

**Review of the European Competition Law Regime for the
Assessment of Horizontal Cooperation Agreements**

Comments submitted by Arnold & Porter LLP

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Arnold & Porter LLP regularly advises clients on different types of horizontal cooperation agreements in various industries. The following comments reflect our experience with the instruments that are subject of the Commission's request for feedback, that is, the *Commission Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements* ("Horizontal Guidelines"), *Commission Regulation No. 2959/2000 on the application of Article 81(3) of the Treaty to categories of research and development agreements* ("R&D BER") and *Commission Regulation No. 2658/2000 on the application of Article 81(3) of the Treaty to categories of specialisation agreements* ("Specialisation BER").

The two block exemption regulations and the Horizontal Guidelines continue to be of significant practical relevance. For the self-assessment of agreements by companies and their advisors, they often constitute the main source of guidance, given that pertinent Commission decisions and European court judgments on horizontal cooperation agreements are scarce and that Regulation 1/2003 significantly reduced the parties' possibility to obtain *ex-ante* guidance from the Commission on a specific agreement. Moreover, Member State competition authorities and courts apply the R&D BER, the Specialisation BER and the Horizontal Guidelines, either directly, or by reference or incorporation when applying national competition laws.

Based on our experience, there are a number of aspects where the current regime would greatly benefit from enhanced clarity. Moreover, we would see benefit in bringing the current regime more in line with other Commission guidelines and block exemption regulations, notably the *Guidelines on the application of Article 81(3) of the Treaty* ("Article 81(3) Guidelines"), *Commission Regulation No. 772/2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements* ("TT BER"), the *Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements* ("TT Guidelines"), the *Guidance on the Commission's enforcement priorities in applying Article 82 EC* and the *Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings* ("Horizontal Merger Guidelines").

We focus the following observations on the two types of horizontal cooperation agreements for which the Commission has adopted block exemption regulations, that is, R&D agreements and production agreements.

R&D Agreements

1. Clarification of the relationship between the R&D rules and the technology transfer rules

The current legal framework for the assessment of R&D agreements differs in a number of important respects from the legal framework for the assessment of technology transfer agreements. At least some of these differences will likely remain even after the present review. It would be useful if the Commission could clarify, preferably illustrated by specific examples, which set of rules applies in situations where a technology owner licenses a technology that still requires some additional R&D before commercialization can take place, and the agreement tasks the licensee with producing and selling the final products.

The R&D BER requires “joint” R&D and “joint” exploitation of the results by the parties (Article 1(1)(a) R&D BER), but this requirement can be met by allocating the R&D and/or the exploitation of the results to one of the parties (Article 2 No. 11(c) R&D BER, see also Section 2.a below). Accordingly, the R&D BER can apply even if the licensee has the exclusive responsibility under the agreement to produce and market the final product. At the same time, the application of the TT BER is not precluded by the fact that further investment and development work by the licensee is required before the product is ready for commercial exploitation, provided only that “a contract product has been identified” (TT Guidelines, paragraph 45). The Horizontal Guidelines’ “center of gravity” test, which decides which chapter of the Horizontal Guidelines applies to a specific horizontal cooperation agreement (Horizontal Guidelines, paragraphs 12 and 39), does not address the relationship between the R&D rules and the TT rules.

2. Clarification of the conditions for the applicability of the R&D BER

The application of the R&D BER depends on the fulfillment of the conditions listed in Article 3 R&D BER. From our experience, two points need clarification.

- a. ***Clarify when R&D and exploitation are carried out “jointly” by means of task allocation between the parties (Article 2 No. 11(c) R&D BER).*** Under Article 2 No. 11(c) R&D BER, R&D and exploitation of the results are carried out jointly (so that the R&D BER can apply) if the tasks are “allocated between the parties by way of specialisation in research, development, production or distribution”. It would be helpful if the Commission could clarify whether or not this is the case if all tasks are allocated to one party, and the other party only provides an initial IP license and continued funding without otherwise actively contributing to the R&D or exploitation tasks. If “joint” R&D or exploitation requires active contribution by all parties, the Commission should also clarify whether this contribution must reach a minimum scale, or whether it is sufficient if, for example, one party carries out the R&D and the other party participates in the managerial or scientific supervision and evaluation of the progress achieved.

- b. ***Clarify the meaning of “access” to the R&D results in Article 3(2) R&D BER.*** Under its Article 3(2), the R&D BER only applies if all parties have “access to the results of the joint research and development for the purposes of further research or exploitation.” Neither the R&D BER nor the Horizontal Guidelines explain what it takes to satisfy this access requirement, which causes uncertainty about the application of the R&D BER in numerous cases. Assuming that “access” requires each party to obtain a license to the R&D results, two questions that often arise in practice and would benefit from clarification are (i) whether such licenses must be for free or can provide for royalty payments, and (ii) whether they must include the right to sub-license. Moreover, it would be helpful if the Commission could clarify that there is no violation of the access requirement if the agreement precludes the parties from individually exploiting the R&D results for as long as joint exploitation is taking place pursuant to the agreement.

