COMMENTS ON THE DRAFT GUIDELINES ON THE APPLICABILITY OF ARTICLE 101 OF THE TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION TO HORIZONTAL CO-OPERATION AGREEMENTS

ECLF WORKING GROUP ON HORIZONTAL AGREEMENTS

Introduction

1. This paper is submitted on behalf of the European Competition Lawyers Forum (the ECLF) in response to the European Commission's public consultation on the Draft Guidelines on the Applicability of Article 101 of the Treaty on the Functioning of the European Union to Horizontal Co-operation Agreements (the Draft Guidelines). The ECLF is a group of practitioners in competition law from around 80 law firms across the European Union (see Annex 2).

2. This paper has been compiled by the ECLF Horizontal Agreements Working Group (the Working Group) (see Annex 1) and does not purport to reflect the views of all ECLF members. While the paper has been circulated within the Working Group for comment, its content does not necessarily reflect the views of the individual members of the Working Group or of their law firms.

3. The Working Group makes a number of specific comments regarding the Draft Guidelines. They focus on the following themes:

- Information Exchange
- Standardisation Agreements
- R&D Block Exemption

4. In addition, the Working Group has considered the implications of Paragraph 11 of the Draft Guidelines, which addresses the concept of "undertaking" under EU competition law, in particular as regards the extension of parent–subsidiary principles to joint venture situations. A majority of the Working Group is satisfied with the text of Paragraph 11 as it is a welcome step in clarifying that, for cases not involving hard-core cartels, agreements between a joint venture and its parents should not be subject to antitrust scrutiny. In this regard, certain members of the Working Group considered that for the sake of clarity an additional footnote may be added to the Draft Guidelines to explain that Paragraph 11 does not apply to the treatment of joint ventures under

Article 23 of Regulation 1/2003, to the Guidelines on the Method of Setting Fines or to the Leniency Notice. However, a minority of the Working Group urges the Commission either to delete the wording in issue or to replace it with further guidance addressing the issues considered in the paper provided at Annex 3.

I. Information Exchange

5. As an initial observation, we note that information exchange is an area of great practical importance in many contexts, yet little legal guidance (particularly outside the cartel context) exists. Chapter 2 of the Draft Guidelines is therefore a welcome development. We have several comments and suggestions regarding specific issues raised in the chapter.

A. Restriction of Competition by Object

6. We note at the outset that the distinction between "object" and "effect" is generally at odds with the Commission's positive move to an effects-based approach to Article 101 enforcement. We find the distinction to be particularly unhelpful in the context of analysing information exchange. That said, if the distinction is to be employed, then we would welcome rules that provide as much certainty as possible as to how the concepts will be applied and the consequences of their application in particular cases. This is particularly true following the judgment of the Court of Justice in *T-Mobile*,[1] which we do not think offers a practically applicable test for identifying "restrictions by object".

7. Paragraph 68 of the Draft Guidelines states that "information exchanges between competitors of individualised data regarding intended future prices or quantities" are particularly likely to lead to a collusive outcome and particularly unlikely to be done for procompetitive reasons, and should therefore be considered as restrictions of competition by object within the meaning of Article 101(1). This presumption would apply both to direct exchanges of such information and to the exchange of information on current conduct or other information that enables the direct deduction of intended future prices or quantities. We interpret this language as referring to actual future prices and quantities of the party disclosing the information, and not perceptions as to general market trends or estimates of average/expected prices—future or current—in the market. If that is correct, then we consider this basic principle relatively easy to apply and classification as a restriction "by object" seems

[1] Case C-8/08 *T-Mobile Netherlands BV and others v Raad van bestuur van de Nederlandse Mededingingsautoriteit* [2009] not yet reported.

appropriate, at least assuming, as the ECJ does in *Glaxo*,[2] that a restriction by object does not imply that an exemption under Article 101(3) is excluded from the outset. Nevertheless, particularly given that the distinction between current and future pricing is not always clear, we think the Draft Guidelines might usefully clarify that such exchanges will "generally" or "normally" be considered as restrictions by object, so as not to draw too rigid a line around an area where distinctions are sometimes blurred.

8. As a related point, we note that the Draft Guidelines' definition of "intended future quantities" in footnote 46 may be too narrow. In some industries (eg mining), information on intended future capacity and production levels—which may correspond closely to "intended future sales" or "market shares"—is widely publicised. This is procompetitive in that, *inter alia*, it helps both producers and consumers of the products to plan long-term investments. Yet the Draft Guidelines could be interpreted as placing such exchanges into the category of "restrictions by object", which seems clearly inappropriate. Editing the Guidelines as suggested above to clarify that the presumption of anticompetitive object is not rigid and that there may be exceptions, would help to address this issue. The Guidelines also might usefully clarify at this point (in line with Paragraph 84) that the open or public dissemination of such information would normally not be regarded as a restriction by object.

