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New Guidelines on Horizontal Co-operation Agreements

On January 14, 2011, the European Commission (the "Commission") published new Guidelines on the Applicability of Article 101 TFEU to Horizontal Co-operation Agreements (OJ 2011, C11/1, the "Guidelines"), replacing the corresponding Guidelines from 2001 (the "2001 Guidelines"). A draft of the Guidelines was published in May 2010 for public consultation (the "Draft Guidelines"), which led to over 100 contributions from stakeholders and the subsequent revision of the Draft Guidelines.

The Guidelines cover cooperation in the area of exchange of information, research and development, specialization, production, purchasing, commercialization, technical standardization and standard terms. This Alert Memo focuses on the two most important changes in the Guidelines: the newly introduced information exchange section and the standardization section, which contains substantial changes in comparison to the 2001 Guidelines.

Together with the Guidelines, the Commission also adopted two block exemption regulations, one relating to research and development agreements (the "R&D BER"),[1] and one relating to specialization agreements (the "Specialization BER").[2] This Alert Memo briefly highlights the changes compared to the previous versions of these block exemption regulations.

I. STANDARDIZATION AGREEMENTS

The section on standardization agreements in the Guidelines contains rules, presumptions, and considerations to assess standardization agreements under Article 101. It is substantially longer than the corresponding section of the 2001 Guidelines, but also more detailed than the corresponding section in the Draft Guidelines. Given the ever-increasing importance of standardization, this is a welcome development.

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[1] Commission Regulation of 14 December 2010 on the application of Article 101(3) TFEU to research and development agreements, OJ L 335, p. 36.

[2] Commission Regulation of 14 December 2010 on the application of Article 101(3) TFEU to specialisation agreements, OJ L 335, p. 43.

The main focus of the standardization section is on effective access to standard-setting procedures and access to technology needed to implement adopted standards. Special attention is given to IPRs that cover technology that is essential for implementing the standard ("standard essential IPRs") and to the *ex ante* disclosure of standard essential IPRs and of maximum royalty fees that a company would charge if its technology were incorporated in a standard. One reason for this is the risk that holders of standard essential IPRs could "hold up" the standard by refusing to license their IPRs or by charging excessive royalty fees.[3]

The two most important sections deal with the "safe harbor" exception for standardization agreements within Article 101(1) and with an effects-based assessment of standardization agreements that fall outside the safe harbor:

1. ***Safe harbor***. The Guidelines provide that standardization agreements that risk creating market power are normally not prohibited under Article 101(1), if the following conditions are fulfilled: (i) unrestricted industry participation in a transparent standard-setting procedure, (ii) no obligation to comply with the adopted standard, (iii) good faith disclosure of standard-essential IPRs, and (iv) access to the standard on fair, reasonable and non-discriminatory (FRAND) terms.

2. ***Agreements outside of the safe harbor.*** If a standardization agreement deviates from the safe harbor principles, there is no presumption of illegality, but parties to the standardization agreement must assess whether the agreement falls under Article 101(1), and if so, if it is justified under Article 101(3). For this self-assessment, the Commission provides a number of considerations in line with an effects-based approach.

The following sections further explain the safe harbor exception and the considerations for assessing agreements outside of the safe harbor.

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[3] Para. 269 of the Guidelines. The Guidelines do not contain rules relating to discriminatory or restrictive licensing terms for standard essential IPRs, although reference may be made to the Technology Transfer Guidelines (OJ 2004, C 101/2, para. 226) and the Technology Transfer Block Exemption Regulation (OJ 2004, L 123/11). When applying the rule of reason and exemption criteria under the Technology Transfer Guidelines, it is necessary to take into account the standardization context, including the need to avoid horizontal collusion in fixing license terms, and the need to preserve effective competition in the markets for products implementing the standards in question.

A. <u>SAFE HARBOR EXCEPTION UNDER ARTICLE 101(1)</u>

Of the above-mentioned conditions for the application of the safe harbor exception under Article 101(1) the two most important ones are the requirement of good faith disclosure of standard-essential IPRs, and access to the standard on FRAND terms.

