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The EC Commission's Review of the EU Competition Rules on Horizontal Agreements

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I. INTRODUCTION

It is no wonder that the revisions of the block exemption regulations for research and development agreements and specialization agreements, as well as the changes to the Horizontal Guidelines that the EC Commissions has proposed, have given rise to a lively debate on the proper regulation of agreements under EC antitrust law between actual and potential competitors and have uncovered some thorny policy issues.² There are two principal reasons for this.

First, for many companies co-operation with competitors is key to their ability to develop and market both existing and innovative products. For instance, it is likely that the introduction of the CD technology as we know it would have been seriously delayed, or would not have taken place at all, if antitrust rules had prevented Philips and Sony from collaborating on optical storage technology in the 1970s and early 1980s. Similarly, the standard-setting activities in the telecommunications area that took place under the auspices of the European Telecommunications Standards Institute ("ETSI") involving many actual and potential competitors have greatly facilitated the introduction of the 3rd generation mobile phone standard.³ And absent the collaborative research by Genzyme and Novazyme, there may not have been a treatment for Pompe disease.⁴ Exchange of market information and benchmarking enables numerous smaller and larger firms to more intelligently adapt to market circumstances and to improve their productivity.

While many businesses are increasingly required to cooperate in globalizing markets with quickly changing market dynamics, many of these activities require significant upfront investments that companies may not be willing to undertake against the backdrop of restrictive, overly prescriptive, or uncertain requirements under antitrust law. It is therefore important that antitrust law preserves and stimulates the incentives for companies to enter into efficiency-enhancing collaborative activities. As the two block exemption regulations and the Horizontal Guidelines have a direct bearing on precisely those incentives, there is a need for a clear, consistent, and economically rational framework to be embodied in those regulations, allowing

¹ Paul Lugard's contribution is written in the author's capacity as lecturer of law at the Tilburg Law and Economics Centre (TILEC).

² The proposed revised texts of the two block exemption regulations and the Horizontal Guidelines, published in May 2010, as well as the replies to the public consultation, are *available at* http://ec.europa.eu/competition/consultations/2010_horizontals/index.html.

³ See, for instance, Bekkers & West, *Standards, Patents and Mobile Phones: Lessons from ETSI's Handling of UMTS*, (7)1 J. OF IT STANDARDS AND STANDARDIZATION RESEARCH, 13-34, (January-June 2009).

⁴ See the US FTC press release of 13 January 2004, *FTC Closes its Investigation of Genzyme Corporation's 2001 Acquisition of Novazyme Pharmaceuticals, Inc.* (2004), available at <http://www.ftc.gov/opa/2004/01/genzyme.shtm>.

companies to assess with a reasonable degree of certainty the risks involved. More fundamentally, unjustified restraints on desirable innovative activity are potentially the most damaging Type 1 errors as innovation is a key driver of consumer welfare.⁵

The existing regime under European antitrust law for research and development agreements, as well as production agreements, has been in force since 2000 and has functioned relatively well—despite a number of notoriously technical difficulties and uncertainties involved in applying the block exemption regulations. For instance, over the years practitioners dealing with joint research and development projects have struggled with the notions of “specialisation in research and development” and “specialisation in exploitation” within the meaning of Article 1 Regulation 2659/2000 on Research and Development (“R&D”) agreements.⁶ The moderate satisfaction among practitioners and regulators with the current block exemptions and the current Horizontal Guidelines explains why the EC Commission believes that the current legislative framework does not require a radical overhaul. Instead, it has stated that it primarily seeks to update and clarify the existing rules.⁷

However, as set out in the various contributions included in this special *CPI Antitrust Chronicle* issue, the proposed revisions do, in fact, raise a significant number of technical and more fundamental issues. This applies both to the proposed modifications of the two block exemption regulations, as well as—in particular—to the newly introduced chapter of the draft Horizontal Guidelines on the assessment of information exchange between companies and the largely revised section on standardization agreements.