9. Finally, we note that the last two sentences of Paragraph 68 appear to undermine the legal certainty created by the first two regarding the identification of restrictions by object. The third sentence suggests that a private individualised exchange of information on prices or market shares may be found to involve a restriction by object if it "aims to restrict competition on the market", without explanation as to how one could identify such an aim. If the Commission has in mind, for example, direct corroborating evidence of subjective intent (eg correspondence between companies), then this could be specified in the Guidelines. However, if the Commission intends to infer an anticompetitive "object" merely from the nature of the information (other than intended future prices or quantities) that is exchanged, then significantly more guidance is needed.

B. Exposure to Fines

10. The Draft Guidelines do not make clear which categories of information exchanges would be viewed as an infringement of Article 101 that could give rise to a fine. In particular, while Paragraph 9 of the Draft Guidelines states that they are "not intended to give any guidance as to what does and does not constitute a

[2] Joined Cases C-501/06 P, C-513/06 P, C-515/06 P and C-519/06 P *GlaxoSmithKline Services Unlimited v Commission*, [2009] not yet reported.

cartel", at other places (eg Paragraphs 59 and 68) they appear to suggest the types of information exchange that could be investigated, and subsequently fined, as constituting a cartel. The distinction between an "exchange of information" and the notion of "cartel" can be elusive (eg in the case of a legitimate exchange of information between companies, followed later by illicit collusion), and the clearest possible rules for distinguishing these situations would be welcome.

11. The last sentence of Paragraph 68 could be read as suggesting that only restrictions by object could lead to a fine being imposed on an undertaking. If this is the intention of the Guidelines, it should be stated more clearly. However, the broad formulation provided in the third sentence of Paragraph 68 (as outlined above) severely undermines any intended safe harbour from fines for information exchanges that are merely restrictive by effect. Even a small chance that the Commission could find an exchange to constitute an infringement may, because of the enormous exposure under the Fining Guidelines, deter the procompetitive exchange of information, particularly in large markets. As the Draft Guidelines recognise elsewhere that the public nature of an exchange is generally indicative of its procompetitive nature,[3] there may be good sense in providing a safe harbour from fines at least for information exchanges that do not involve the disclosure of future intentions on pricing or quantities and operate in an "open and notorious" manner.

C. Restrictive Effects on Competition

12. The Draft Guidelines espouse a predominantly effects-based approach to the analysis of horizontal agreements. While an effects-based approach tends, as a purely theoretical matter, to disfavour extensive safe harbour rules, it may be appropriate, where the market shares of undertakings involved are low, to forego a full effects-based approach in order to promote the efficient allocation of enforcement resources and compliance costs, and provide a higher degree of legal certainty.

D. Public Information

13. The description of genuinely public information set out in the Draft Guidelines is not sufficiently clear. The Draft Guidelines provide, in Paragraph 82, that genuinely public information be "costless" to obtain, but then later in the same paragraph state that, for information to be genuinely public, "obtaining it should not be more costly for buyers and companies unaffiliated to the exchange system than for the companies exchanging in the information". Both tests are too restrictive. Frequently, third-party sources such as industry analysts make a

[3] See, eg Paras 84 and 99 of the Draft Guidelines.

significant amount of market information available to undertakings that will pay for it. Such information is not "costless" to obtain, but is generally regarded as being publicly available. Similarly, such information providers may offer preferential terms to firms that also agree to contribute information. The fact that some purchasers (eg customers who do not contribute information) would have to pay a higher price should have no bearing on the key consideration, namely that the availability of the information to customers and other market participants indicates that there is no anticompetitive aim in collecting and publishing the information.

E. Aggregation of Data

14. The treatment of aggregated/non-aggregated data in Paragraph 85 of the Draft Guidelines appears to consider only two forms of data: "genuinely aggregated" data and "company level" (ie presumably fully individualised) data. In order to aid the practical application of the Guidelines, further guidance on the level of aggregation likely to be acceptable to the Commission would be useful. In particular, if the Commission intends to depart from the generally understood rule of thumb that "genuinely aggregated" information should combine data from more than three market participants (which is presumed to make it too difficult to "reverse engineer" competitively sensitive individual company data), this should be made clear.

F. Age of Data

15. While the adoption of a predominantly effects-based approach generally counsels against establishing firm ex ante "rules of thumb", the Draft Guidelines nevertheless suggest a significant change to the typical current treatment of historic data. In previous cases, the Commission has indicated that data that is more than one year old is likely to be considered "historic",[4] and this principle has fallen into common use. However, Paragraph 86 of the Draft Guidelines suggests that data can generally be considered as historic if it is "several times older than the average length of contracts in the industry". As many industries operate with annual contracts, and assuming that "several" must be taken to mean more than two, the proposed wording would have the effect of considerably broadening the current "rule of thumb" suggested by the Commission's previous decisions.