1. <u>Requirement of *Ex Ante* Disclosure</u>

The Commission encourages disclosure of potentially relevant IPRs before the standard is finally agreed ("*ex ante* disclosure") since it allows the participants to determine which technologies are covered by IPRs owned by other standard-setting organization (SSO) members, and which are not.[4] Participants to the standard-setting do not have to undertake patent searches to identify which of their IPRs claims read on the potential standard. It may be sufficient that they declare that it is likely that they have IPR claims over a particular technology. No *ex ante* disclosure is required for royalty-free standards.[5]

2. <u>Access to the standard on fair, reasonable and non-discriminatory (FRAND) terms</u>

In order to guarantee effective access to the standard, the Guidelines encourage SSOs to adopt IPR policies requiring IPR holders who wish to have their IPR-protected technology included in the standard to make an irrevocable commitment to license their IPRs on FRAND terms prior to the adoption of the standard.[6] The Guidelines explain that royalty-free licensing terms can be considered fair and reasonable even if they do not provide licensing revenues to the IPR owners.[7] If the license is royalty-bearing, it is the task of the participants of the standard-setting process to assess whether the terms comply with the FRAND commitment.[8] Whether license fees for a standard essential IPR are unfair or unreasonable depends on whether the fees bear a reasonable relationship to the economic value of the IPR.[9] The Commission acknowledges that there are various methods available for assessing FRAND rates, and the Guidelines do

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4 Para. 268 of the Guidelines. *Ex ante* disclosure of IPRs (allowing SSO members to determine whether other SSO members have IPRs) is to be distinguished from *ex ante* disclosure of most restrictive terms (allowing SSO members to compare the prices and terms of competing technologies).

5 Para. 286 of the Guidelines.

6 Para. 285 of the Guidelines.

7 Footnote 3 of para. 285 of the Guidelines.

8 Para. 288 of the Guidelines.

9 Para. 289 of the Guidelines.

not aim to provide an exhaustive list of methods.[10] One benchmark mentioned is the royalty payable for a patent in a competitive environment before the industry has been locked into the standard ("*ex ante*"), assuming that rival technologies exist that could have been used for the standard.[11] *Ex ante* declarations of licensing terms in the context of a standard-setting process may be accepted as an indication of a FRAND rate, but only "*in an appropriate case*".[12] Experience in the negotiation of license terms for 4G telecommunication standards have indicated that complex standards with long lead times and multiple patent owners are not *"an appropriate case"*, absent an effective auction or similar process, because patentees outside auction conditions have incentives to declare high rates, especially if all competing technologies are royalty-bearing. Appropriate cases could, on the other hand, include situations where royalty-bearing technologies compete effectively with royalty-free technologies for inclusion in the standard, or where the *ex ante* declarations are made in conditions that approximate effective auction conditions.

The Guidelines at least partially address the important issue of transfers of standard essential IPRs *after* adoption of the standard, by holding that the IPR policy of SSOs should require that all IPR holders, who participated in standard-setting and provided a FRAND commitment, ensure that any company to which the IPR owner transfers its IPR is bound by the same FRAND commitment, for example, through a contractual clause between buyer and seller.[13]

Finally, the Commission emphasizes that parties are free to resolve their disputes about FRAND royalty rates by having recourse to civil or commercial courts.[14] This indicates that the Commission believes that FRAND disputes under EU competition law fall – at least initially – into the jurisdiction of national courts. As the guardian of the Treaty, the Commission arguably cannot, however, decline the responsibility to apply

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[10] Para. 289 et seq. of the Guidelines. An important example of an appropriate benchmark that is not mentioned in the Guidelines, but that is relevant in practice and economically sound, is the royalty charged for complementary IPRs included in the standard. If an IPR owner charges more per standard essential patent than all or most other IPR owners, then that is an indication that the fee is unfair or unreasonable, unless the IPR owner can show that its IPR is more valuable than that of the others.

[11] Para. 289 of the Guidelines.

[12] Para. 290 of the Guidelines.

[13] Para. 285 of the Guidelines. In *Nokia/Bosch+IPCOM* (COMP/39.615), the Commission pointed out that the pro-competitive economic effects of standard-setting could be eliminated if, as a result of a transfer of standard essential patents, the FRAND commitment would no longer apply (Commission Press Release, December 10, 2009, MEMO/09/549). There are good arguments that, for this holding to have useful effect, competition law also requires that FRAND commitments apply to patent applications and divisional applications. It is unfortunate that the Guidelines do not state that.

[14] Para. 291 of the Guidelines.

competition law if needed to ensure unrestricted competition and avoidance of consumer exploitation.

