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How can competition rules support innovation?

Innovation is recognised as a 'parameter of competition' and so, as a basic principle, companies are encouraged to innovate in competition with other players in the market.[1] This has become particularly relevant for innovation-driven industries – such as the pharmaceutical and digital sectors for example where research and development activities are an important driver of competition.[2] However, some innovation-related projects cannot be achieved by one company on its own and it may be necessary to collaborate to achieve certain objectives. Open innovation is therefore becoming increasingly important.

In these situations, it is essential that competition rules do not 'get in the way' or slow down these innovation-related objectives – instead, collaborations should be defined in compliance with competition rules. For this purpose, this article sets out some practical steps to consider when embarking on open innovation projects.

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The pro-competitive objective of collaboration

Open innovation is likely to be viewed positively by competition authorities to the extent that it is likely to give rise to efficiencies and consumer benefits. At the outset, the pro-competitive rationale, the efficiencies and consumer benefits expected from any proposed collaboration should be clearly defined as they will be key to the competition law assessment. In particular, being clear about the 'true' purpose of collaboration is essential.

It is also essential that these efficiencies and consumer benefits are well evidenced, supported by economics and internal documents. Internal documents have become increasingly relevant to competition authorities' assessments generally and therefore they should accurately reflect and be consistent with the pro-competitive objective of a cooperation.

Collaboration should be necessary to achieve this objective

The starting point of any competition law assessment is that businesses should act independently in the market. Therefore a key question will be whether the same objective could have been achieved without collaboration, ie by a business alone. Working together should therefore be the exception and strictly justified by the objective. Before entering into any form of collaboration, it is

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OPEN INNOVATION: COLLABORATE TO INNOVATE

1 Communication from the Commission, Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements Text with EEA relevance OJ C 11, 14.1.2011, ("**Horizontal Guidelines**") para 27. See also, CMA Guidance, Joint Venture Business Advice, 12 April 2018.

2 See Bundeskartellamt, Innovations – challenges for competition law practice, November 2017, p. 1.

therefore essential to be able to demonstrate that the open innovation project could not have been achieved (1) without collaboration and (2) without the specific partners involved in the project.

The form of collaboration

Collaboration can take various forms and the form of collaboration will typically have an impact on the competition law assessment.

More integrated forms of collaboration may result in companies combining their research and development ("**R&D**") activities or one company taking some form of control or material influence (even if this is only through contractual arrangements and does not give rise to a transfer of equity) over part of another company's business. It could also take the form of a joint venture created by the parties to the collaboration. For example, under EU merger control rules, if this joint venture is full function – ie it is autonomous and independent from its parents – it may fall within the scope of merger control rules. These integrated forms of collaboration could give rise to merger control scrutiny.

While a merger control review gives the parties the comfort of being formally reviewed and (hopefully) approved by a competition authority, it can also give rise to challenges as shown by a number of in-depth investigations in the UK that resulted in substantive remedies, or where these remedies could not be agreed, prohibition.[3]

Companies may therefore find flexibility in collaborating through joint venture arrangements, partnerships and alliances. These arrangements could include, under certain circumstances, exclusivity obligations to allow the parties to the collaboration to invest in and develop their projects. However, these arrangements also have to be self-assessed under applicable competition laws. It is down to the parties to seek legal advice to get as much comfort as possible that their arrangements do not raise competition law concerns. Certain forms of collaboration can break competition law and the consequences of this can be serious.

It is important therefore that this self-assessment starts alongside the negotiation of a term sheet/outline parameters and before any formal agreement is signed so that competition law considerations can be reflected in the transaction documents and before the arrangement implemented. It is equally important to regularly check agreements to ensure that they continue to comply with competition law and are up-to-date with regulatory changes.

The scope of collaboration

Does the cooperation risk restricting competition?

Competition laws generally prohibit any agreement or concerted practice that has the object or the effect of preventing, restricting or distorting competition. This includes any agreement that results in a loss of competition on prices, output, product quality, product variety or innovation itself. The concept of an "agreement" is defined widely, covering anything from formal agreements to gentlemen's agreements, and even the mere provision or receipt of competitively sensitive information.