The current EC competition law regime under EC competition law for horizontal cooperation consists of two block exemption regulations: Regulation 2659/2000 covers R&D agreements, while Regulation 2658/2000 applies to specialization and joint production agreements. The accompanying Horizontal Guidelines provide a framework for the assessment of specific types of horizontal agreements, such as joint commercialization, purchasing, standardization, and other types of agreements that are either not covered or not automatically exempted under the block two exemptions for horizontal agreements.

II. THE DRAFT BLOCK EXEMPTION REGULATIONS FOR RESEARCH & DEVELOPMENT AGREEMENTS AND SPECIALIZATION AND JOINT PRODUCTION AGREEMENTS

The main proposed changes to the two block exemptions are the following. First, the Commission proposes to make the exemption under the future block R&D regulation dependent on the requirement that the participating companies, prior to starting their research and development, agree to disclose in an open and transparent manner all their existing and pending intellectual property rights relevant for the exploitation of the results by the other co-operating companies (Article 3(2) draft Regulation). In addition, it suggests expanding the list of hard-core restrictions of Article 5(d) by stipulating that passive sales restrictions with regard to customers (and not only with respect to territories) will be considered as a hard-core restriction that prevents

⁵ See, for instance, Herbert Hovenkamp, *Signposts of Anticompetitive Exclusion: Restraints on Innovation and Economies of Scale*, 2006 FORDHAM COMPETITION L. INST. 409-431 (B. Hawk ed. .) (2007).

⁶ See, in this regard, Axel Gutermuth, *Revision of the EU Competition Rules on Cooperation in Research and Development and Production: Scope for Improvement*, 9(1) CPI ANTITRUST CHRON. (September, 2010).

⁷ See

<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/489&format=HTML&aged=0&language=EN&guiLanguage=en>.

the exemption from applying. The draft Article 5(e) provides that restrictions on active sales not exclusively allocated to one party are also considered as hard-core restrictions. In contrast, active sales restrictions regarding territories and customers that are exclusively allocated to one of the parties through specialization in exploitation are allowed without time restriction. The current block exemption allows this restraint for a period of 7 years.

In his contribution to this special issue that concentrates on further improvements that could be made to the draft R&D and specialization block exemptions, Axel Gutermuth expresses a cautiously optimistic view on the proposed revisions to the R&D block exemption, but convincingly argues that further improvements could be made. He welcomes the revised definition of “specialisation in research and development” of Article 1(12) that—despite the fact that uncertainty remains—more clearly states that particular ways of dividing the parties’ contributions to the joint R&D will qualify as specialization in R&D and will not result in the loss of the exemption. He also—correctly—notes that there is a practical need to exempt joint R&D where one party merely co-finances the R&D of the other party with a view to benefiting from the R&D results. In addition, Gutermuth criticizes the unnecessary narrow scope of the notion “specialisation in exploitation” and observes that the requirement that each of the parties must “carry out some exploitation of the results in the internal market” may prevent potentially pro-competitive R&D co-operation between European and non-European companies from occurring. Among the many other insightful comments that Gutermuth makes with regard to the draft block exemption for R&D agreements, one other comment merits mentioning: the unnecessarily restrictive, albeit still unclear, requirement of Article 3(3) that access to the results of the joint R&D must be “equal.”

The draft specialization block exemption introduces a second market-share threshold for specialization of joint production agreements in the case of intermediary products. If the agreement concerns an intermediate product that one or more of the parties fully or partly use captively for the production of downstream products, then the exemption is only available if the parties’ combined market share of the relevant market for the products which are the subject matter of the agreement, as well as the combined market share in downstream product markets, do not exceed 20 percent (Articles 1(7) and 3(7)). This additional requirement limits the scope of the exemption. On the positive side, the Commission proposes to make the exemption also available where one of the parties only partly ceases production (Article 2(b)).

In his comments on the draft specialization block exemption Gutermuth appreciates the broadening of the scope of the exemption, but questions the precise scope of Articles 2(1)a and b and wonders whether a contractual agreement to reduce production is sufficient for the exemption to apply, or whether the Commission requires an actual reduction of production capacity. Obviously, the latter interpretation may, in some instances, not be conducive for parties to enter into this type of arrangement. Gutermuth also invites the Commission to provide more guidance with regard to the notions of “joint production” within the meaning of Article 2(1)c and “cost communality” in paragraphs 169-173 of the draft revised Horizontal Guidelines.