B. AGREEMENTS OUTSIDE OF THE SAFE HARBOUR

If a standardization agreement departs from the safe harbor conditions, parties have to assess whether the agreement is in accordance with Article 101(1) and, if not, whether Article 101(3) applies.

1. Assessment under Article 101(1)

Compared to the Draft Guidelines, the Commission now provides more detailed guidance for self-assessment under Article 101(1). Some of the relevant considerations to be taken into account include the terms of the standards agreement (such as the freedom to develop alternative standards or products that do not comply with the adopted standard), the accessibility of the standard, the openness of participation in the standard-setting process, and market conditions (such as the availability of competing technologies or standards, and the market shares of the goods or services based on the standard). The most important considerations relate to *ex ante* disclosure of most restrictive licensing terms, and participation in standard-setting:

a. Ex Ante Disclosure of Most Restrictive Licensing Terms

In order to avoid disputes about FRAND royalty rates, the Commission endorses arrangements allowing SSO members, prior to the adoption of the standard, *unilaterally* to disclose their most restrictive licensing terms, including their maximum royalty rates. Such arrangements as such do not infringe Article 101(1).[15] The Guidelines also point out that such a unilateral *ex ante* disclosure should not serve as a cover to jointly fix prices either of downstream products or of substitute IPR/technologies, since this would constitute a restriction of competition by object.[16] This statement precludes arrangements between IPR owners to restrict *ex ante* inter-technology competition by fixing fees, exchanging information, signaling to each other with a view to keeping royalties above competitive levels, or agreeing to include technologies from all IPR owners in the standard in order to ensure that all receive royalty revenues, even if certain technologies are redundant or unnecessary to meet the goals of the standard ("standard

[15] Para. 299 of the Guidelines. *Ex ante* declarations of terms may not be sufficient to guarantee fair and reasonable terms. As explained above, experience in the negotiation of license terms for 4G telecommunication standards have indicated that absent an effective auction or similar process, patentees may have incentives to declare high rates, especially if all competing technologies are royalty-bearing.

[16] Footnote 1 of para. 299 in combination with para. 274 of the Guidelines.

stuffing"). Some IPR owners have suggested that the statement precludes *ex ante* auctions by SSOs, or agreements between SSO members to cap aggregate royalties to a maximum level, although there are no indications in the Guidelines that the statement is intended to prohibit agreements to keep fees at competitive levels, or to prevent aggregate fees from rising above levels that make the standard commercially unviable.

b. Participation in Standard-Setting

The Guidelines suggest that for standard-setting to fall outside Article 101(1), participation in the standard-setting process should normally be open and undistorted.[17] This principle applies to standards for which no alternative exists, or that are highly successful and have achieved a high share in the relevant technology market. The principle is without prejudice to the *de minimis* Notice[18] or the R&D BER,[19] which imply that membership restrictions may well be permissible under Article 101(1) or (3) below certain market share thresholds. Even above the thresholds, the Commission recognizes that restrictions on participation in standard-setting may be compliant with Article 101(1) if in the absence of the limitation it would not have been possible to adopt the standard,[20] or justified under Article 101(3) if the adoption of the standard would have been delayed by an inefficient process.[21]

2. Assessment under Article 101(3)

The section on the assessment of standardization agreements under Article 101(3) is relatively brief. It repeats criteria used in the context of the assessment of standardization agreements under Article 101(1) and contains general statements on the requirements of Article 101(3). The Commission views the FRAND licensing obligation as a prerequisite for the safe harbor under Article 101(1). There is no discussion of when, if ever, a standard-setting agreement not requiring FRAND licensing or royalty-free could be justified under Article 101(3).

Two important clarifications in the Article 101(3) section are:

- ***Compliance Testing.*** Standardization agreements that entrust certain bodies with the exclusive right to test compliance with the standard may go beyond

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17 Paras. 294 et seq. Vote packing or exclusion of interested participants from SSO committees would be inconsistent with this principle.