In addition, we would invite the Commission to consider amending Article 3(2) R&D BER to make clear that parties may limit their individual exploitation rights to certain fields of use in cases where they are not competitors when entering into the agreement. Article 3(3) R&D BER explicitly allows non-competitors to split exploitation rights according to fields of use provided the R&D agreement does not include a period of joint exploitation, whereas Article 3(2) R&D BER arguably renders the R&D BER inapplicable to agreements that provide for an initial joint exploitation phase and limit the parties’ subsequent individual exploitation rights to certain fields of use. We do not see a good policy reason for this. Non-competitors should be allowed to split exploitation rights in line with their areas of activity without losing the benefit of the R&D BER, even if they initially exploit the R&D results jointly. Forcing non-competitors to grant each other unlimited exploitation rights risks having a chilling effect on innovation, because companies may be less willing to cooperate with non-competitors in R&D if, by doing so, they effectively create a new competitor due to the requirement to share full access to the R&D results.

3. Alignment of the R&D BER hardcore list with the TT BER hardcore lists

R&D agreements often include technology licenses, so that there is a certain substantive relationship between R&D agreements and technology transfer agreements. However, the two current sets of rules significantly differ in a number of respects, including with regard to the hardcore lists. Not only is this situation questionable from a policy perspective, but it also creates practical difficulties in cases where it is presently not clear which set of rules applies. To align the two sets of rules, we would suggest the following:

- a. ***Take non-challenge clauses out of the R&D hardcore list (Article 5(b) R&D BER).*** Article 5(b) R&D BER qualifies certain types of non-challenge clauses as hardcore restrictions. We invite the Commission to consider taking non-challenge clauses out of the R&D hardcore list. Article 5(1)(c) TT BER treats non-challenge clauses regarding the licensor’s technology as excluded restrictions, but not as hardcore

- restrictions. There does not appear to be a convincing policy reason for treating non-challenge clauses more strictly in R&D agreements.
- b. ***Treat customer and territorial sales restrictions in the same way (Article 5(e) to (g) R&D BER).*** We suggest amending the R&D BER so that customer and territorial sales restrictions are treated in the same way, as is the case under Article 4 TT BER.
 - c. ***Distinguish field of use restrictions from customer restrictions (Article 5(e) R&D BER restrictions).*** We would welcome if the revised Horizontal Guidelines could confirm that field of use restrictions do not constitute customer restrictions (compare TT Guidelines, paragraph 180).
 - d. ***Do not treat all passive sales restrictions as hardcore (Article 5(f) R&D BER).*** All territorial passive sales restrictions are currently treated as hardcore restrictions under Article 5(f) R&D BER. This is considerably more restrictive than Articles 4(1)(c) and 4(2)(b) TT BER, which allow passive sales restrictions under certain conditions, notably restrictions on passive sales into territories that are reserved for the other party. We suggest aligning the approach of the R&D BER with that of the TT BER.
 - e. ***Do not treat all active sales restrictions as hardcore after seven years (Article 5(e) and (g) R&D BER).*** Under Article 5(e) and (g) R&D BER, it constitutes a hardcore restriction if the parties agree on a prohibition of active sales for longer than seven years from the time when the contract products were first put on the market within the common market. This applies even if the parties are not competitors and even if their market shares are sufficiently low so that the R&D BER continues to apply (absent the hardcore violation). This is considerably more restrictive than the approach under the TT BER, which treats active sales restrictions between non-competitors never as hardcore, and between competitors as hardcore only under limited circumstances. We suggest aligning the approach in the R&D BER with that of the TT BER.

4. Amendment to Article 5(h) R&D BER

Article 5(h) R&D BER qualifies as a hardcore restriction “the requirement not to grant licenses” to the R&D results to third parties in situations “where the exploitation by at least one of the parties of the results of the joint research and development is not provided for or does not take place.” While we acknowledge that it constitutes a legitimate policy goal to make sure that the results of joint R&D are effectively used and exploited, we invite the Commission to rethink the necessity for Article 5(h) R&D BER in its present form. The access requirements of Article 3(2) and (3) R&D BER already ensure that the R&D BER cannot apply if the parties’ agreement does not allow either joint or individual exploitation of the R&D results, and Article 7(c) R&D BER foresees the possibility to withdraw the benefits of the R&D BER if the parties do not exploit the R&D results without any objectively valid reason. Moreover, the practical handling of Article 5(h) R&D BER is sometimes complex. Accordingly, we would welcome a simplification or potentially the deletion of Article 5(h) R&D BER.

5. Introduction of a safe harbor that identifies the number of independent research poles that is sufficient to exclude a restriction of competition in innovation

Under paragraph 51 of the Horizontal Guidelines, an R&D agreement does not raise competitive concerns in innovation if there are “a sufficient number” of R&D poles left in addition to the parties. It would be of practical benefit to introduce a safe harbor that identifies the number of independent R&D poles that are sufficient in this respect, without suggesting that the existence of a smaller number of competing R&D poles might typically raise concerns.

6. Clarification that an individual exemption under Article 81(3) EC is not excluded for dominant companies

The Horizontal Guidelines should be aligned with the Article 81(3) Guidelines and the Guidance on the Commission's enforcement priorities in applying Article 82 EC by clarifying that an individual exemption is not excluded under the fourth requirement of Article 81(3) EC (no elimination of competition) simply because one of the companies holds a dominant position.