III. THE DRAFT HORIZONTAL GUIDELINES—INFORMATION EXCHANGE

The draft revised Horizontal Guidelines include numerous smaller and larger modifications. For instance, the introductory chapters have been amended to more clearly reflect the economic insights that were laid down in the 2004 Notice on the application of Article 101(3), while more attention is given to the various ways in which the various forms of cooperation can give rise to anticompetitive harm. However, two main substantive changes to the Horizontal

Guidelines require specific attention: the new chapter of information exchange and the significant modifications that the Commission proposes for the section on standardization agreements. Both chapters are commented upon in this special issue. Andreas Reindl comments on the parts of the draft Horizontal Guidelines that relate to information exchange, while Richard Taffet, Anne Layne-Farrar & Jorge Padilla, and Julia Holtz & Tero Louko concentrate on standardization agreements.

The existing Community's Courts' case law on information exchange between competitors is controversial. In particular, the Court's reasoning in *T-Mobile Netherlands*, while ambiguous, opens the door—at least in theory—to a quick condemnation of nearly every information-sharing arrangement under a (pseudo) *per se* standard of analysis.⁸ However, in the chapter on information exchange, the Commission acknowledges that information exchange can in some circumstances be efficiency enhancing. As a result, after attempting to distinguish agreements on information exchange that are to be considered as restrictive of competition by object, the draft Horizontal Guidelines seek to provide guidance on the conditions under which information exchanges can be deemed to meet the conditions of Article 101(3).

In his contribution that is entirely devoted to the treatment of agreements on information exchange, Andreas Reindl observes that the draft Horizontal Guidelines potentially do a better job in enabling firms to assess the risks of information sharing and may contribute to desirable case outcomes. His contribution provides a lucid and concise overview of the state of affairs under EC competition of information sharing. With some satisfaction, he notes that the Commission has resisted the temptation to rely on *T-Mobile* to create a wider category of information exchanges that would qualify as restrictions by object. However, when considering the evidentiary requirements, Reindl notes a number of shortcomings and suggests further aligning the text of the Horizontal Guidelines to the *Impala* judgment.⁹ His contribution also includes a number of other suggestions for improvement, in particular with regard to unilateral information disclosures.

IV. THE DRAFT HORIZONTAL GUIDELINES-STANDARDISATION

Inspired by a number of recent cases, in particular *Rambus* and *Qualcomm*, chapter 7 of the draft Horizontal Guidelines provides guidance on how activities of standard-setting organizations (“SSOs”) and their members can be structured to prevent infringements of Article 101 (and 102). The cornerstone of the significantly expanded and more detailed chapter is the observation that, in order to avoid findings of antitrust liability, standard-setting processes be open and transparent (paragraph 277) and that holders of intellectual property which may be adopted as part of a standard must be obliged to provide an irrevocable commitment to license their intellectual property rights on fair, reasonable, and non-discriminatory (“FRAND”) terms (paragraphs 282-283).

While the draft Horizontal Guidelines acknowledge that standardization may encourage inter-technology competition, help prevent lock-in to one particular supplier, increase consumer choice, and decrease prices (paragraph 300), they take a critical stance against these types of agreements. Indeed, in addition to giving rise to horizontal spill-over effects (paragraph 259), by their nature standards result in the exclusion from the market of competing technologies (paragraph 261), and may restrict innovation as a result of one or more stakeholders controlling

⁸ Case C8/08, *T-Mobile Netherlands BV et al. v. NMa*, ECR I-4529.

⁹ Case C-413/06, *Bertelsman and Sony Corporation of America v. Impala*, 2008 ECR I-4951.

the standard-setting process (paragraph 261). A main, if not the most important, concern identified in the draft Horizontal Guidelines is, however, the potential for patent hold-up, i.e. the situation that a company holding intellectual property rights that are necessarily infringed if the standard is implemented would extract excess rents by not disclosing and making its intellectual property rights available, and thus “hold up” users after the adoption of the standard (paragraph 262). To prevent this from occurring, the draft guidelines not only mandate in general terms the use of FRAND commitments but, in addition, include a number of ways to determine whether fees imposed for the use of essential patents are fair and reasonable, i.e. bear a reasonable relation to the economic value of the patent. In this respect, the draft Horizontal Guidelines propose in particular the comparison of royalties with those that are charged “in a competitive market” and the assessment by an independent expert.