18 OJ 2001, C 368/13.

19 OJ 2010, L335/36.

20 Para. 295 of the Guidelines.

21 Footnote 2 of para. 295.

the primary objective of defining the standard and may also restrict competition. However, the Commission concedes that under certain conditions the exclusivity can be justified for a certain period of time, for example by the need to recoup significant start-up costs.[22]

- ***Compatibility/Interoperability Standards.*** Standards that create compatibility on a horizontal level between different technology platforms are likely to give rise to efficiency gains.[23] In addition, it is presumed that standards that facilitate technical interoperability and compatibility or competition between new and already existing products will lead to consumer benefits.[24]

C. COMMENT

The substantially revised standardization section of the new Guidelines contains useful clarifications in comparison to the 2001 Guidelines but also in comparison to the Draft Guidelines. Together with the safe harbor conditions and the more detailed criteria for an assessment under Article 101(1), the clarifications are a clear improvement. However, on some important issues the standardization section remains somewhat vague, *e.g.*, the discussion of the FRAND definition does not contain a full discussion of the various criteria that have been used by the European Courts in excessive pricing cases, and contains no discussion at all of the analysis of discriminatory or restrictive license terms (the “ND” in FRAND). Nor do the Guidelines discuss auctions, or the question when agreements – as distinct from unilateral statements – about maximum royalty levels are allowed.

Some other important issues have not been addressed either: There is no proper discussion of the rules that apply to small standard-setting groups. There is no statement on the legal consequences under Article 101, if individual participants in a standard-setting fail to license standard essential patents on FRAND terms or ignore the *ex ante* disclosure rules. The obvious answer is to declare the SSO IPR Rules and the standard itself null and void, which is ineffective if the standard is already widely applied in practice, and akin to punishing the victims of the FRAND violation. It can be argued that no explanation of the legal consequences of a FRAND violation is needed, because discriminatory or unreasonable license terms can be addressed under Article 102, or perhaps by direct enforcement of Article 101(3) against the infringer. Yet, it would have

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22 Para. 319 of the Guidelines.

23 Para. 311 of the Guidelines.

24 Para. 321 of the Guidelines.

been useful had the Guidelines explained these issues further, if only to avoid the counterproductive outcome of declaring the standard null and void under Article 101(2). These deficiencies may be due to the opposed interests of stakeholders and the lack of final Commission decisions in the field of standardization. The Commission has indicated that disputes about FRAND royalty rates should preferably be resolved by national courts. National courts are also likely to be first confronted with the other standardization issues that the Commission left unanswered.

II. INFORMATION EXCHANGE

The information exchange section deals with the Article 101 assessment of agreements, decisions by associations of undertakings, or concerted practices, where the main economic function lies in the exchange of information.

A. ASSESSMENT UNDER ARTICLE 101(1)

The Commission recognizes that information exchange can generate various types of efficiencies, *e.g.*, by solving problems of information asymmetries or by improving consumers' choices and reducing their search costs.[25] However, the Commission also expresses some competition concerns regarding information exchanges: They can artificially increase transparency in the market and can thereby facilitate anti-competitive coordination of companies' competitive behavior.[26] If the exchanged information is very strategic for competition (*e.g*, commercially sensitive information of competitors) and covers a significant part of the relevant market, the information exchange can foreclose companies that do not participate in the information exchange.[27] The Commission differentiates between competition concerns regarding information exchanges that amount to restrictions of competition by object and those that amount to restrictions of competition by effect:

1. Restriction of competition by object

The exchanges of information between competitors of individualized data regarding intended future prices or quantities are assessed as restrictions of competition by object.[28] These are, therefore, *per se* violations of Article 101(1).

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[25] Para. 57 of the Guidelines. The Commission applies different rules to information exchanges pursuant to vertical arrangements (Guidelines on Vertical Restraints, OJ 2010, C 130/1, paras. 20 and 212).

[26] Paras. 65 et seqq. of the Guidelines.

[27] Paras. 69 et seqq. of the Guidelines.

[28] Para. 74. of the Guidelines.

2. Restrictive effects on competition

Information exchanges have restrictive effects on competition if they are likely to have an adverse effect on one or several competitive parameters such as price, output, product quality, product variety or innovation. The Commission analyzes the likely effects of an information exchange on a case-by-case basis. The competitive assessment of information exchange depends on the characteristics of the market in question and of the exchanged information:[29]

- ***Market characteristics.*** The Guidelines provide that companies are more likely to achieve a collusive outcome in markets that are sufficiently transparent, concentrated (*e.g.*, tight oligopolies), non-complex, relatively stable (*e.g.*, markets not characterized by innovation) and symmetric (*i.e.*, where products have homogenous characteristics).[30] The outcome of the assessment depends on the initial market characteristics and on how the exchanged information might change those characteristics.[31] For a finding of a sustainable collusive outcome, it must be likely that there is a threat of a sufficiently credible and prompt retaliation in case of cheating,[32] which disciplines coordinating companies to stick to the terms of the collusive agreement.

