

**RESPONSE TO CONSULTATION ON HORIZONTAL CO-OPERATION  
GUIDELINES AND RELATED BLOCK EXEMPTIONS**

**1. INTRODUCTION**

- 1.1 Baker & McKenzie is grateful for the opportunity to provide views on the R&D and specialisation block exemptions and complementary horizontal co-operation guidelines ("Guidelines").
- 1.2 In our view, the Commission has greatly improved the Guidelines by setting out a similar analytical framework to be followed for each area and by including a number of useful worked examples. The new section on information exchange (plus coverage of this topic in the context of other forms of collaboration) is particularly useful for businesses and their advisers.
- 1.3 We focus our comments on the areas where we believe further improvements may be made and where clarity is still lacking. It is essential to provide these clarifications in the light of the direct application of Article 101(3) which inevitably means that national authorities/judges will rely heavily on the Commission's Guidelines. Clarity is key in order to ensure the consistent application of EU competition law throughout the EU.

**2. BASIC PRINCIPLES**

*Harmonisation of market share thresholds*

- 2.1 The market share thresholds in the Guidelines and block exemptions should be set uniformly at 25 per cent. There is no explanation, nor does there appear to be any economic justification for the use of different thresholds in respect of different horizontal agreements. To the extent that market shares are used as a proxy for market power, market power is assumed to derive from the parties' combined market position, not the category of agreement.
- 2.2 Although market shares cannot on their own be conclusive of market power, there is a strong consensus among economists and regulators that market power is extremely unlikely to arise with market shares below 25 per cent. Indeed the Commission's horizontal merger guidelines themselves create a safe harbour for mergers giving rise to a market share less than 25 per cent.

*Notion of potential competitor*

- 2.3 According to paragraph 10 of the Guidelines, a company is treated as a potential competitor of another company if, absent the agreement, in case of a small but permanent increase in relative prices it is likely that this first company "within a short period of time" would undertake the necessary additional investments to enter the relevant market. This is consistent with Article 1 (1)(c) of the block exemption for vertical agreements.
- 2.4 However, it is of concern to us that the specialisation and R&D block exemptions each introduce<sup>1</sup> a different notion – defining potential competitor as a company that could enter the relevant market within three years. In our view this is substantially different from a "short

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<sup>1</sup> Article 1, paragraph 12 of the specialisation block exemption and Article 1, paragraph 16 of the R&D block exemption.

period of time" - as evidenced by paragraph 27 of the verticals guidelines which explain that a "short period of time" is normally not longer than one year.

- 2.5 The need to consider likely market events over a three year period will, in our view, descend to conjecture, resulting in considerable uncertainty as to whether the block exemptions are available.
- 2.6 We consider that the Commission's approach should be consistent and that the approach set out in paragraph 10 of the Guidelines (and indeed the Verticals block exemption and related guidelines) should be reflected in the specialisation and R&D block exemptions.

*Agreements between non-competitors*

- 2.7 On a related point, we also query what is meant by the last sentence of paragraph 1 which states that the Guidelines also apply to "agreements between non-competitors". It is not clear to us why this notion is needed, nor the situations in which the Guidelines would assist. Indeed, we query whether arrangements between non-competitors are likely to be restrictive of competition at all.

*Vertical agreements between non-competitors*

- 2.8 Paragraph 12 states that "vertical agreements between competitors have to be assessed according to the principles described in these guidelines". The guidelines should indicate precisely which principles the Commission has in mind.

*Counterfactual*

- 2.9 Paragraph 28 explains that cooperation between competitors that would not be able to independently carry out the project themselves will not normally give rise to restrictive effects. Further guidance is also required as to how parties may reasonably assess whether they are unable to independently carry out any activity, for example in view of access to finance or the requirement or ability to do individual research. We note that paragraph 2 of the Guidelines acknowledges that horizontal co-operation can lead to substantial benefits including by enabling the parties to launch innovation faster. Paragraph 28 should also indicate whether the ability to launch a product faster should mean that the cooperation falls outside of Article 101.

*Application of Article 101 to joint ventures and their parent companies- paragraph 11*

- 2.10 We appreciate the Commission's attempts to adopt a legally coherent position in relation to joint ventures (under the single economic entity theory), but point out that this is a complex area with different lines of case law - e.g. relating to attribution of liability and 'control' within the meaning of the ECMR. This creates a complex matrix of factors which cannot be dealt with in a short paragraph. We therefore invite the Commission to provide further guidance. To assist, we set out below a series of scenarios - each of which could conceivably be seen as being outside Article 101. We should be grateful for clarification in the Guidelines.

