EC Competition Policy Overhaul for R&D Agreements – Finally Freeing Joint Innovation from its EU Antitrust Straitjacket?

Simon Topping
Bird & Bird, Brussels

The author can be contacted by e-mail at simon.topping@twobirds.com

A new approach towards the antitrust analysis of innovation through joint research and development agreements has just been adopted by the European Commission, in the form of a new Block Exemption Regulation and guidelines on horizontal collaboration agreements. Simon Topping analyses the approach that has been taken, and looks at whether a step forward has been made in the EC antitrust analysis of joint innovation.

A significant factor in the analysis of the attitude of the EC antitrust rules towards innovation is the approach taken towards joint research and development agreements. The current European Commission approach towards such agreements has only very recently been revealed through the adoption of a new block exemption regulation for research and development agreements,[1] replacing the existing block exemption for those agreements,[2] and through the adoption of guidelines on horizontal agreements,[3] indicating, amongst other things, how the Commission analyses research and development agreements under Article 81 (1) and (3) of the EC Treaty.

The new block exemption and guidelines, together with a block exemption for 'specialization' agreements, form the new EC antitrust policy on 'horizontal' agreements, follow on from the reappraisal of vertical agreements in 1999.

The Commission's intention was to adopt streamlined new versions of (a) the research and development block exemption and (b) the specialization block exemption which, in line with a general policy move, have less of a straitjacket approach to the clauses which can be included in an agreement (see below-white list).

The Guidelines are intended to indicate the type of analysis which will be applied to various forms of horizontal cooperation agreements, including those relating to research and development, production, purchasing, commercialization, standardization and environmental schemes. They in turn have to be seen against the background of a general move towards a more economic analysis in the application of EC competition law, and the Commission's proposals[4] for modernizing the application of EC competition law. Under that modernization, there would no longer be a scheme of prior notification to the EC Commission for an exemption, but national courts and competition authorities would apply Article 81(1) and (3) as a unitary provision comprising a rule establishing the principle of prohibition unless certain conditions are met. The Commission has recognized that clear guidelines on how different types of agreement, such as horizontal agreements, are to be assessed from a competition perspective are a vital part of such a new approach.

Analysis of R&D agreements under the Guidelines

The approach of EC competition law toward joint research and development agreements in the past has been that when a stage of industrial application is reached, such agreements may have the effect of reducing competition between actual or potential competitors, and reducing technological differentiation, and may as a result fall within Article 81.

The Commission considered that for parties which were actual or potential competitors, agreements for joint research and development up to but not including the stage of industrial application did not affect competition, unless there was a restriction of the parties' ability to carry out independent R & D or a restriction on the use of results of R & D by either party. There could also be a restriction where agreements were entered into regarding exploitation of the results of R & D, such as obligations not to manufacture products competing with those developed jointly, or sharing of future production, or excluding any party from exploiting the results or granting a license.

The experience of the Commission showed, however, that it was often very difficult to separate the research from the industrial application, and led the Commission to conclude in a number of cases that the formation of an R & D joint venture could restrict competition between the parents and the joint venture, even where there was no express provision in the agreement to this effect.

The Commission also considered that while agreements between non-competitors rarely caused problems, there could nevertheless be an issue where there was a foreclosure effect whereby third parties were restricted in their access to the necessary technology to compete on the relevant R & D and downstream markets.

Although the Commission made a number of statements suggesting that the application of Article 81 was exceptional, there was a broad grey area, due to the fact that where the results were useful, joint R & D in the majority of cases could or did lead on to joint exploitation of the results, and more significantly due to the sometimes extensive interpretation by the EC Commission of the notion of a potential competitor. This effectively left open the possibility in many cases of a finding that one party was a potential competitor of another where it had the technical and financial possibility of engaging in the research and development on its own, whether or not it was commercially feasible for it to do so. As a result, practitioners were often left with the very difficult task of trying to ensure that a research and development agreement conformed to the terms of the research and development block exemption, or considering whether the agreement would be likely to obtain an individual exemption.

It is against that background that the new Guidelines and block exemption need to be assessed.

Situations where Article 81(1) will not apply

The Guidelines point out that most research and development agreements do not fall under Article 81(1),[5] and suggest a range of situations in which research and development agreements will not be considered anti-competitive.

(1) Where the level of research is at a theoretical stage, far removed from the marketing of possible results,[6] the Article will not apply.

(2) Cooperation between non-competitors does not generally restrict competition.[7] Where the parties are not able to carry out the research separately, any cooperation between them does not restrict competition. The Commission suggests that the issue of potential competition has to be assessed on a realistic basis, and that the decisive question is whether each party independently has the necessary means in terms of assets, know-how and other resources.