- ***Characteristics of the Information Exchange.*** The Commission takes in particular the following considerations into account when assessing the effects on competition of the information exchange: (i) The exchange of strategic information, *i.e.*, data that reduces strategic uncertainty in the market (*e.g.*, information related to prices or quantities), is more likely to be caught by Article 101. (ii) Exchanges of aggregated information, *i.e.*, information, where recognizing individual company information is sufficiently difficult, are much less likely to cause restrictive effects on competition than exchanges of company level data. (iii) Companies involved in the information exchange have to cover a sufficiently large part of the relevant market for the exchange to be likely to lead to restrictive effects on competition. (iv) Generally, exchanges of genuinely public information, *i.e.*, information that is generally *equally accessible (in terms of costs of access)* to all competitors and customers are unlikely

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[29] Paras. 75 et seq. of the Guidelines.

[30] Paras. 77 – 82 of the Guidelines.

[31] Para. 77 of the Guidelines.

[32] Para. 85 of the Guidelines.

> to constitute an infringement of Article 101. (v) The exchange of historic data is unlikely to lead to a collusive result. (vi) Frequent exchanges of information increase the risks of a collusive outcome.[33]

B. ASSESSMENT UNDER ARTICLE 101(3)

The Commission recognizes that information exchange can result in various types of efficiency gains. In order to qualify for an exemption under Article 101(3) the information exchange must not restrict competition beyond what is necessary to achieve the efficiency gains. For fulfilling the condition of indispensability, parties have to prove that the information's subject matter, aggregation, age, confidentiality and frequency, as well as coverage bear the lowest risks indispensible for achieving the claimed efficiency gains.[34]

C. COMMENT

The introduction of a section on information exchange in the Guidelines is an improvement since it provides for the first time the Commission's interpretation of the respective case law. It is, however, unfortunate that the information exchange section does not contain a "safe harbor" for the application of Article 101(1). While no type of information is explicitly exempted from the application of Article 101 – not even publicly available information is generally excluded – the Commission points out that the list of competition concerns in the information exchange section is not exhaustive.[35] It can be inferred from the statements in the Guidelines that the Commission is inclined to take a strict approach when assessing information exchanges. Competition problems may arise whenever information is exchanged that is individualized, not "*genuinely public*" or strategic, notably regarding current or future business practices.

III. R&D AND SPECIALIZATION BERs

The new R&D and Specialization BERs, which entered into force on January 1, 2011, provide safe harbours for R&D and specialization agreements under Article 101(3). Agreements are presumed not to produce anti-competitive effects, when the competitors' combined market share does not exceed 25% in case of an R&D agreement or 20% in case of a specialization agreement, and the parties comply with further conditions set out in the respective BER.

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[33] Paras. 86 – 94 of the Guidelines.

[34] Para. 101 of the Guidelines.

[35] Footnote 1 on p. 15 of the Guidelines.

While the new BERs remain largely unchanged compared to the previous BERs, some changes have been introduced:

1. The scope of the R&D BER has been expanded explicitly to cover so called “paid for research”, *i.e.*, when participation of one party is limited to financing the research conducted by the other party. Moreover, the parties’ freedom to jointly exploit the result of an R&D agreement has been broadened, *e.g.*, the BER applies to situations where only one party produces and distributes the contract products in the EU on the basis of an exclusive license granted by the other party.

2. Two important clarifications are introduced in the new Specialization BER: First, it is now made clear that the BER applies to specialization agreements under which one party partly ceases production of certain products or provision of certain services. This enables a company that operates two production plants for a certain product to close one plant, outsource the output of the closed plant, and still benefit from the BER. Second, in situations where the products under a specialization agreement are intermediary products used by one or more of the parties for the production of their own downstream products, the combined market share of the parties must also not exceed 20% in the downstream product market to fall under the Specialization BER.

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If you have any questions, please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under Antitrust and Competition under the "Practices" section of our website at http://www.clearygottlieb.com.

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