1. A and B set up a joint venture, AB, with which they do not compete. AB appoints A as its distributor and imposes RPM onto A.

2. A and B set up a joint venture, AB. A and B are competitors but only A remains in the same market as AB:

- (a) AB sends pricing information up to each of A and B
- (b) A sends down pricing information to AB
- (c) AB and A coordinate joint sales

3. A and B set up a joint venture, JV1. B is in another joint venture with C, called JV2. On the basis that the two JVs are part of the same economic entity, please confirm that any agreement between JV1 and JV2 would be outside the scope of Article 101.

2.11 We also assume that the principles set out in paragraph 11 would apply regardless of the nature of the joint venture - i.e. whether full function/joint production etc but this should be confirmed in the Guidelines.

### **3. R&D AGREEMENTS**

#### *Upfront disclosure of IPRs*

3.1 The draft R&D block exemption inserts a new condition for the application of the block exemption. The parties are required – prior to starting joint research - to disclose any existing and pending IPRs which may affect the exploitation of the results of the R&D by the other parties. If they do not do this, their R&D agreement will not benefit from the block exemption.

3.2 We understand that the Commission is keen to prevent one party ambushing joint-exploitation by subsequently disclosing IP rights of which the other party/parties were previously unaware.

3.3 However, this change is unhelpful and should be removed as it introduces unnecessary costs and uncertainty into the applicability of the block exemption. This is likely to place a significant administrative burden on firms with large IP portfolios (particularly where unregistered IP, e.g. copyright, is concerned). It is also not always clear what IP will be relevant to exploitation at the outset of the R&D. The disclosure of all IPRs which may possibly prove relevant will impose a significant – and unwarranted - burden on large portfolio holders.

3.4 A more proportionate approach - which would avoid imposing an ex ante burden on the parties - would be to include an obligation for the parties to license any necessary IP for the R&D project/agreed field.

#### *Equal access to results*

3.5 Under the current law, both parties must have access to the results of the R&D for exploitation/further research. However, the draft R&D block exemption inserts an additional requirement that the access be "equal".

3.6 It is not entirely clear what "equal" means in this context and the Guidelines should clarify this. For example, if the parties have contributed to the R&D to different extents, then the access rights should be able to reflect this.

### **4. INFORMATION EXCHANGE**

4.1 The Guidelines are a welcome attempt to codify the often conflicting, and highly fact specific, case law and decisional practice.

4.2 In particular, the Guidelines draw helpfully a distinction between exchanges of information on future conduct regarding prices and quantities (which will generally be regarded as restrictive "by object") and other forms of information exchange which must be analysed on a case by case basis. Indeed, we note that the list of "parameters of competition" in paragraph 69 does not include costs (which are regarded as having lesser importance at paragraph 81), unlike paragraph 50 of the Maritime Guidelines. We believe that this reflects a better economic approach.

4.3 In order to demonstrate that this approach is not inconsistent with *T-Mobile Netherlands* (referred to in paragraph 68 in which an exchange of cost information was treated as

restrictive ‘by object’) the Guidelines should highlight out the particular circumstances of that case (i.e. why the information exchanged in that case should not be considered to be simple cost data).

- 4.4 At various points, including at paragraph 61 of the Guidelines, the claim is made that transparency tends to raise the risk of a collusive outcome. However, that problem arises only if the transparency is one-sided or asymmetrical between sellers and buyers/consumers. If the transparency extends market-wide and enables buyers and consumers (and clients in a tendering context) to be well informed about the competitive situation and to make more rational choices, that surely is better for competition (as implicitly recognised in paragraph 84). The problem identified at paragraph 63, for instance, is that there is a cartel (which is more easy to monitor through the price information exchanges), not one of transparency. The same applies to paragraph 64.
- 4.5 In paragraph 86 and in Example 5 the point is made that "data can be considered historic if it is several times older than the average length of contracts". In most cases parties can be fairly confident that data of a significantly younger age than that is no longer competitively sensitive. Of course, each case needs to be examined on its facts, but the example is unhelpful because it might lead a national court unfamiliar with EU competition law to believe that the law is stricter than it actually is. We suggest the last sentence of para 86 is deleted, along with Example 5.
- 4.6 The Commission should therefore strive to provide some more borderline examples on the subject of what constitutes non-historic data. The Commission should also make clearer whether it still accepts the “one year rule” noted in footnote 57 of the draft Guidelines.
- 4.7 Indeed, we invite the Commission to develop more borderline cases than currently contained in the information exchange section and to cover issues that will make the Guidelines more helpful in day-to day business, such as legitimate benchmarking, addressing information asymmetries and reducing search costs - as well as the sorts of efficiencies that justify information exchange between competitors.
- 4.8 The Guidelines should also indicate when the limited market coverage of an information exchange would preclude the application of Article 101 - e.g. where, say, X players merely account for X per cent of the market.