(3) Where previously captive research and development is outsourced, under an agreement, to a specialist company, academic body or research institute which is not active in the exploitation of results,[8] the agreement usually imposes an obligation on the specialist entity to transfer the relevant know-how acquired and/or an obligation to supply the results exclusively to the company which is contracting for the work to be done.

(4) Where cooperation relates only to research, and does not include joint exploitation of the results[9] by means of licensing, production or marketing, Article 81 will not be relevant unless effective competition with respect to innovation is significantly reduced.

It is helpful for the Commission to indicate that most research and development agreements do not fall under competition law, and to give examples, but there still seems to be a considerable amount of uncertainty as to whether any of the particular examples apply. Whether or not research is theoretical or not may be a matter for some debate in many cases. Further, in assessing whether parties are potential competitors, although it is suggested that the assessment should be realistic, the question of whether or not he parties have the necessary means including assets, know-how and other resources to carry out the research independently is a test which does not really advance the understanding of this issue. Further, even the 'research body' exception might leave some room for doubt where such bodies were engaged in licensing to third parties, which will very often be the case, since licensing is clearly a form of exploitation. In addition, the exception for cooperation which relates only to research may also not be as big a let-out as it seems to be-even where an initial agreement only relates to research and development, if that research is successful, the participants will often find that they want to agree on how to exploit the results, for which purposes Article 81 may apply. The scenario where there is no cooperation in exploitation of the results assumes that each party is fully able to independently exploit the results in any way it wishes, including by licensing. It may

therefore not apply where there are blocking rights preventing the independent exploitation of rights.

Relevant markets

Where research and development agreements cannot be assessed from the outset as clearly no-restrictive, they must, according to the Guidelines, be analyzed in their economic context. This initially requires an assessment of which markets are relevant for such an evaluation. According to the Guidelines, three types of market may be relevant to a competition analysis of the effects of a research and development agreement: existing product markets, markets for competing technology, and future, and the impact of the agreement on innovation:

(1) *Existing product markets* are relevant markets where the cooperation concerns the improvement of existing products.[10] They may also be relevant in the case of new products replacing existing ones, where joint research and development efforts are likely to lead to a coordination of the parties' behaviour as suppliers of existing products.

(2) *Technology markets* may also be relevant.[11] These consist of intellectual property that is licensed and its close substitutes, ie other technologies which customers could use as a substitute.

(3) Lastly, *competition in innovation*[12] may also be affected where cooperation concerns the development of new products or technology which may replace existing products or technology, or which are developed for a new intended use and will therefore not replace existing products but create a completely new demand. In some sectors, such as the pharmaceutical industry, the process of innovation is structured in such a way that it is possible at an early stage to identify research and development 'poles'-efforts directed towards a certain new product or technology and the substitutes for that research and development. However, in other sectors, where the nature of innovation is not clearly structured to allow the identification of research 'poles', the Commission will not, apart from exceptional circumstances, look at the effect on innovation markets.

The possible analysis of the effect on competition in innovation, and the comparison of poles of R & D is not entirely new. It was mentioned in the Commission's 1993 Notice on Cooperative Joint Ventures, and has been developed in the Commission's practice under the EC Merger Regulation in the pharmaceutical sector. It also follows a similar identification of the relevance of innovation in the US Antitrust Guidelines for collaborations among competitiors.[13] On the other hand, it has been questioned whether innovation could be considered to be a market in itself, or simply a factor to be considered in assessing the effect on the product market, as merely one of the parameters of competition. To be fair, the Commission does not actually suggest in the Guidelines that there is an innovation market as such, although it does talk about the effect on competition of innovation being a relevant factor to be assessed. Comparison of poles of

innovation can only be a very inexact process because of the nature of research and development, and such an analysis may be limited to a very few sectors, or possibly only the pharmaceutical sector itself. Overall, it seems clear that the analysis of effects on innovation may be an arbitrary process, which simply depends on whether the relevant poles of research can be sufficiently identified. Consequently, the introduction of innovation analysis is unwelcome.

Possible anti-competitive effects

The Guidelines point out that research and development cooperation can restrict innovation, cause coordination of the parties' behaviour in existing technology or product markets, or cause foreclosure problems at the stage of the exploitation of possible results. However, these effects are only likely to emerge when the parties have significant market power on existing markets and/or competition with respect to innovation is eliminated. A foreclosure problem may only arise in the context of cooperation involving at least one dominant player with respect to a key technology and the exclusive exploitation of results. While the analysis given in the relevant sections of the Guidelines on this issue is useful, it will not resolve the issue in many cases, and practitioners may still often need to try to conform agreements to the new block exemption. So will their task be easier than it has been under the old block exemption?