As a starting point, it is therefore recommended to check whether the proposed cooperation could reduce or remove existing competition between the collaborating businesses. The greater any reduction in competition, the higher the legal risk.[4] Moreover, any reduction of competition should be absolutely necessary to achieve its goals. For example, competition authorities have previously found that a restriction of competition between the parties in a country outside the scope of their collaboration infringed competition rules.[5] The question therefore is whether any reduction in competition brought about by the collaboration is strictly necessary to achieve the innovation-related objective.

Justifications and safe harbours

Where open innovation could lead to a restriction of EU competition law, some 'safe harbours' under EU current rules may allow, in certain circumstances, innovation-related agreements not to be found in breach. This is on the basis that competition law recognises that these agreements can result in significant efficiency gains. These safe harbours provide companies with some legal certainty as it allows them to implement relevant agreements safe in the knowledge that they comply with EU competition law. However, the comfort that they offer remains limited in practice.

- First, cooperation in research and development of products or technologies ("**R&D**") and in the exploitation of the results, can be exempted under competition

3 See for example, CMA Final report, JD Sports/Footasylum, 6 May 2020. CMA Final report, Hunter Douglas/247 Home Furnishings (blinds), 15 September 2020.

4 See also, CMA Guidance, Joint Venture Business Advice, 12 April 2018.

5 Case T-216/13, *Telefónica, SA v European Commission*, 28 June 2016.

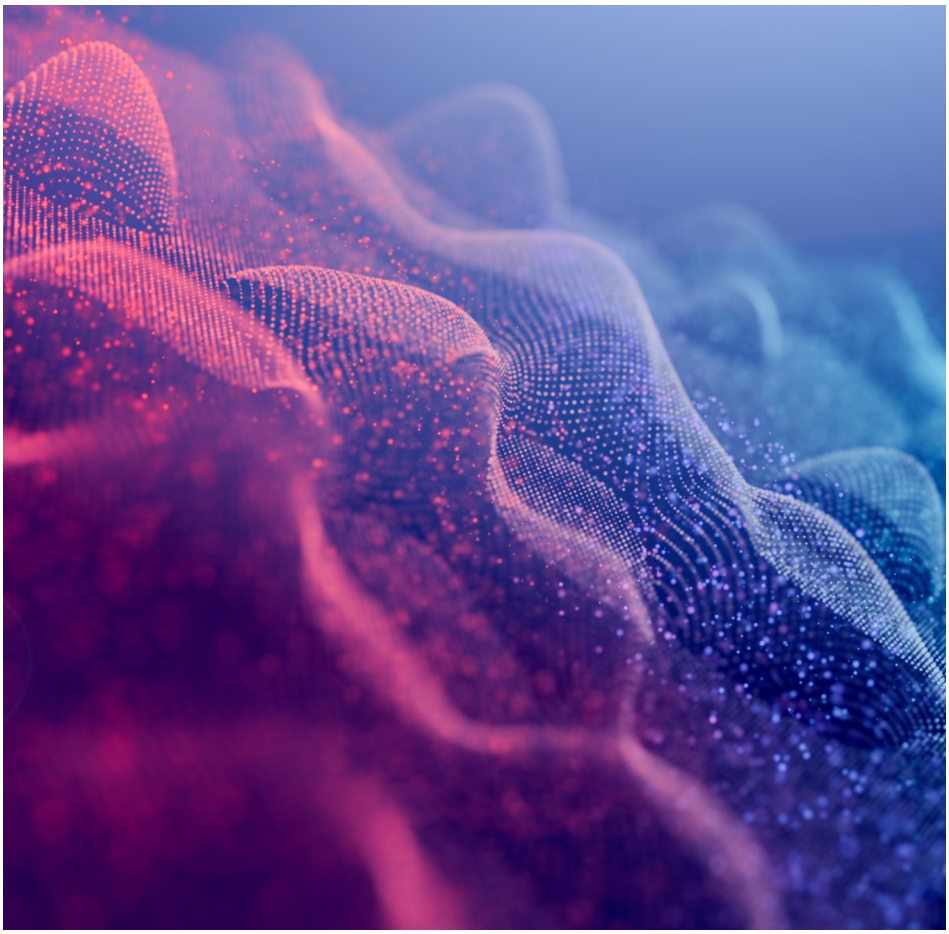
law rules, subject to certain conditions.[6] In particular, to benefit from the exemption, the parties' combined market share should not exceed 25% in any of the relevant markets affected by the agreement.[7]