## **5. PRODUCTION AGREEMENTS**

- 5.1 We regularly advise companies on the application of the specialisation block exemption and guidelines in relation to joint production. Our main issue relates to the wording of the block exemption in so far as it covers the selling activities of a production joint venture.
- 5.2 Although the specialisation block exemption and the related guidance has been improved significantly, there remain a number of areas where further clarification is needed.
- 5.3 Article 1, paragraph 15 defines when distribution is carried out “jointly”. However, it is still not clear what is meant by “distribution”. In particular, it is still not clear whether the block exemption would cover price setting where the production joint venture entrusted the selling to its parent companies or to only one of them. There are numerous ways in which the product of the joint venture can be distributed - e.g. by "offtake" agreement; through distribution by one of the parents (e.g. with revenue sharing); or simply the joint venture selling the products but with varying levels of assistance from one of its parent companies. There is no economic rationale for treating such method differently to joint selling by the joint venture entity itself. The definition in Article 1, paragraph 15 should be amended to clarify that the specialisation block exemption will continue to apply when such alternative methods are employed.

- 5.4 Article 1, paragraph 16 should clarify that distribution also includes the setting of prices – i.e., it goes beyond logistics.
- 5.5 The reference in Article 2, paragraph 3(b) to “products which are the object of the specialisation agreement” continues to be ambiguous. It is unclear whether the protection of the block exemption would be lost if the parents were to sell products which competed with the products (but were not identical to the products being produced by the joint venture).
- 5.6 Paragraphs 161 and 163 of the Guidelines explain that setting sales prices may not restrict competition provided the price-fixing by the joint venture is necessary for “integrating” the production and commercialisation functions of the cooperation agreement. However, we query what is meant by integration (which we assume can arise without a joint venture being ‘full function’). For example, does this require an actual combination of facilities etc such that there are identifiable efficiencies or does this merely mean something other than a negotiation over selling terms by distinct marketing arms of the parent companies? The Guidelines should also clarify why the relevant degree of integration is thought necessary by the Commission in order for it to be legitimate for the joint venture to set sales prices. In other words, the underlying economic theory needs to be explained in the Guidelines.
- 5.7 Significantly, we note that integration is not a pre-requisite to the setting of sales prices when the joint exploitation of R&D includes the joint distribution of the contract products (see Article 5(c) of the draft R&D block exemption). The Guidelines should therefore explain why a different position is justified in relation to joint production.

#### *Additional market share requirement re intermediate products*

- 5.8 Recital 10 of the block exemption introduces a new market share requirement where the joint production concerns an intermediate product, stating that “... in case the products which are the subject matter of a specialisation agreement are intermediary products which one or more of the parties fully or partly use captively for the production of downstream products which are sold by these parties on the merchant market, in addition, the parties' share on the relevant merchant market for these downstream products should not exceed 20% either in order to avoid the risk of input foreclosure.”
- 5.9 The Guidelines introduce this extra requirement without explaining the economic rationale. We assume that the extra criterion (looking at the parties' combined market share on the downstream market) has been added on the basis that the smaller the downstream share, the less likely input foreclosure is to be profitable because the less likely a higher input price for third parties would cause diversion from those third parties to the downstream operations of the integrated firms. However the theory of harm needs to be explained fully, including why input foreclosure may result despite the fact that 80% of upstream supply will be unaffected by the specialisation agreement.