New block exemption on R & D

The new Block Exemption applies to agreements entered into for the purpose of[14]:

(1) joint research and development of products or processes and joint exploitation of the results of that research and development;

(2) joint exploitation of the results of research and development of products or processes jointly carried out pursuant to a prior agreement between the same undertakings; or

(3) joint research and development of products or processes excluding joint exploitation of the results, insofar as such agreements fall within the scope of Article 81(1).

For the purposes of the Block Exemption, exploitation of the results means[15] the production or distribution of the contract products or the application of the contract processes or the assignment or licensing of intellectual property rights or the communication of know-how required for such manufacture or application. Further, research and development or exploitation are deemed to be carried out jointly where[16] the work involved is either:

– carried out by a joint team, organization or undertaking; or

– jointly entrusted to a third party; or

– allocated between the parties according to specialization in research, development, production or distribution.

Conditions

The Block Exemption will only apply on condition that:

- all the parties have access to the results of the work of the joint research and development for the purposes of further research or exploitation, except that research institutes or academic bodies or undertakings which supply research and development as a commercial service without normally being active in the exploitation of results may agree to confine their use of results to the purposes of further reserach[17];

- where the agreement provides only for joint research and development, each party must be free to exploit the results of the joint research and development and any necessary pre-existing know-how necessary for the purposes of such exploitation independently.[18] However, this right to exploit the results may be limited to one or more technical fields of application, where the parties are not competing undertakings at the time the research and development agreement is entered into;

- any joint exploitation must relate to results which are protected by intellectual property rights or constitute know-how which substantially contributes to technical or economic progress and the results must be decisive for the manufacture of the contract products or the application of the contract processes[19];

- any undertakings charged with manufacture by way of specialization in production must be required to fulfil orders for supplies form all the parties, except where the agreement also provides for joint distribution.[20]

One important change in the new block exemption, is that it is no longer necessary to draw up a framework programme prior to engaging in research and development, as it was under the previous block exemption. The Commission considered that this requirement did not make sense economically, as it was not always practical for companies to enter into such agreements prior to undertaking research and development: ‘Further improvement is implied by the fact that the right of each party to jointly exploit the results may be limited to a technical field of application where the parties were not previously competitors’.

Research and development

White list and opposition procedure

By far the most significant change in the new block exemption is the abolition of the previous ‘white list’ and opposition procedure arrangements. The previous block exemption included a list of 20 or so clauses which were exempted, in addition to the basic provisions relating to joint research and development and/or exploitation. An

agreement containing clauses which might be considered restrictive of competition but which were not within the list of provisions mentioned, could not benefit from the automatic exemption. On the other hand, provided that such an agreement was otherwise within the scope of the block exemption, and it did not include any of a number of 'black listed' provisions, it could benefit from an 'opposition procedure' whereby if it was notified and the Commission did not oppose an exemption within a period of six months, it was deemed to benefit from the block exemption. The white list approach was frequently criticized, because businesses that wanted to benefit from the block exemption without making a notification could only include restrictive clauses which were within the permitted white list, or of the same type as those in the white list, but more limited in scope. Other clauses could not be included, even though they may have been acceptable restrictions, in that they would otherwise have been exempted.

The new block exemption, however, does away with the white list clauses, and in so doing allows the parties to continue to benefit form automatic exemption while including any clauses they wish to in their agreement, apart form those on the black list (see below).

Duration of the exemption

The new block exemption period applies for the duration of the research and development programme and, where the results are jointly exploited, for seven years form the time the contract products are first put on the market within the EU.[21] However, where two or more of the parties are competing undertakings, the exemption will only apply if at the time the agreement is entered into, the parties' combined market share of the products does not exceed 25 per cent of the products capable of being improved or replaced buy the contract products.[22]

After the end of the seven-year period of exemption described above, the exemption only continues to apply so long as the combined market share of the participating undertakings does not exceed 25 per cent of the relevant market for the contract products.[23] Even where the level of 25 per cent is exceeded, however, in the latter case the block exemption may continue to apply for a further period of one or two years, depending on how fast the percentage is increasing.[24]

The possibility of continuing to benefit from the exemption for seven years after the research and development phase, rather than five, as applied under the previous regime, is a significant improvement. The new market share thresholds of 25 per cent also compare favourably with the existing block exemption, where a limit of 20 per cent is applied at the end of the five-year period, or 10 per cent if the parties cooperated in the distribution of products exploiting the research. It should be noted that the 25 per cent limit is not a continuous requirement, in that it only applies when the agreement is signed, and then after the initial period of exemption indicated above.

