

Recommendations of Alcatel Lucent for Clarifications to the EU Research and Development Block Exemption Regulation

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Cooperation with other parties in research and development has been an important means for Alcatel Lucent ("ALU") to bring innovative new products to the market, by making it possible to pool technological expertise and share what are often very high R&D costs, sometimes requiring the assumption of risk of an investment in the many millions of euros. Since it came into force in 2001, and even more so after May 2004 when "self-assessment" replaced notifications to the Commission, Commission Regulation No. 2659/2000, the research and development block exemption regulation ("R&DBER"), has been critical in providing the legal security that ALU requires before it can commit to joint R&D projects.

When given an interpretation which ALU believes is consistent with the literal wording of the regulation, the R&DBER is flexible in the arrangements for obtaining a return on R&D investment which are exempted. However, ALU has sometimes encountered parties who argue in favor of different interpretations, which has led us to conclude that the Commission either needs to clarify the text of the R&DBER or, more simply, to adopt guidelines to its intended meaning. For Commission Regulation No. 2790/1999, the Vertical Agreements Block Exemption ("VABER"), the Commission did publish such guidelines to the text of the VABER as part of its overall statement of policy on vertical agreements, at 2000 OJ C291/1 ("Vertical Guidelines"). Unfortunately the guidelines on horizontal cooperation agreements, 2001 OJ C3/2, did not contain a similar section explaining the meaning of the provisions of the R&DBER.

The following are the aspects of the R&DBER which we believe it could be useful to clarify:

- **If one of the parties contributes only specifications and funding to the proposed R&D project, or even funding only, leaving all the R&D work to the other party, is this arrangement sufficient to constitute "joint" R&D within the meaning of R&DBER Art. 1.1.a or 1.1.c?**

We believe that such an arrangement fits within the definition of joint R&D in R&DBER Art. 2.11:

"research and development, or exploitation of the results, are carried out 'jointly' where the work involved is:

- (a) carried out by a joint team, organization or undertaking,
 - (b) jointly entrusted to a third party, or
 - (c) allocated between the parties by way of specialization
- in research, development, production or distribution".

Significantly, the definition says nothing about the relative nature or degree of each party's contribution. Moreover, there is no policy reason to exclude any particular arrangement chosen by the parties as long as the end result is technological progress within the EU.

- **When the parties organize exclusive channels to distribute the product(s) resulting from the R&D, it is clear from the wording of R&DBER Art. 5.1.f that the parties may structure such channels as exclusive geographic territories (subject to the right of “passive sales”). However, it is not explicitly stated that channels could be organized according to exclusive customer groups.**

The VABER explicitly exempts (subject to passive sales) exclusive territories or exclusive customer groups. See VABER Art. 4.b, and Vertical Guidelines paragraphs 50; 179.

It appears that the drafters of the R&DBER, which was issued by the Commission almost a year after the VABER, intended to extend the exemption to cover exclusive customer groups as well: R&DBER Art. 5.1.e states that any “restriction of the customers that the participating undertakings may serve” will no longer be exempted after seven years from the time the contract products are first put on the market within the Common Market. But since the text of the R&DBER is not as precise as that of the VABER on this point, clarification would be helpful.

- **In ALU's negotiations with another party, the question has been raised whether the parties engaging in joint R&D may each be assigned exclusive distribution channels for the product(s) resulting from the R&D even if each also manufactures the products separately.**

R&DBER Art. 1.1 exempts not only joint R&D, but also “joint exploitation” of the products resulting from that R&D. It has already been noted above that the R&DBER's definition of “joint” includes allocation between the parties by way of “specialization in research, development, production or distribution”. It therefore once again seems clear from the use of the word “or” in the definition that the R&DBER exempts allocation of different exclusive territories or customer groups to the parties even if they neither specialize in production nor engage in joint production.

However, some confusion on the part of our potential R&D partner arose from the wording of R&DBER Art. 3.3: “ ... where the research and development agreement provides only for joint research and development, each party must be free independently to exploit the results of the joint research and development”. There was a concern that this language arguably implies that specialization in distribution is not sufficient to constitute “joint exploitation”, in contradiction with Art. 2.11.c's statement that such distribution allocation does by itself amount to joint exploitation. In commenting on the predecessor regulation, Commission Regulation No. 418/85, Professor Valentine Korah's view (and that of two other commentators she cites, Eric White and James Venit) was that allocation of distribution between the parties is alone sufficient to meet the definition of joint exploitation. V. Korah, *Research and Development and the E.E.C. Competition Rules: Regulation 418/85* (1986), §3.1.7.