[4] Commission Decision of 17 February 1992 in Case IV/31.370 *UK Agricultural Tractor Registration Exchange* [1992] OJ L68/19 of March 13, 1992, para 50; Commission Decision of 26 November 1997 in Case IV/36.069 *Wirtschaftsvereinigung Stahl* [1998] OJ L1/10, para 17.

G. Illustrative Examples

16. The use of examples to illustrate the application of the Draft Guidelines is welcome. However, in general, to be more useful in practice the examples provided in the Draft Guidelines could provide more detail regarding the analytical methodology likely to be adopted by the Commission. Further practical examples that cover more complicated, borderline situations might also be useful.

17. The examples provided in Paragraphs 98–99 sharply distinguish between a situation in which one exchange (Example 1) is viewed as a restriction by object and unlikely to fulfill the criteria of Article 101(3), whereas the same exchange with minimal modifications (Example 2) is viewed as being most likely compatible with Article 101(3). The Guidelines attribute this difference to a distinction between "intended future prices" and "present prices of future services". However, this distinction is not as clear-cut as the Draft Guidelines suggest. In particular, present prices for future services, or the availability of services for the price in question, can often change quickly (as is the case, for example, in the airline industry). The perceived risk of competitors revising future prices in light of what competitors offer (see Example 1) is thus also inherent in any reservation system that is publicly accessible. It is not the distinction between "intended future prices" and "present prices for future services" that should be decisive, but rather a weighing of (i) the benefits of making prices available to the general public against (ii) the risk of competitors using the publication of prices to align their conduct.[5] The latter risk is low where, as for example in the airline industry, yield management and pricing is extremely complex and subject to constant changes, making any kind of anticompetitive alignment difficult.

18. Example 3 as drafted is not very instructive. In particular, given the nature of the hotel industry it is surprising to conclude that "from the information exchanged the parties can directly deduce their [competitors'] actual current prices", unless this information were to be broken down further (eg by room category). In any event, current prices are not future prices, and it is not clear what "collusive outcome" the system is designed to monitor. In addition, it is not obvious why, in practice, cost structures of luxury hotels would be "largely homogeneous". Finally, as hotel rooms are perishable goods, the exchange of occupancy rates would have at least the potential benefit of allowing the hotels to efficiently forecast demand (identified in Example 7 as a potential efficiency).

[5] For instance, in Example 1 in the Draft Guidelines, the fact that the exchange is limited to competitors negates any benefits to customers, thus also suggesting an anticompetitive motivation.

H. Further Guidance

19. In addition to the comments offered above on the content of the Draft Guidelines as they currently stand, further guidance would be useful on certain other common (and potentially problematic) areas, in particular:

- Information exchange within the context of EU regulatory regimes (eg consortia between companies to comply with REACH obligations).
- The use of common calculation tools in the context of information exchange.
- The role of trade associations and conduct acceptable within this context. In this regard, the Draft Guidelines might usefully place more emphasis on the legitimate and efficiency-enhancing role of trade associations in providing their members with (i) useful statistical information and (ii) other information, tools and training. More precise guidance as to acceptable conduct of a trade association, for example as regards benchmarking, would also be helpful. In this context, it may be helpful to distinguish between various forms of trade association (eg information exchanges within a trade association representing a large number of small businesses versus one representing a small number of large players), which may call for different levels of analysis.
- The Draft Guidelines are silent with respect to information exchange in connection with mergers or other transactions. Such information exchange is commonplace and essential for transaction negotiations and the planning of transaction implementation and post-closing company integration. Companies typically implement such exchanges under the (assumed) protection of safeguards such as the use of "clean teams", confidentiality agreements and agreements to return or destroy confidential information in case the transaction is aborted. Yet such measures are taken largely in the absence of legal precedent or other guidance. This is an area that the Guidelines could usefully address, even in brief.
- The Commission has suggested that while the Draft Guidelines do not specifically address so-called "hub-and-spoke" infringements, the general principles set out in the Guidelines will apply equally to this type of arrangement. However, "hub-and-spoke" arrangements also raise issues not currently covered in the Draft Guidelines, particularly regarding the exchange of information within the distribution chain (eg in the context of trading negotiations between retailers and suppliers). In particular, recent UK case law has highlighted the concept of an indirect concerted practice between competing retailers based on the exchange of confidential information between them via a common supplier.[6] It is important that undertakings are able to distinguish between situations in which retailers can share information

[6] See *Littlewoods v Office of Fair Trading* and *JJB Sports v Office of Fair Trading* [2006] EWCA Civ 1318.