Production Agreements

7. Clarification of the circumstances under which a detailed individual assessment of an agreement is not required

The Horizontal Guidelines' section on production agreements explains in paragraphs 86 to 89 which types of agreements are not normally caught by Article 81(1) EC. We would welcome the following clarifications in this respect.

- a. ***Revise language to clarify that no concerns arise if the parties are unlikely to carry out a production project individually.*** The Horizontal Guidelines should more firmly endorse the concept that cooperation in production does not restrict competition if the parties are unlikely individually to carry out the production in question. The current language of the Horizontal Guidelines is overly restrictive in this respect. Paragraph 24 second sub-paragraph of the Horizontal Guidelines requires that the parties “cannot” independently carry out the project or activity. Paragraph 87 of the Horizontal Guidelines refers to situations (albeit with regard to closely related markets) where the cooperation is the “only commercially justifiable possible way” to enter a market, launch a new product or carry out a specific project. The Horizontal Guidelines should adopt the standard described in paragraph 18(1) of the Article 81(3) Guidelines, which excludes a competitive relationship between the parties already “if, due to the financial risks involved and the technical capabilities of the parties *it is unlikely* on the basis of objective factors that each party would be able to carry out on its own the activities covered by the agreement” (emphasis added).

- b. *Clarify what constitutes a sufficiently low degree of cost commonality that allows the conclusion that concerns do not arise.* Under paragraph 88 of the Horizontal Guidelines, restrictive effects on competition are highly unlikely to arise from a production agreement if the parties have only “a small proportion of their total costs in common” or, in other words, if the agreement leads to “a low degree of commonality of total costs”. It would be of practical benefit if the Commission could provide further guidance on when it considers total cost commonality to be sufficiently low in this respect, without suggesting that a higher degree of cost commonality would be indicative of a restriction of competition.
 - c. *Differentiate between cost commonality and one-way cost transparency.* Under paragraph 88 of the Horizontal Guidelines, it is currently not clear how the Commission would assess situations of one-way cost transparency. One-way cost transparency arises in one-way supply agreements between competitors, for example when Competitor A supplies products to Competitor B and thereby knows Competitor B’s input costs for these products, without Competitor B knowing Competitor A’s input costs. This situation does not create a “commonality” of cost in a narrow sense of the word, because Competitor A and Competitor B have no costs in common. Nevertheless, the third sentence of paragraph 88 of the Horizontal Guidelines suggests that situations of one-way cost transparency might be assessed in the same way as situations of cost commonality. We believe that such an approach is misguided because one-way cost transparency creates a significantly lower risk of (tacit) coordination. This should be made clear in the revised Horizontal Guidelines.
- 8. Alignment of the Horizontal Guidelines’ section on the assessment of production agreements that may fall under Article 81(1) EC with the more effects based approach of the Article 81(3) Guidelines and the Horizontal Merger Guidelines**

The framework for the assessment of production agreements that do not clearly fall either inside or outside Article 81(1) EC needs a thorough revision to reflect a more balanced economic and effects based approach - such as is the case, for example, in the Horizontal Merger Guidelines’ section on coordinated effects. To point to only two examples in this respect, we would submit that the analysis in Examples 1 and 2 of the Horizontal Guidelines (paragraphs 107 and 108) is truncated to such an extent that it strongly misrepresents what would be a proper analysis under Article 81(1) EC. The analysis for Example 1 suggests that a restriction of competition arises simply because “coordination would give [the parties] considerable market power”. The analysis lacks reference to the need to establish the likelihood of the parties reaching and being able to sustain such coordination. The analysis for Example 2 suggests that a production agreement between Competitors A and B automatically creates harmful links also between Competitors A and E simply because B already has a separate production agreement with E. Again, a full analysis would have to assess how exactly the fact that B has separate agreements with A and E can contribute to a restriction of competition between A and E. Generally, network effects (paragraph 97) need more explanation in the Horizontal Guidelines.

9. Clarification of the definition of “joint production agreement” (Article 1(1)(c) Specialisation BER)

The Commission should clarify when an agreement constitutes a “joint production agreement” in the sense of Article 1(1)(c) Specialisation BER. At present, it is not clear whether an agreement can only be qualified as joint production agreement if the parties completely abandon the individual production of the products in question, or whether joint production also arises where the parties agree to cooperate with regard to a certain part of their production only, for example, with regard to a new production plant, leaving their existing plants for the same product outside the cooperation. If the former approach is adopted, agreements that only partially integrate the parties’ production for a specific product cannot benefit from the Specialisation BER. We would question whether there is a convincing policy reason to exclude such agreements from the block exemption, because they normally lead to efficiencies and their negative effects on competition are more limited than in the case of complete production integration, given that partial integration of production only leads to partial commonality of costs.

10. Increase of the Specialisation BER’s market share threshold to 25%

We would invite the Commission to consider increasing the market share threshold for the application of the Specialisation BER from 20% to 25%, which is the threshold applicable to competitor agreements in the R&D BER.

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