## **6. PURCHASING AGREEMENTS**

- 6.1 The Guidelines do not recognise the very often efficiency-enhancing and pro-competitive benefits of buying groups when there is downstream competition. By way of contrast, we refer to the recent OFT short-form opinion on joint purchasing<sup>2</sup> which notes that joint purchasing is generally acknowledged to generate the following benefits where there is downstream competition:
- lower consumer prices through negotiating better terms of supply or creating efficiencies that are passed on to final consumers
  - upstream pro-competitive effects, as the increased ability of purchasers to switch supplier - or sponsor a new entrant - can intensify rivalry among suppliers

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<sup>2</sup> <http://www.offt.gov.uk/OFTwork/competition-act-and-cartels/short-form-opinions/>

- downstream pro-competitive effects, as smaller businesses joining a purchasing group might compete more effectively with their rivals, and
- innovation or investment - since cooperation between purchasers can solve purchaser coordination problems which result in underinvestment or reduced innovation; or suppliers' incentives to innovate could increase as they seek to improve their bargaining position when faced with a purchasing group.

6.2 The Guidelines should also acknowledge these benefits. The current drafting risks giving the mistaken impression that joint purchasing is likely to give rise to Article 101 issues (as it involves cooperation between competitors), meaning that businesses and their advisers should concentrate on whether there are offsetting efficiencies under Article 101(3).

6.3 It is also our view that the 'safe harbour' market share thresholds of 15 per cent in the upstream and downstream markets are unnecessarily low. The OFT opinion sensibly draws an analogy between the economic effects of a merger and the economic effects of a purchasing agreement (noting that mergers and purchasing groups require an assessment of unilateral and coordinated effects). Although the OFT acknowledges that the analogy is imperfect - because, on the one hand, a purchasing group involves less coordination than a full blown merger and, on the other hand, involves less benefits than a merger (due to a lower likelihood of efficiencies), the OFT logically concludes that "...the first point implies that if no anti-competitive effects would arise from a full merger (even absent any off-setting benefits), it is unlikely that they would arise under a purchasing agreement".

6.4 It follows that there is a 'disconnect' between the 25% safe harbour for EU merger control (in paragraph 18 of the EU horizontal merger guidelines and recital 32 of the ECMR) and the lesser safe harbour thresholds for joint purchasing contained in the horizontal cooperation guidelines.

6.5 The Commission should therefore increase the safe harbour employed for the share on the downstream market to 25% on the basis that the buying group agreement can be no worse for competition than a merger of its members. (Indeed, typically a buyer group will be far less effective than a merger at harming competition due to the difficulties of coordinating the behaviour of each member. )

6.6 Finally, the Guidelines fail to make it clear that issues of commonality of cost etc are subsidiary to the issue of market power - i.e. if the parties do not have a combined share of 25 per cent in the downstream market - such that the benefits of the joint purchasing can be assumed to be passed on to consumers - then a high degree of costs in common should not affect this conclusion.

## 7. STANDARDISATION AGREEMENTS

7.1 In broad terms, we believe the section on standardisation improves significantly on the corresponding section in the current Guidelines by setting out a useful methodology to be followed. We make the following comments however.

### *Nature of standard-setting*

7.2 The Guidelines should contain greater commentary on when a narrower group of industry participants will lead to efficiencies (the possibility of which is expressly acknowledged in paragraph 307 of the Guidelines) and how the parties would be expected to demonstrate this (in so far as the Commission believes this to be necessary under Art 101(3)). Absent this clarification, the Commission's approach towards standardisation in the light of 'agreements between independent companies' (to use the wording in footnote 87) remains unnecessarily unclear. The Guidelines should also clarify what types of procedures the Commission would regard as a "recognised procedure[s] for the collective representation of interests" (paragraph 307).

### ***SSOs and Article 102***

- 7.3 The Guidelines are obviously intended to preclude the abuse of dominance (e.g. through excessive pricing once a standard has been set) as well as counsel on how to comply with Article 101.
- 7.4 In the absence of case law ‘collectivising’ responsibility for a subsequent unilateral abuse of market power, the Commission should explain why the rules of an SSO which, for example, do not mandate ex ante disclosure of IPRs, may fall within Article 101. The Guidelines (or FAQs) should also explain why Article 102 is not sufficient to address the issue. In the absence of clarification, it seems to us, that the safe harbour described in paragraphs 278 and 279 is drawn too narrowly.