with suppliers for legitimate (often procompetitive) reasons (eg bargaining) and situations in which retailers will be considered to be effectively using the supplier as a "go-between" for the anticompetitive exchange of information. In this regard, it may be useful for the Commission to highlight that actual knowledge (and not merely constructive knowledge) of the role being played by the supplier is required of both the retailer and its competitor in order for a concerted practice to be established. This not only seems like a sensible approach for providing businesses with sufficient legal certainty to guide information exchange within the supply chain, but is also the most consistent interpretation of "hub-and-spoke" arrangements with existing EU case law, under which a concerted practice can only be found where undertakings "knowingly substitute practical co-operation between themselves for the risks of competition".[7] More generally, the Commission's approach to exchanges of information amongst competitors through third-party "conduits" or indirect "signalling" behaviour would be clarified.

II. Standardisation Agreements

A. Preliminary Observations

20. Standard-setting activities play a fundamental role in fostering innovation and competition in many different markets. There is a great variety of standard-setting organisations (SSOs), which often compete with each other. SSOs have among their members companies operating on the basis of very different business models, and the forthcoming Commission guidelines should not favour one particular business model at the expense of another. In particular, great care should be taken to ensure that these guidelines do not discourage intellectual property rights (IPR) holders from participating in SSOs out of concerns that such SSOs' IPR policies would harm their ability to monetise their IPR and thus hurt their ability to innovate. IPRs are often an effective instrument for promoting and protecting innovation, and in many fields, standards benefit significantly from the inclusion of proprietary technologies.

21. Certain members of the Working Group question whether standard setting should be addressed in general horizontal guidelines at all. Clearly major disputes have arisen and continue to exist in the context of mobile communications standards, where the explosion of standards-essential IPRs and the

[7] See, Cases 48, 49 and 51-57/69 *ICI v Commission* [1972] ECR 619, para 64. Similarly, this appears to be most consistent interpretation with the requirement that in order for the existence of a concerted practice to be found, implementation should occur on the market. See, eg Case C-199/92 P *Hüls AG v Commission* [1999] ECR I-4287.

enormous stakes involved for all users of the standard raise particular issues. The current Draft Guidelines reflect these recent experiences. However, it is not obvious that the issues which arise in the context of mobile communications are representative of what could be perceived to be a wider problem across industries and SSOs. An attempt to address industry-specific issues in great detail through general guidelines risks leading to either over- or under-enforcement, and may prove to be of little relevance to or complicate the operation of many SSOs and standardisation agreements.

22. The objective of guidelines regarding the application of Article 101 to certain categories of practices, in this case horizontal cooperation agreements, is to help companies determine whether an agreement they have concluded or are planning to conclude with one or several other companies falls within the scope of Article 101(1) and, if so, whether this agreement can be justified under Article 101(3). However, regarding standardisation agreements, the description in the Draft Guidelines of circumstances that fall under Article 101(3) may actually create uncertainty within SSOs. Similar to the 2001 Guidelines, the new Draft Guidelines provide a safe harbour approach, explaining under which circumstances standardisation generally would not include an appreciable restriction of competition and thus fall outside the scope of Article 101(1). However, unlike other chapters in Guidelines, the chapter on standardisation provides little concrete guidance on how the Commission would assess whether individual agreements fall under Article 101(1) and, if so, how such agreements would benefit from the exception contained in Article 101(3).

23. In particular, the Draft Guidelines do not refer to elements essential to such an analysis, including: (i) the role of competition between products that implement different standards and competition between standardised and non-standardised products; and (ii) the importance of the standard in question, including whether access to it is necessary in order to effectively compete on a relevant market. Similarly, the Draft Guidelines do not address some of the pitfalls of standardisation on which guidance would be welcome, such as the question of when do standardisation efforts exceed what is appropriate under Article 101 (ie over-standardisation).

24. Certain members of the Working Group feel that, given the changes that have occurred in the international standardisation landscape in general, and the growing number and importance of specialised fora and consortia in particular, such a framework would be very welcome, and should set out the relevant criteria for analysing agreements that do not meet all the (highly set) safe harbour criteria that are typically pertinent for formal standards bodies (such as the ESOs) and other important SSOs.

25. With these general observations in mind, we would like to make a number of comments, focusing on the following themes:

- Safe harbour requirements
- Role of Article 102
- Environmental standards

B. Safe Harbour Requirements

1. Unrestricted Participation

26. With regard to the "no bias" rule contained in Paragraph 278, on the one hand, royalty-free standards and standards involving IPR whose holders seek financial compensation should be able to co-exist and compete. However, on the other hand, in certain sectors, eg software, royalty-free licensing may be the norm and, to the extent that the rule contained in Paragraph 278 may be read to suggest that an SSO cannot require royalty-free licensing of standards essential IP without infringing Article 101, clarification may be required.