Moreover, the R&D Block Exemption Regulation specifies a number of so-called 'hardcore restrictions' which, if included in an agreement, will take the entire agreement outside the scope of the safe harbour, regardless of the market shares of the parties. These hardcore restrictions include restricting the parties' freedom to carry out R&D independently or in cooperation with third parties in a field unconnected to the R&D agreement, the limitation of output or sales unless specified circumstances.[8]

- Second, specialisation agreements, which by their nature restrict competition in agreeing that one party or the parties give(s) up the manufacture of a particular product or the supply of a service, can also benefit from an exemption under certain circumstances.[9] This is on the basis that such agreements are more likely to promote technical and economic progress if the parties contribute complementary skills, assets or activities.[10]

  However, the market share thresholds of the 'safe harbour' are low and require that the parties' market shares on any relevant market affected by the specialisation does not exceed 20%.[11] 'Hardcore restrictions' – which make the benefit of the exemption fall through – include the fixing of prices when selling the products to third parties (unless the products are jointly distributed to immediate customers), limiting output or sales (except in specified circumstances) and the allocation of markets or customers.[12]

- Third, the Technology Transfer Block Exemption ("**TTBE**") applies to technology licensing agreements in relation to



intellectual property rights (patents, know-how and software copyright) where the licensor permits the licensee to exploit the licensed technology rights for the purpose of producing goods or services.[13] The TTBE covers both the transfer of technology as such as well as other provisions contained in technology transfer agreements if, and to the extent that, those provisions are directly related to the production or sale of the contract products.

For technology transfer agreements between competitors, the exemption applies if the parties' combined share of the relevant markets does not exceed 20% subject to further conditions, while the market share threshold is 30% for agreements between non-competitors.[14] Hardcore restrictions include the restriction of a party's ability to determine its prices when selling products to third parties, the limitation of output or the allocation of markets or customers, except in specified circumstances.[15] Moreover, the European Commission has the right to withdraw the benefit of the exemption where a relevant agreement has effects which are incompatible with the objectives of the Treaty on the Functioning of the European Union ("**TFEU**").

6 Subject to such R&D agreements restricting competition. Commission Regulation (EU) No 1217/2010 of 14 December 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of research and development agreements, OJ L 335/36, 18.12.2010 (the "**R&D Block Exemption Regulation**").

7 R&D Block Exemption Regulation, Article 4.

8 R&D Block Exemption Regulation, Article 5.

9 Commission Regulation (EU) No 1218/2010 of 14 December 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of specialisation agreements Text with EEA relevance OJ L 335, 18.12.2010 (the "**Specialisation Block Exemption Regulation**"),

10 Ibid, para 6.

11 Specialisation Block Exemption Regulation, Article 3.

12 Specialisation Block Exemption Regulation, Article 4.

13 Commission Regulation (EU) No 316/2014 of 21 March 2014 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of technology transfer agreements, OJ L 93, 28.3.2014, p. 17–23 ("**TTBER**").

14 TTBER, Article 3.

15 TTBER, Article 4.

While these exemptions are helpful tools for companies, their limited scope means that some part of collaboration may fall outside of the exemption. In addition, given innovative projects are by definition evolving, it may be difficult for companies to assess whether their cooperation will meet the strict criteria of any safe harbour. Therefore, in practice, the legal certainty which companies can draw from these exemptions may remain limited. However, the principles arising from these exemptions can be applied by analogy and assist the self-assessment of a collaborative project.

Beyond general exemptions, competition authorities may also recognise, on a case-by-case basis, the benefits arising from certain cooperation on the basis that certain restrictions of competition can give rise to efficiencies and consumer benefits which could not be achieved without such restriction.[16] Four cumulative criteria for an efficiencies exemption should be met: (1) the agreement contributes to improving the production or distribution of goods or to promoting technical or economic progress; (2) consumers are allowed a fair share of the benefit; (3) only restrictions indispensable to achieving those objectives are imposed on the parties concerned; and (4) the parties are not afforded the possibility of eliminating competition in respect of a substantial part of the products concerned. In practice it remains difficult to conclude with any certainty that any particular arrangement meets the criteria above, which makes the definition of the pro-competitive objective of a collaboration all the more important (see section 1).