### ***Upfront disclosure of IPRs***

- 7.5 The requirement put forward in paragraph 281 that there should be a good faith disclosure by companies participating in standards setting of essential patent rights gives rise to a number of practical difficulties, e.g. patent applications may remain confidential for a period of time during their filing and IPRs may include trade secrets which do not form part of a publicly available standard.
- 7.6 The Guidelines should be restricted to requiring a good faith disclosure of IPR which can be determined from publicly available filings. In particular, it should expressly be stated that a company need not go as far as to carry out patent searches for all potentially essential IPR. It could also perhaps be specified that a statement by a company representative with expert knowledge in the relevant field on whether the company has IPR or pending IPR would be sufficient.
- 7.7 This will cover patents, patent applications which have reached the disclosure stage and design rights. In any event the obligation to license on FRAND principles will also serve to address the same concern (provided it is expressed to apply to undisclosed IPRs).
- 7.8 On a related point, we note that example 2 on page 77 of the Guidelines indicates that SSO rules which fail to mandate upfront disclosure of IPRs are “likely” to give rise to restrictive effects on competition. This example is difficult to reconcile with paragraph 276 of the Guidelines which states that it is not necessary for standard-setting agreements to fulfil the conditions of the safe harbour - i.e. an individual assessment is always required. In contrast to paragraph 276, example 2 effectively shows that there will be a presumption that Article 101 is infringed when the safe-harbour is not met. Instead, the example should state that restrictive effects are possible and then explain why (providing the clarification requested above).

### ***FRAND***

- 7.9 The disadvantages of attempting to address Article 102 violations via Article 101 guidelines is illustrated by the difficulties of establishing when a licence fee is excessive. In our view, the attempt to be pragmatic over-simplifies the situation:
- the reference to *United Brands* overlooks the fact that it may also be appropriate to approach the issue of excessive pricing/the notion of “economic value” by examining the demand-side of the market – i.e. by taking into consideration the revenue-earning potential of the product for customers. This should be acknowledged in the Guidelines.
  - the suggestion that, in order to test for fair/reasonable prices, the prices should be compared before and after the standard-setting may also be too simplistic. Companies may well lack the information (pre standard-setting) to know how to value their IPR (e.g. because they may not be aware of all the commercial applications

of the technology). Equally, companies may wish to drive demand prior to the standard-setting process by pricing at lower levels. Companies may find that they are penalised for this normal commercial behaviour if regulators rely overly on the ‘comparator’ approach.

- The Commission also appears to be advocating a counterfactual which is the price charged “a competitive environment” before the standard-setting. We assume that the Commission is not proposing to attempt to construct a price based on a particular competitive hypothetical model before the standard setting process. The aim of the comparator approach should be to flush out any market power conferred by the standard setting process and not to impugn any pre-existing market power. The competition policy objective should not be to force low or “reasonable” licensing fees, but rather to prevent IP owners from receiving more by using an ambush strategy than they would have received if they had not used that strategy.

7.10 Overall, the Guidelines should recognise that its approach is not without complication.

## **8. STANDARD TERMS**

8.1 The Guidelines state that agreements to use standard terms will fall within Article 101 if they are capable of having an effect on the price of the product. This will be the case where the standard terms recommend adoption of specific prices, rates, discount policies, excesses or retentions. Beyond these price sensitive terms, the Guidelines provide that standard terms will generally lead to a restriction of competition in industries, such as insurance, where the standard terms define the nature of the product. The draft goes on to say that there will generally be countervailing benefits from standardisation which merit exemption for the practice under Article 101(3) TFEU.

8.2 This approach – of presuming anticompetitive effect, albeit one that may benefit from exemption - is unhelpful in the context of the financial services industry, since it places the burden of proof on those engaged in establishing joint wordings to prove that the arrangement has beneficial effects. This can be a substantial compliance burden for companies and results in highly damaging legal uncertainty to a practice which underpins much of the industry.

8.3 The contrary view would be that where conducting business would be impossible (or least, very difficult) without extensive standard terms – for example, an efficient reinsurance market depends to a large extent on uniformity – standard terms should not be condemned under Article 101(1) in the first place, even if potentially redeemable under Article 101(3). Equally, the suggestion that standard wordings cause a lack of product diversity in insurance markets ignores the fact that they are often only one benchmark for sophisticated buyers (and their expert brokers) and sellers of insurance. If there is no obligation to use the standard terms, then there is no reason to think that alternative negotiated terms are impossible. These points should be acknowledged in the Guidelines to avoid an unnecessary chilling effect on normal commercial conduct.

**BAKER & MCKENZIE**

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