2. Misuse

27. The focus of the Draft Guidelines on open and transparent procedures is broadly welcomed. However, certain aspects of the text deserve particular attention.

28. The requirement set out in Paragraph 281 that within the SSO, "IPR holders [should] make reasonable efforts to identify existing and pending IPR reading on the potential standard" and that results that might be essential for the standard should be disclosed before the standard is agreed, is important. However, it should not place a disproportionate burden on those participating in SSOs and consequently act as a disincentive to taking part.

29. Regarding a mandatory disclosure rule, on the one hand, this may prove difficult to implement and may conflict with general IP law principles. On the other hand, it is important to keep in mind the procompetitive benefits that may result from mandatory *ex ante* disclosure.

30. Further, while it is arguable that the inclusion in the mandatory disclosure of IPR that might be essential for the standard would run counter to well-established SSO practice and generate significant costs, it is also arguable that covering potentially essential IPR is necessary in order to be as inclusive as possible at this early stage in the process when the essentiality of the IPR at question may not be clear.

31. Finally, certain members of the Working Group feel that the Draft Guidelines should indicate that the belated (*ex post*) disclosure of essential IPR does not constitute evidence of unlawfulness or bad faith. Empirical evidence shows that a very significant percentage of essential IPR is disclosed *ex post*

standard adoption in good faith and does not hinder the implementation of the standard.

3. FRAND Terms

32. The Commission's effort to set out the aim and basic principles of fair, reasonable and non-discriminatory (FRAND) licensing in Paragraphs 280 and 283 is welcomed by a majority of the Working Group membership. A minority view is that there is no need to define the meaning of FRAND further. Pursuant to this view, the fact that FRAND is not further defined cannot indeed be viewed as a shortcoming of SSOs' IPR policies but as its strength. In the view of this minority, it is the very absence of a definition mechanically translatable into concrete terms that bestows on the FRAND commitment the suppleness required to achieve one of the fundamental aims of standardisation, ie to ensure the widest availability of the technology embodied in the standard in the widest possible variety of circumstances, without unduly diminishing the innovation incentives that patent law was designed to create.

33. The extent to which the methods referred to below (or any other methods for defining FRAND) will be suitable for a particular standard will vary depending on the specific factors pertaining to that standard. The businesses that are likely to be in the best position to evaluate such factors are the SSO members themselves. Therefore, rather than seeking to provide a non-exhaustive list of methods to assess whether royalty demands may constitute an abuse under Article 102, a majority of the Working Group considers it would be useful if the Draft Guidelines required SSOs to define FRAND with greater precision in their IPR policies for each of the particular standards they develop. This could include the requirement that SSOs provide for a mandatory complaints procedure. The Commission should also provide guidance on how SSO members may act collectively in relation to royalty rates without infringing Article 101. A minority of the Working Group expresses reservations in this regard indicating that this has been tried and failed and hence is considered unrealistic. In addition, this minority notes the potential for confusion caused by multiple definitions of FRAND and expresses concern that collective action in relation to royalty rates will amount to an effort by standard implementers to depress the income of essential IPR owners.

4. Excessive Pricing Benchmarks

34. The Draft Guidelines correctly note that cost-based methods are not well adapted to the assessment of royalty rates for standard-essential patents. Accordingly, a non-exhaustive list of methods to assess whether royalty fees are excessive is set out:

a) "compare the licensing fees charged by the undertaking in question for the relevant patents in a competitive environment before the industry has been locked into the standard (*ex ante*) with those charged after the industry has been locked in (*ex post*)"[8]
b) "obtain an independent expert assessment of the relevant IPR portfolio's objective quality and centrality to the standard at issue"[9]
c) "rely on previous unilateral ex ante disclosures of most restrictive licensing terms"[10]

35. While there is some merit to each of these methods, there are also a number of disadvantages. Generally, it is arguable that all three options are of limited use in that royalties are typically only one of the forms of consideration that may be agreed between the parties to a licensing negotiation. Hence, because the parties negotiate over a range of elements, the determination of a FRAND royalty cannot be determined in the abstract. Whether or not a royalty is fair and reasonable depends on the circumstances proper to each licensing negotiation. In addition, the proposed excessive pricing benchmarks omit any reference to *ex ante* bilateral negotiations and to the relevance of existing license agreements, which should arguably be among the most influential factors in determining whether specific licensing terms are reasonable.

36. In relation to the first method, *ex ante* licence negotiations are a good benchmark of a competitive royalty rate if the patent landscape is sufficiently clear and the alternatives to the relevant patented technology are readily identifiable at the time of the negotiation. However, where licensing only takes place after the first release of a standard, any licensing agreements reached *ex ante* may not provide an accurate reflection of fair and reasonable *ex post* royalty rates for the relevant patent portfolio.

