EU Regulation

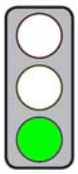
BER FOR RESEARCH AND DEVELOPMENT AGREEMENTS

Status: 30 August 2010

MAIN ISSUES

Objective of the Regulation: Agreements between undertakings operating in the field of research and development (R&D) – which the Commission believes will create pro-competitive effects – are to be deemed in line with competition law and therefore to be exempted from cartel bans.

Parties affected: Undertakings, consumers, competition authorities



Pros: (1) The conditions for exemption and hardcore restrictions protect competition from excessive restrictions.

(2) The market share threshold value of 25% is an appropriate compromise.

Cons: –

CONTENT

Title

Draft [without number] of 4 May 2010 for a Commission **Regulation on the application of Article 101 (3)** of the Treaty on the Functioning of the European Union **to categories of research and development agreements**

Brief Summary

The articles and recitals quoted refer to the Regulation, while the numbers refer to the accompanying horizontal Guidelines (SEC(2010) 528).

- **Context**
  - The revised version of the Block Exemption Regulation (BER) for research and development agreements (BER R&D) is to replace and update the existing Regulation [(EC) No. 2659/2000], which will expire on 31 December 2010.
    - R&D agreements are horizontal agreements between undertakings. They can stipulate provisions on the partial outsourcing of R&D activities, R&D co-operations or the common distribution and marketing of jointly developed products. Thus they can increase efficiency, lower costs and intensify the exchange of ideas and experience, thus promoting the development of products and techniques (No. 105).
    - "Horizontal agreements" are agreements and concerted practices of undertakings operating at the same level in the value-added chain of producing or distributing goods or providing services ("products").
    - Horizontal agreements, the point of which is to restrict competition in the EU market, are in principle prohibited (Art. 101 (1) TFEU. In exceptional cases they may be exempted from this prohibition, subject to the provision that they contribute to improving the production or distribution of goods or to promoting technical or economic progress ("efficiency gains") and that they benefit consumers (Art. 101 (3) TFEU).
  - The aim of the BER R&D is to define agreements which may be exempted from the prohibition of anti-competitive agreements and conduct because their positive effects prevail (Art. 101 (3) TFEU).
- **Scope of BER R&D**
  - The BER R&D covers horizontal agreements regarding arrangements and concerted action of normally competing enterprises.
  - R&D agreements are exempted from the prohibition under Art. 101 (1) TFEU if their common aim is:
    - carry out joint R&D of products or processes and to exploit the accomplished results jointly (Art. 2 (1) lit. a),
    - exploit the R&D results of a prior cooperation jointly (Art. 2 (1) lit. b), or
    - carry out joint R&D without aiming at a joint exploitation (Art. 2 (1) lit. c).
  - Exempted are also ancillary agreements to R&D agreements (Art. 2 (2)) which
    - affect the assignment of intellectual property rights or the granting of licences to one or more parties and
    - directly refer to the implementation of an agreement and are therefore necessary.

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- **Exemption requirements and market threshold value**
  - An exemption from the cartel ban is subject to the condition (Art. 3) that
    - all parties disclose "all their existing and pending intellectual property rights" prior to starting the R&D, in as far as they are "relevant" for the exploitation of the results (Art. 3 (2));
    - all parties are granted free access to R&D results for further research and exploitation purposes (Art. 3 (3));
    - each party is granted access to the know-how (Art. 1 No. 10) of the respective other party in so far as such know-how is indispensable for the exploitation of the R&D results and only joint R&D works are planned (Art. 3 (4));
    - the joint exploitation pertains to R&D results protected by intellectual property rights or represents indispensable know-how for the exploitation (Art. 3 (5)) and
    - the parties charged with manufacturing the contract products must also fulfil orders for manufacturing and supplying the contract products from other parties (Art. 3 (6)), whereby each party must participate in the exploitation of R&D results to "some" extent (Art. 1 No. 13).
  - The competing parties' combined share in the materially and geographically relevant markets for the products, technologies and processes which are to be "improved or replaced" by the contract products must not exceed 25% (Art. 4 (2)).
    - The exemption remains in effect for the duration of the R&D and, in the case of joint exploitation of the R&D results, for a further seven years following the first exploitation.
    - After seven years the exemption is continued as long as the combined market share does not exceed 25% (Art. 4 (3)).
    - If, after seven years, the combined market share exceeds the market share threshold of 25%, the exemption is extended as follows:
      - for two calendar years if the market share is below 30% (Art. 7 (2));
      - for one calendar year if the market share is above 30% (Art. 7 (3)).
  - If the aim of R&D works is to develop a completely new product, the market shares relevant to the market share threshold cannot be calculated on the basis of the market sales value (cp. Art. 7 (1)). R&D agreements are then treated as agreements between non-competing parties, which are exempted for seven years after the first exploitation, irrespective of the market share threshold (Art. 4 (1); No. 120).