The main reason why the draft chapter on standardization agreements has given rise to a heated debate is the potentially diverging interests of the various parties involved in—or affected by—standard-setting activities. Firms involved in standard setting may have a common interest to develop a standard, but nonetheless have different interests depending on their activities. Pure innovators earn their revenues solely by licensing their technology, while manufacturers that do not own intellectual property rights consider royalties as a cost of production and therefore have an incentive to reduce or eliminate them. These diverging interests may also have an impact on the admission policy of SSOs and the technology choices made by SSO members.

The contributions in this issue of the *CPI Antitrust Chronicle* clearly illustrate the scope for these diverging interests. Julia Holtz and Tero Louko, Competition Counsel with Google, stress the importance of early disclosure of licensing terms associated with the use of a specific technology. They also stress that there are many ways to foreclose rival technologies (and thus the use of products that integrate those technologies), including allegations that competing technologies are not adequately protected under intellectual property rights. This point is not addressed in the draft Horizontal Guidelines and it remains to be seen whether this is a common concern that merits discussion in the final text of the Horizontal Guidelines. The contribution of Holtz & Louko also contains an interesting and novel suggestion to balance the interests of intellectual property holders and (future) users of the technology.

In contrast, the comments by Anne Layne-Farrar and Jorge Padilla concentrate on the position of technology owners. They, *inter alia*, express the concern that the imposition of FRAND terms limits the remuneration of innovators participating in standard setting and may thus adversely affect innovation. The authors also express criticism with respect to the methods that the Commission proposes to assess the economic value of technology. Their arguments appear persuasive.

Richard Taffet approaches the draft chapter on standardization from an intellectual property rights and innovation perspective. He considers that, as currently drafted, the draft Horizontal Guidelines reflect a bias against the legitimate and pro-competitive exercise of intellectual property rights and, by so doing, undermine the use of intellectual property rights in standards and thereby limit innovation. A number of his arguments mirror the observations made by Layne-Farrar & Padilla. This applies also to the provisions in the draft Horizontal Guidelines that seek to cap the amount of royalties or license fees that may be sought by owners of intellectual property rights.

Taffet’s contribution contains two additional points that are worth mentioning. First, he argues that hold-up concerns arise in practice relatively infrequently and that, as a consequence,

the Commission places too much emphasis on the need to prevent these situations from occurring. It will be interesting to see whether the Commission will take up this argument. Second, Taffet particularly opposes the suggestion of paragraph 316 that a failure of SSO members to undertake “reasonable efforts” to identify relevant intellectual property rights is likely to automatically amount to a violation of Article 101. This view is shared by Layne-Farrar & Padilla. Finally, both Layne-Farrar & Padilla and Taffet stress that the adoption of restrictive provisions regarding standard-setting activities may have significant international repercussions.

Overall, it seems that, as currently drafted, the draft chapter on standardization agreements raises a number of technical and more fundamental concerns and, in addition, creates significant uncertainty. For instance, under which precise circumstances can companies be deemed to have made “reasonable efforts” to have identified existing and pending intellectual property rights reading on the “potential” standard and have disclosed their intellectual property “in good faith” in the sense of paragraph 281? Second, how does a company know that it has adequately assessed the value of its technology (paragraph 284-285)? And how should SSOs determine whether a standardized specification is “too detailed” (paragraph 260-306) and may, according to the draft guidelines, therefore limit innovation? And finally, how does one reconcile the requirement that standardization activities should be open and transparent (paragraphs 277, 278, 301, and 307) with the practical need to limit those activities to a limited, flexible group of companies with proven experience in the field, as well as the fact that potentially competing standards are often simultaneously developed by different groups of companies?

It is hoped that future drafts of the Horizontal Guidelines, as well as the final version thereof, will adequately address the issues identified in this special *CPI Antitrust Chronicle* issue.