37. With regard to the second method, an independent expert assessment of the relevant IPR portfolio is considered by some members of the Working Group to be potentially helpful (others disagree). However, patent litigation experience shows that two independent experts may fundamentally disagree on the assessment of a particular patent portfolio. Moreover, it would be better to refer to the value of the patents from the viewpoint of users, rather than the "quality and centrality" of the patents. The value of patents depends on whether they are considered likely to be valid and essential, and their significance for any function or feature that the user plans to incorporate in its product for the downstream market. It would be helpful to give experts as much practical guidance as the Commission feels able to give about the value of patents from the viewpoint of licence negotiation, although certain members of the Working Group feel that

[8] Para 284 of the Draft Guidelines.
[9] Para 285 of the Draft Guidelines.
[10] Para 285 of the Draft Guidelines.

such experts can rely on the generally accepted economic methods of patent valuation and that there is no need for the Commission to promote any such particular methods.

38. In relation to the third suggestion of relying on unilateral *ex ante* disclosures of most restrictive licensing terms, certain members of the Working Group think that this approach is unlikely to lead to fair and reasonable royalty rates. In addition, it appears that this method has value as a safe harbour for licensors, but not otherwise.

39. An important distinction should be drawn between unilateral disclosures of maximum royalty rates and an effective *ex ante* auction. For an *ex ante* auction to be effective in a standard setting context, it is suggested that at least the following prerequisites need to be fulfilled:

a) the alternative technologies that are candidates for inclusion in a standard must be well developed, ie known and stable; and
b) the essential patent landscape must be sufficiently transparent in order to identify which companies own the patents that are essential to each alternative technology.

40. A majority of the Working Group considers that although these conditions may exist in relation to a basic standard, they are often not present in a complex dynamic standard setting process. For example, telecoms standards such as the third-generation mobile standard, UMTS, are not developed through the use of "building blocks" of patented "off-the-shelf" technologies. The standardisation model used by ETSI is based on an ongoing dynamic process involving the setting of requirements and the identification of a multitude of technical problems, which are then solved by substantial R&D efforts conducted by a large number of different contributors as the standardisation process develops over a number of months and years.

41. The Draft Guidelines note that standardisation is a collaborative process involving various industry stakeholders who may have different incentives with regard to royalties.[11] Nevertheless, if the royalty levels are cumulatively too high, this may adversely impact and negate the economic benefits of standardisation. It is therefore important when negotiating royalty rates that individual licensors take into account the cumulative royalty levels payable by licensees. A significant feature of any standard-specific definition of FRAND could therefore include a cap on the aggregate royalty rate for standard compliant products agreed prior to the standard being finalised.

42. It is suggested that an aggregate royalty cap could be defined as reflecting the maximum amount that would be payable by a company that has no IPR to

[11] Paras 271–74 of the Draft Guidelines.

cross-license. For those licensees that do have IPR to cross-license, the result of bilateral negotiations may be that the aggregate royalty payable is far below the aggregate royalty cap (and may even be royalty free in some circumstances). It would also be helpful if the SSO members were able to define the principles that should be applied for the allocation of maximum royalty rates between the various essential patent holders within the confines of the aggregate royalty cap. This model would allow flexibility in bilateral negotiations to accommodate different parameters and considerations applying to different essential patent portfolios.

43. Where such an aggregate royalty cap is appropriate, the key objective for SSO members in setting the cap should be to achieve a maximum royalty rate that represents a fair balance so that, on the one hand, sufficient royalties are available for each essential patent holder to achieve a reasonable rate of return on its research and development investment, while on the other hand, ensuring that implementation costs for the standard are sufficiently low to allow a competitive downstream industry to the ultimate benefit of end-consumers. Where this balance lies will depend on the specific facts of a standard, and it is unlikely to be the case that a single aggregate royalty cap would be appropriate for all standards. However, certain general economic principles could be established for these purposes. For example, one factor that might influence the level of the aggregate royalty cap is the level of *ex ante* competition between technologies for inclusion in the standard. Where there are competitive alternatives for inclusion in a standard, this suggests that, had it been possible to hold a formal *ex ante* competitive auction, this would have reduced the cumulative royalty rate to a low level. The aggregate royalty cap for the standard should therefore reflect this competitive level.

44. Given that the membership of an SSO is likely to include the bulk of the patent owners and their potential licensees, an agreement between SSO members in relation to an aggregate royalty cap should not be considered as a buyers cartel or a restriction of competition by object if a broad consensus between the various stakeholders can be reached. The transparency of the potential royalty burden for a standard could be substantially improved if the Draft Guidelines provided guidance on aggregate royalty caps and how the Commission would assess such practices under Article 101(3).