- **"Hardcore restrictions" in exemptions**

  An exemption does not generally apply to R&D agreements which directly or indirectly aim at ("hardcore restrictions"):
  - restricting the parties' freedom to carry out research and development in other fields, or in the same field after completion (Art. 5 lit. a);
  - restricting the production or sales, unless it concerns setting production or sales targets where the joint exploitation of the results includes the joint production, distribution or joint licensing (Art. 5 lit. b);
  - fixing the prices of products or licensing processes, unless the joint exploitation includes the joint distribution or the joint licensing (Art. 5 lit. c);
  - restricting the territory into which the individual parties may sell or license the contract products passively (Art. 5 lit. d); "passive sale" means processing the unrequested demand of individual customers, i.e. delivering goods or services to such customers;
  - prohibiting or restricting active sales into territories or to customers, unless the territories have been allocated exclusively to either party (Art. 5 lit. e), whereby each party must be involved in the exploitation of the R&D results to "some" extent (Art. 1 No. 13);
  - refusing to meet the demands of customers (Art. 5 lit. f),
    - located in the parties' respective territories or
    - otherwise allocated between the parties by way of specialisation in exploitation, who wish to sell the contract products in other territories within the EU internal market;
  - making it difficult for consumers and retailers to buy the contract products from other retailers in the internal market (Art. 5 lit. g).

- **Excluded restrictions**

  The exemption does not apply to R&D provisions which
  - prohibit the contract parties from challenging, after the completion of the research and development, the validity of the intellectual property rights "which are relevant to the research and development" or "protect the results of research and development" (Art. 6 lit. a) or
  - require that licences not be granted to third parties for the production of contract products or the application of contract processes, unless the exploitation of the R&D results by at least one of the parties is provided for and takes place in the internal market (Art. 6 lit. b).

Changes Compared to the Status Quo

- The BER provides for a new exemption requirement, namely that prior to starting the R&D all parties must disclose "all their existing and pending intellectual property rights".
- The BER extends the "hardcore restrictions". Illegal are:
  - now also the restriction of passive distribution regarding customer groups; to date this prohibition related only to territorial restrictions;
  - the prohibition and the restriction of the active distribution of contract products or processes into territories or to customers not exclusively allocated to one of the parties with regard to exploitation; to date the prohibition related only to the period following the exemption period.
- The BER clarifies that also ancillary agreements to an R&D agreement which affect the assignment of intellectual property rights or the granting of licensing to one or several parties are covered by the exemption.
- The BER refines the definition of "potential competition", which is also protected by Art. 101 (1) TFEU: it must be realistic that an enterprise enters the relevant market within three years in order to be a potential competitor.

Statement on Subsidiarity by the Commission

Not applicable.

Policy Context

The Commission plans to revise the provisions on horizontal agreements and block exemption. To this end, it has submitted a package which, along with the revised version of BER R&D, contains a revised version of the BER on specialisation agreements [(EC) No. 2658/2000] and horizontal Guidelines [SEC(2010) 528]. The latter are to simplify the examination procedures for enterprises regarding the question of whether or not a horizontal agreement is in line with exemption requirements. For R&D agreements the guideline chapter "Research and Development Agreements" applies (No. 105 et sqq.). The final versions are to be adopted by the Commission at the end of 2010.

Options for Influencing the Political Process

Leading Directorate General:	DG Competition

Formalities

Legal competence:	Art. 101 (3) TFEU (Competition Law)
Form of legislative competence:	Exclusive competence (Art. 3 (1) lit. b TFEU)
Legislative procedure:	Procedure sui generis (pursuant to Regulation (EEC) No. 2821/71)

ASSESSMENT

Economic Impact Assessment

Ordoliberal Assessment

R&D agreements can boost the innovative capabilities of the participating undertakings and with that their competitiveness. This is especially true where the parties bring capabilities to the synergy that complement one another. This can result in new products or processes being developed faster and cheaper. Imitation competition can also be intensified through R&D agreements. Thus R&D co-operations can enable imitators to challenge the position of a market-dominating enterprise.