See also subsequent commentaries taking the same view as Korah: S. Poillot-Peruzzeto, *L'application du règlement 418/85 de la Commission relatif aux accords de recherche et de développement*, RTDE n°23, juill.-sept 1987, p. 481, 491; Ritter and Braun, *European Competition Law: a Practitioner's Guide* (3d ed. 2004), p.218. The Commission now has an opportunity to put this issue to rest definitively.

The argument has also been made by one of ALU's partners that the meaning of the word "specialization" should be derived from the types of specialization exempted by the block exemption regulation on specialization agreements, Commission Regulation No. 2658/2000 (the "SBER"):

“(a) unilateral specialization agreements, by virtue of which one party agrees to cease production of certain products or to refrain from producing those products and to purchase them from a competing undertaking, while the competing undertaking agrees to produce and supply those products; or
 (b) reciprocal specialization agreements, by virtue of which two or more parties on a reciprocal basis agree to cease or refrain from producing certain but different products and to purchase these products from the other parties, who agree to supply them; or
 (c) joint production agreements, by virtue of which two or more parties agree to produce certain products jointly.”

According to this argument, only such “unilateral”, “reciprocal” or “joint” arrangements meet the definition of “specialization”. (But unlike the R&DBER, the SBER does not provide a definition of what is “joint” production.)

However, the SBER describes only arrangements for production, not distribution, so the analogy does not fit. It is also significant that the drafters of the R&DBER did not incorporate a definition of “specialization” from the other regulation, when they easily could have done so. Professor Korah specifically rejects the argument, concluding that “specialization” is used in a more general sense in the R&DBER. We would welcome the Commission's position.

- **Even though the R&DBER provides that parties must be allowed to carry out further independent R&D in the same field as that covered by the contract's R&D program, presumably the parties may nevertheless agree not to compete with the products resulting from the R&D?**

In order to ensure that they will achieve an adequate return on their investment in R&D, the parties normally want to include a non-compete clause in their arrangements for “joint exploitation”. Yet, R&DBER Art. 5.1.a provides that an R&D cooperation agreement will not be exempted if it restricts

“the freedom of the participating undertakings to carry out research and development independently or in cooperation with third parties in a field unconnected with that to

which the research and development relates or, after its completion, in the field to which it relates or in a connected field".

In this connection the Commission could clarify a potential ambiguity: at least during the initial seven-year period of exemption for joint exploitation provided by R&DBER Art. 4.1 (which may be extended by Art. 4.3 as long as the parties' combined market share remains below 25%), Art. 5.1.a should not be interpreted to prevent the parties from being bound not to sell any products competing with the products resulting from their R&D cooperation.

- **Resale price maintenance appears to be exempted where the parties engage in joint exploitation of the products resulting from the R&D.**

In 2007 the United States Supreme Court concluded, in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 127 S. Ct. 2705, that the century-old rule making fixed or minimum resale prices (resale price maintenance, or "RPM") a per se antitrust violation should be reversed. The court reasoned that there was no present economic justification for condemning RPM and that it should henceforth be subject to case-by-case analysis under the Rule of Reason.

Despite the policy change in the U.S., at least for the time being RPM is still characterized as a "hard-core" restriction, for which exemption is normally not possible, in the EU block exemption regulations for vertical agreements and for technology transfer agreements. On the other hand, the wording of the R&DBER apparently does exempt RPM, in exempting at Art. 5.2.b:

"the setting of sales targets and the fixing of prices charged to immediate customers where the exploitation of the results includes the joint distribution of the contract products".

It should be remembered that "joint" distribution is defined as distribution "allocated between the parties by way of specialization", Art. 2.11.c, including allocation by way of exclusive distribution territories, Art. 5.1.f-g (presumably by exclusive customer groups as well -- see discussion above). The language of Art. 5.2.b therefore appears to state that each distributor of the product resulting from the R&D may be bound to a fixed resale price. This is also a sound interpretation on economic grounds, since permitting RPM will insure that each party distributing the product will be able to maintain a margin sufficient to generate a return on the original investment in R&D. Confirmation of this point by the Commission would be appreciated.