45. Other considerations for assessing an appropriate royalty rate, which may be deserving of consideration in the Guidelines, are the royalty rate charged by the company in question for the same patents for another standard and the royalty charged by other companies for similar patents for the same standard, or for another standard. Further, it is suggested that the Draft Guidelines should contain reference to how the "reasonableness" of a royalty rate and the associated terms may change over time. Similarly, the Draft Guidelines could

usefully touch upon the issue of how best to deal with royalties that are expressed as a percentage of a product price where the nature and pricing of the product have changed over time.

46. A minority of the Working Group expresses strong reservations with regard to the approach set out in paragraphs 40–45 above and suggests that the concerns underlying the Draft Guidelines ("[a]n abuse of market power gained by virtue of IPR being included in a standard constitutes an infringement of Article 102", Draft Guidelines, Paragraph 284) are based on an uncritical acceptance by the Commission of the highly speculative theories of "hold-up" and "royalty stacking" developed by certain standards implementers and their advocates. The position of this minority of the Working Group is set out in paragraphs 47–52 below.

47. This minority of the Working Group considers that, as regards "hold up", despite a long record of standards development by organisations operating under remarkably uniform IPR policies, there is simply no empirical record of any serious or systematic "misuse of the standardisation process through hold-ups and the charging of abusive royalty rates by IPR holders" (Paragraph 280). The minority view is that, despite the large and controversial literature, advocates of regulatory intervention have offered (to the knowledge of this minority) little or no empirical evidence of instances in which alleged "hold-up" has impaired the uptake and success of a standard.

48. In addition, this minority considers that the "royalty stacking" conjecture equally suffers from serious flaws. First, it is based on the assumption that all the IPR included in any given standard should not be awarded more than a certain percentage of the price of products that comply with the standard—above that level, it would be considered "unreasonable". This does not, however, say anything about the level at which cumulative royalties would be excessive. The IPR contribution to a product can vary from nil (eg commodities) to 100% (eg software), and in many high-technology fields this contribution will be very significant. As pointed out by the European Commission in its Communication on "Intellectual Property and Standardization":

> "In many high technology industries, the highest costs are incurred in the research and development phase when the intellectual input in terms of man-hours work is at its greatest, the manufacturing phase being a relatively low cost operation. The economic value of the intellectual property rights in such a product will therefore constitute an important factor in price calculations and figures prominently as a company asset."[12]

[12] See Communication from the Commission, "Intellectual Property Rights and Standardization", COM(92) 445 final, 27 October 1992.

49. It is the view of this minority of the Working Group that to make the case that any particular cumulative royalty level is "unreasonable" for any particular product would thus require at the very least an extensive empirical analysis of the relative costs of the different inputs comprising such product, including the cost of the R&D incurred to create the incorporated IPR, manufacturing costs, marketing costs, etc. Once such an analysis is conducted, "reasonable" returns could then be apportioned among all firms in the production chain. Only then could one be in a position to argue that a particular total royalty burden is "unreasonable". Those claiming that cumulative royalty rates for implementing a standard are too high should bear the burden of conducting such an analysis.

50. Secondly, this minority of the Working Group considers that the royalty stacking proposition requires conditions that will rarely be met in practice. The standard in question must involve many essential patents held by numerous distinct patent holders as otherwise the stack would be small and either inconsequential or relatively easy to negotiate out of. These conditions will be only present for complex, technology-heavy standards. Even in such cases, however, an additional condition must be present for the royalty-stacking scenario to be likely to occur, which is that some or all standard implementers must have no patents to trade with the essential patent owners from which they seek licenses. Unless this condition is met, cross-licensing between the parties will drastically reduce the risk of royalty-stacking. Indeed, in high-technology industries, most licensors are also licensees, and cross-licensing arrangements between them will be able to reduce any eventual royalty-stacking.

51. It is the position of this minority of the Working Group that cross-licensing between essential patent holders thus significantly dampens the risk of royalty-stacking since most standard implementers will either not pay any royalties or will only pay low royalties to each other. In fact, the only firms that may pay significant royalties are those that have no valuable IPR to trade (pure manufacturers) and are thus unable to conclude cross-licensing agreements. It is far from clear, however, that the fact these companies may have to pay significant cumulative royalty rate such firms is unreasonable. The patent portfolios developed by pure innovators or vertically integrated firms are the result of costly and risky research and development (R&D) efforts which need to be adequately rewarded.[13] The fact that pure manufacturers who do not invest in R&D may in certain circumstances have to pay significant royalties to essential IP owners is, according to the views of this minority, merely a reflection of the Coasean "make-or-buy" decision faced by every firm once it has to consider whether to

[13] Moreover, allowing firms to freely benefit from the investments of others would have several negative consequences. First, it would encourage inefficient entry. Secondly, the results of such R&D efforts would be expropriated to the benefit of those firms which would not have undertaken similar efforts (in this case the pure manufacturers). This would negatively impact incentives to invest in R&D.

produce a manufacturing input in-house (through vertical integration) or to acquire it in the open market. Should pure manufacturers decide that their interests are best served by lowering their royalty payments through cross-licensing of essential patents, they will have an incentive to engage in R&D to develop their own portfolio of essential patents.