A further advantage of R&D agreements is that as the results of R&D are never perfectly protected, not even through patents, company investments often remain below the level otherwise attained. R&D agreements can partly tackle this issue. All these advantages can lead to lower prices and new and better products creating benefits to consumers. Therefore, it can make sense to exempt R&D agreements from the cartel prohibition (Art. 101 (1) TFEU).

However, the positive effects must be weighed against the potential disadvantages of such an exception. Particularly in the case of R&D agreements between undertakings with a similar R&D orientation, **the danger is that research intensity might diminish**. This can lead to less **or** worse product innovations entering the market. Moreover, it is possible **that R&D agreements restrict competition and product diversity** even **on the sales market**. This could happen when competitors who agree to an R&D co-operation with joint distribution would have developed the new product even without such an agreement. Furthermore, there is the possibility that price and volume agreements and an allocation of markets would reduce the competition between the participating undertakings.

The Commission's approach to define exemption requirements, hardcore restrictions and a market share threshold in order to ensure that R&D agreements have a positive impact on consumers **is appropriate**. **The exemption requirements protect competition from excessive restrictions**. In particular, they make sure that enterprises which have not agreed to jointly exploit results can act as competitors in the sales markets. To

be equally welcomed is the innovation that enterprises must disclose relevant rights in intellectual property prior to starting an R&D. Otherwise either co-operation party could be excluded from the exploitation ex-post, since they do not possess the necessary patents or licences.

The hardcore restrictions are also appropriate. They serve to **ensure that R&D agreements are kept a necessary minimum** so as not to restrict competition more than absolutely necessary through the participating undertakings. Particularly **welcome is** the **extension of the ban on restricting passive sales –** that now also covers customer groups – **and on restricting active distribution** in territories not allocated to any party.

The definition of a market share threshold is appropriate, as effects which restrict competition and innovation are all the more likely the higher a market share of an undertaking is. **The** existing and future **market share threshold of 25% constitutes an appropriate compromise,** for it lies below the threshold for vertical agreements (30%) and above the threshold for specialisation agreements (20%). It is also appropriate that the Commission does not meet demands to harmonise market share thresholds: vertical agreements are agreements between non-competing undertakings; hence their anti-competitive potential is lower than that of horizontal agreements. The 5% higher than the specialisation agreement value is also justified, for at the beginning of an R&D agreement it is normally not clear how much demand there will be for the product awaiting development. To this end, undertakings cannot agree on prices and distribution activities under the scope of R&D agreements as easily as they can under specialisation agreements.

Impact on Efficiency and Individual Freedom of Choice

The BER R&D lowers economic costs, as it releases many enterprises from the obligation to review each individual agreement with regard to whether or not they are subject to exemption.

Impact on Growth and Employment

Insignificant.

Impact on Europe as a Business Location

Insignificant.

Legal Assessment

Legislative Competence

The EU is empowered to exempt (Art. 101 (3) TFEU) horizontal agreements from the cartel prohibition (Art. 101 (1) TFEU). Responsible is the Council (Art. 103 TFEU), who may, however, delegate its responsibility to the Commission (Art. 105 Abs. 3 TFEU). This was effected by the Regulation (EEC) No. 2821/71.

Subsidiarity

Since competition law is subject to the exclusive competence of the EU (Art. 3 (1) lit. b TFEU), the principle of subsidiarity is not applicable (Art. 5 (3) TEC).

Proportionality

Unproblematic.

Compatibility with EU Law

Unproblematic.

Compatibility with German Law

According to the Law against Restricted Competition (GWB), which in German law governs "exempted agreements" (§ 2 (2) GWB), the exemption requirements of the European BERs are also applicable to merely German matters.

Conclusion

R&D agreements can improve the innovative capability of the participating parties but can also restrict competition and the diversity of products. The Commission's approach to define exemption requirements, hardcore restrictions and a market share threshold in order to ensure that R&D agreements have a positive impact on consumers is appropriate. The exemption requirements, notably the parties' obligation to disclose all relevant intellectual property rights, protect competition from excessive restrictions. The same holds true for hardcore restrictions and, in particular, the extended bans on restricting passive sale and active distribution. Last but not least, the present and future market share threshold of 25% is an appropriate compromise.