Working together: competition law safeguards

From the initial discussions through to commencement of the project, competition law safeguards should be implemented and competition law considerations taken account of.

A competition authority will consider whether the cooperation risks resulting in a restriction of competition on prices, output, quality and even innovation itself. Moreover, it will also assess the risks of spillover effects of such collaboration, for example if the scope of cooperation goes beyond what is strictly necessary to achieve the pro-competitive objectives or if, as a result of the cooperation, competitors gain insights into each other's commercial strategy, thereby reducing their independence in the market outside of their project.

In particular, it is essential to manage information sharing within the scope of the collaboration. Sharing commercially sensitive information with an actual or potential competitor is prohibited as this may reduce uncertainty about future conduct. Commercially sensitive information includes strategic information on prices, volumes, customers, trading intentions/strategies, margins or costs. This covers even the one-off or one-way provision of information, and can include the indirect provision of information through third parties.

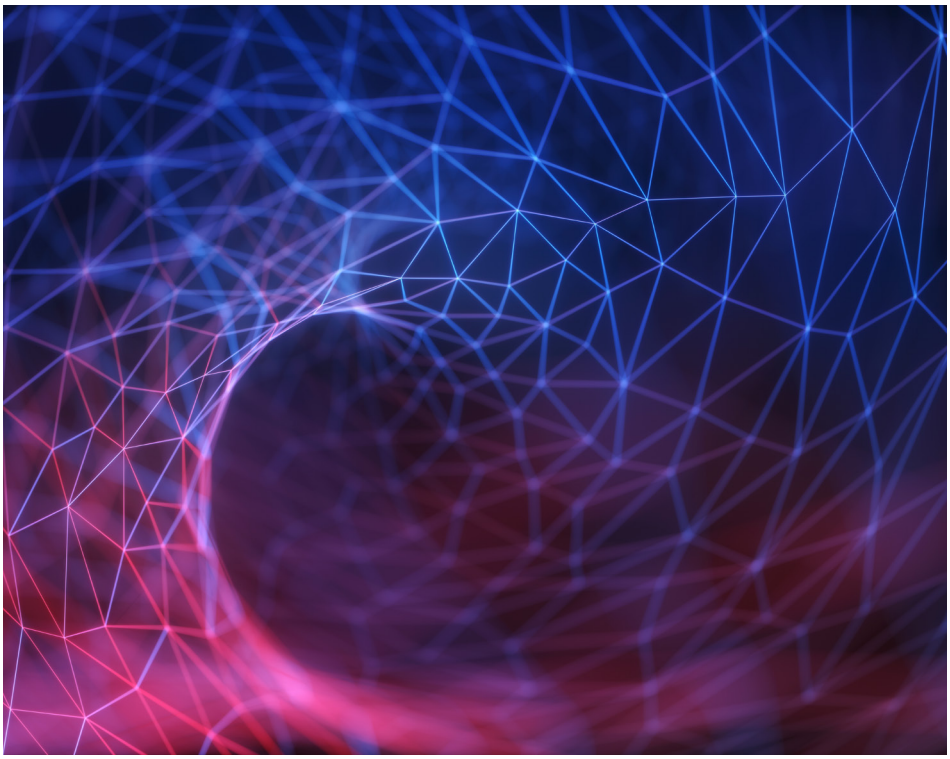
To mitigate such risks, prior to engaging into any collaboration, it is recommended to consider the following questions:

What information do you need to exchange for the purpose of the collaboration?

Limiting any information sharing on a need-to-know basis will be key. Before you start the collaboration, it is important to define (1) whether you need to share or receive any information relating to your or your partner's business that you consider to be commercially sensitive and (2) in what format this information needs to be shared with the other party for the purpose of the collaboration, for example, whether it can be aggregated and/or anonymised. Any exchange of commercially sensitive information should be limited to what is strictly necessary to the purpose of the collaboration.

Who do you need to exchange information with for the purpose of the collaboration?

As a starting point, it will be important to identify delineated teams involved in the innovation-related project. The involvement of business teams should only take place on a need-to-know basis. For this purpose, it may be helpful to implement information barriers between operational teams that are involved in the day-to-day business and teams that are involved in the collaborative project. Constituting a 'clean team' will therefore help to ring-fence any commercially sensitive information which needs to be shared in the context of the innovation-related project from the day-to-day operations of your business. Clean team members should receive competition law guidance and training.