Hard core/blacklisted provisions

The block exemption will not apply to research and development agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object[25]:

(a) the restriction of 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;

(b) a prohibition on challenging, after completion of the research and development, the validity of intellectual property rights which the parties hold in the EU and which are relevant to the research and development or, after the expiry of the research and development agreement, the validity of intellectual property rights which the parties hold in the EU and which protect the results of the research and development, without prejudice to the possibility to provide for termination of the research and development agreement in the event of one of the parties challenging the validity of such intellectual property rights;

(c) the limitation of output or sales;

(d) the fixing of prices when selling the contract product to third parties;

(e) the restriction of the customers that the participating undertakings may serve, after the end of seven years form the time the contract products are first put on the market within the EU;

(f) a prohibition on making passive sales of the contract products in territories reserved for other parties;

(g) a prohibition on putting the contract products on the market or pursuing an active sales policy for them in territories within the EU that are reserved for other parties after the end of seven years form the time the contract products are first put on the market within the EU;

(h) the refusal to grant licenses to third parties to manufacture the contract products or to apply the contract processes 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;

(i) a refusal to meet demand from users or resellers in their respective territories who would market the contract products in other territories within the EU; or

(j) the intention to make it difficult for users or resellers to obtain the contract products form other resellers within the EU, and in particular to exercise intellectual property rights or take measures to prevent users or resellers from obtaining, or from putting

on the market within the EU, products which have been lawfully put on the market within the Community by another party or with its consent.

However, as an exception, the following will not exclude the application of the block exemption under the black list provisions above[26]:

- the setting of production targets where the exploitation of the results includes joint production of the contract products; or

- 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.

These provisions, which are an exception, for example, to the exclusion for limitations on output or sales ((c) above) and price fixing ((d) above), are an improvement on the previous block exemption. Two other changes which are a substantial improvement on the previous block exemption are the fact that for seven years form the time the contract products are first put on the market, it is now possible to have a restriction on the customers that the participating undertakings may serve (under (e) above) and a restriction on actively selling into territories which are reserved for other parties (under (g) above).

Conclusion

The new regime applying to joint research and development agreements is an improvement on what existed previously. The Guidelines on horizontal agreements offer an outline of the analysis to be applied to such agreements, which will be of some assistance to companies and their legal advisers, although they leave considerable scope for interpretation on many points, and unfortunately suggest the need to look at effects on competition in innovation in some circumstances.

The new block exemption for research and development agreements is also more liberal than the previous regime in a number of ways, including the abolition of the straitjacket of the white list clauses, a longer period of exemption after the marketing of the fruits of the contract product, and higher market share thresholds for the discontinuation of the benefits of the block exemption.

Ultimately, however, the impression is of a still overcautious approach to joint research and development agreements, which will leave the practitioner having to look at compliance with the block exemption in too many cases.

---

[1] Commission Regulation (EC) No 2659/2000 of 29 November 2000 on the application of Article 81(3) of the Treaty to categories of research and development agreements (OJ 2000 L 304, 7), hereafter, the ‘Block Exemption’.

[2] Commission Regulation (EEC) No 418/85 on the application of Article 85(3) of the Treaty to categories of research and development agreements (OJ 1985 L 53, 5) as amended by Commission Regulation (EEC) No 151/93 of 23 December 1992.

[3] Commission Notice-Guidelines on the applicability of Article 81 to horizontal cooperation agreements (OJ 2001 C 3,2), hereafter the ‘Guidelines’.

[4] White Paper on Modernization of the Rules Implementing Articles 81 and 82 of the Treaty (OJ C 132 1999, p 1), and Proposal for a Council Regulation on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (COM (2000) 582-27 September 2000).

[5] Guidelines, para 55.

[6] Guidelines, para 55.

[7] Guidelines, para 56.

[8] Guidelines, para 57.

[9] Guidelines, para 58.

[10] Guidelines, para 59.

[11] Guidelines, para 41.

[12] Guidelines, para 50.

[13] Antitrust Guidelines for Collaborations Among Competitiors issued by the Federal Trade Commission and the US Department of Justice, Section 3.32, p 17.

[14] Block Exemption, Article 1(1).

[15] Block Exemption, Article 2(2).

[16] Block Exemption, Article 2(11).

[17] Block Exemption, Article 3(4).

[18] Block Exemption, Article 3(3).

[19] Block Exemption, Article 3(4).

[20] Block Exemption, Article 3(5).

[21] Block Exemption, Article 4(1).

[22] Block Exemption, Article 4(2).

[23] Block Exemption, Article 4(3).

[24] Block Exemption, Article 6(2) to 6(4).

[25] Block Exemption, Article 5(1).

[26] Block Exemption, Article 5(2).