for the Northern District of California.

# Duration of obligation to pay royalties

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## Judgment CJEU, Genentech

Article 101(1) TFEU must be interpreted as **not precluding the imposition on the licensee**, under a licence agreement such as that at issue in the main proceedings, **of a requirement to pay a royalty for the use of a patented technology for the entire period in which that agreement was in effect, in the event of the revocation or non-infringement of a licenced patent, provided that the licensee was able freely to terminate that agreement by giving reasonable notice.**

# Further risks of long running agreements

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**Long running agreements may have serious unforeseen adverse consequences (from the Licensor's perspective), particularly agreements with the following characteristics:**

- exclusive agreement
- for an indefinite period of time; and
- that do not contain recurring obligations, but rather contain one off obligations (such as a one-off royalty payment).

These may ultimately be qualified as amounting to:

- a transfer of rights; or
- an abandonment of the IP rights.

# Further risks of long running agreements

**Tribunal de grande instance de Paris (3rd chamber), 5 January 2020, Unipay v Ipermedia**

- irrevocable royalty free license to use a mark from Unipays to Ipermedia to use a mark;
- the agreement does not contain any further obligations

Then, the licensor wishes to terminate the agreement. Ipermedia objects to the termination and argues that the nature of the agreement means that it cannot be terminated.

## **Court**

- the irrevocable concession is a transfer of property;
- the transfer of the trademark without any limitation of objects or time is total.

**N.B.** Most decisive is the lack of any form of recurring obligations.

# Further risks of long running agreements

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**Cour d'appel de Paris, 14 May 2019, Arthurimmo v Cabinet Essone Immobilier**

- irrevocable license for an indefinite period to use a mark against payment of a fee of 50K Euro;
- no further obligations are imposed.

Then a dispute arises between the parties about the nature of the agreement.

**Court in first instance:**

- the agreement is a contract of instant execution and amount to an assignment of rights

**Court of appeal**

- Confirms the decision in first instance

**N.B.** Most decisive is the lack of any form of recurring obligations.

# Further risks of long running agreements

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**Eva's Bridal Ltd. v. Halanick Enterprises, Inc, No. 10-2863 (7th Cir. May 10, 2011), the Seventh Circuit**

The consequences of failing to exercise quality control are severe and in the subject result in **abandonment of the mark and loss of all rights in the mark**. Thus, any trademark license agreement must include provisions providing for some quality control by the licensor.

N.B. Make sure you always perform your obligations under the agreement.

# Lessons from litigation

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**If one chooses to work with License Agreements that run longer than the life of the Intellectual Property, then:**

- A. make sure that these can be terminated on reasonable notice by the Licensee;
- B. avoid post termination restrictions;
- C. avoid no challenge clauses;
- D. avoid supplementary conditions that have no connection with the subject matter of the agreement.

**In addition:**

- A. avoid one-off royalty payments (as much as possible);
- B. make sure that an agreement contains recurring obligations; and
- C. perform obligations (such as quality control obligations).

**One must avoid the unwanted creating an agreement that constitutes or can be interpreted as an assignment rather than a license.**

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