16 Article 101(3) of the TFEU.

What to do if the project is abandoned?

Because ultimately not every project is taken forward, it is important to agree the parties' rights and obligations in the event that the project is abandoned, for example destroying confidential information received from the other party, considering the parties' rights to develop projects on their own. In this respect, any exclusivity or non-compete obligation should be reviewed closely to ensure that they are terminated if the collaboration is no longer proceeding.

Regulatory developments to watch

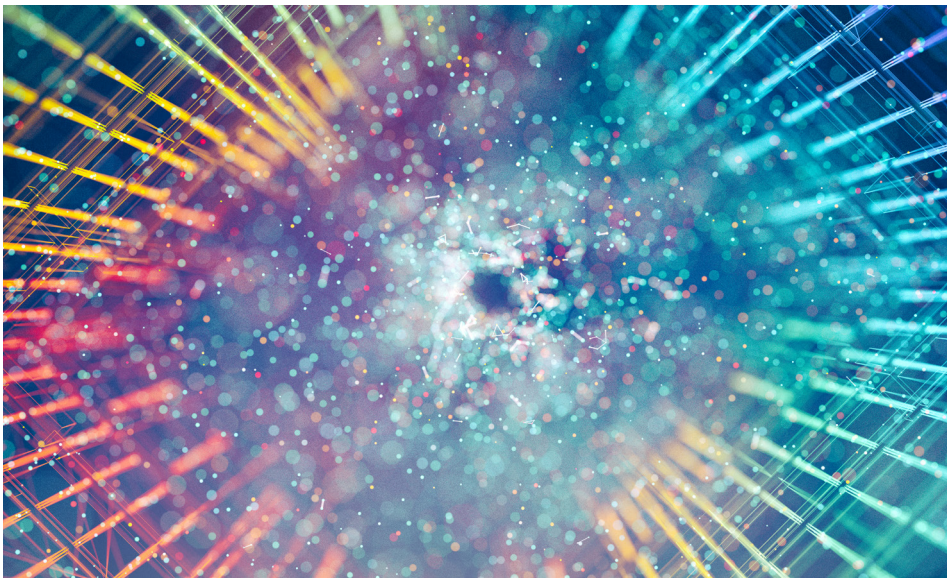
Finally, in addition to the main competition law principles set out above, one should bear in mind that the regulatory space is moving and regulatory developments should be monitored closely. Indeed, a number of potential changes which are underway could impact innovation-related projects.

The European Commission is currently reviewing the rules on vertical agreements, ie agreements between companies which are at different level of the supply chain. Within that framework, the European Commission is notably considering the application of these rules to new and developing business models and the impact of market digitalisation. In response to the European Commission's consultation, stakeholders have notably asked for clarifications on the application of block exemptions relating to and additional guidance on the assessment of intellectual property rights agreements.[17]

Moreover, as part of the European Digital Strategy, the European Commission has announced a Digital Services Act ("**DSA**") package to "strengthen the Single Market for digital services and foster innovation and competitiveness of the European online environment".[18] The new DSA package is proposed to include (1) rules framing the responsibilities of digital services to address the risks faced by their users and to protect their rights and (2) *ex ante* rules covering large online platforms acting as gatekeepers. The European Commission launched a public consultation on these rules which closed on 8 September 2020. The next step is for the European Commission to publish its findings from this consultation.

Finally, certain sectors which are particularly relevant to innovation-related projects are under regulatory scrutiny. For example, in July 2020, the European Commission launched a sector inquiry into the Internet of Things ("**IoT**") for consumer-related products and services in the European Union.

While these are only examples, they show that current regulatory developments should continue to be closely monitored when engaging into an innovation-related collaborative project. The digital sector is given huge prominence at the moment and further changes from a competition law standpoint are yet to come.



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Issue 1

Getting the IP right in collaborations

Issue 2

Data issues in innovation and collaborations

17 Commission Staff Working Document Evaluation of the Vertical Block Exemption Regulation, 8 September 2019.

18 See https://ec.europa.eu/digital-single-market/en/digital-services-act-package

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