52. In addition, this minority of the Working Group questions whether the requirement that SSOs adopt rules designed to curb such unilateral conduct can be properly addressed in the framework of guidelines designed to provide guidance on the assessment of standardisation agreements under Article 101, especially considering the lack of Commission decisional practice and case law on the subject. In this respect, the Draft Guidelines' reference to various "methods" that could be used to determine whether licensing fees "bear a reasonable relationship to the economic value of the patents" (Draft Guidelines at Paragraph 284) appear to the minority view entirely misplaced in the context of guidelines on horizontal agreements as such methods would only be of possible relevance in the context of Article 102 investigations. But for the fact that they deal with exploitative abuses, these issues would have been better addressed in the Commission's Guidance on its enforcement priorities with respect to Article 102 or in a comparable document.

53. A second minority of the Working Group considers that the Draft Guidelines must describe a legal solution under Article 101 that allows users of the standard to invest and go into production with greater confidence that they will not be injuncted if they are willing to pay a FRAND rate. No solution that fails to ensure this can be satisfactory for Guidelines applying Article 101. The essential elements of the solution are clear. In essence, if a standard agreement restricts competition, it can only be acceptable under Article 101 if licences of the essential patent should be available on FRAND terms. Thus, an owner of patents that it claims are technically essential for practising a standard, if it is bound by a commitment to license them on FRAND terms, should be allowed to enforce the patents in question against a creditworthy user only if it is offering a licence on FRAND terms. If it has already licensed the patents for the purpose of the standard, the obligation not to discriminate normally ensures that the terms of the subsequent licences should be clear. If the necessary licence is the first licence that the patent owner would give for the standard, the terms that would be FRAND may be less clear, and more controversial. They may ultimately need to be decided by a court. But the Commission Guidelines should make it clear that, under Article 101, the patent owner should not be able to seek an injunction against the user of the standard, provided that the user is creditworthy and willing to take a licence on FRAND terms of any patents that are valid and technically essential. As a consequence, a national court before which the patent owner seeks to enforce the patents should refuse an injunction if the creditworthy user is willing to take a licence on FRAND terms. No permanent

injunction should be given until the court has determined, if necessary, that the patents are valid and essential, and that the terms offered are FRAND terms under Article 101 and the user has refused to accept those terms. The Guidelines should make it clear that national courts have a duty under Article 4(3) TFEU to "refrain from any measure which could jeopardize the attainment of the Union's objectives" and therefore an obligation under European Union law not to give an injunction where this would facilitate a violation of Community law. Moreover, the Guidelines should make it clear that, in such circumstances, the patent holder bears the burden of proof under Article 2 of Regulation 1/2003 that its licence terms are FRAND and meet the requirements set out under Article 101(3).

5. Non-discriminatory Terms

54. The Draft Guidelines at present effectively only consider the "fair and reasonable" test in FRAND and do not touch in any detail upon the "non-discriminatory" element of the FRAND test.

55. The Commission should consider giving more guidance as to the "non-discriminatory" element of the FRAND test. Indeed, focusing on the "AND" part of the test may help resolve some of the obvious difficulties involved in determining what is "fair and reasonable". For instance, the Commission could usefully indicate that the principle of non-discrimination does not require payments of equal amount, but may be satisfied by cross-licensing arrangements, whether royalty-free or of a lump sum nature. Of course, such rules should not encourage a pattern in which a core group of companies involved in developing a standard uses a web of royalty-free cross-licences that incentivises the mutual "packing" of the standard with would-be essential IP, which is then subsequently used individually or collectively to demand prohibitively high royalties from companies later wishing to implement the standard if those newcomers are viewed as a competitive threat.

C. Role of Article 102

56. First, we note the prominent role of Article 102 analysis in the Draft Guidelines. Some Working Group members have questioned this and in particular whether it provides useful Article 101 guidance for more than a limited number of situations.

57. In this regard, to the extent the Draft Guidelines purport to address FRAND under Article 101, the Draft Guidelines should put less emphasis on the traditional non-IPR related definition of excessive pricing under Article 102 as expressed in the case law when defining "fair and reasonable" royalty rates. The appropriate royalty rate, based on what is "fair and reasonable", might be substantially less than the rate that would be considered unfair under Article 102(a), since the latter has only been applied to situations where a price is

appreciably excessive. While it is not clear which benchmarks should be applied in excessive pricing cases, in cases in which excessive prices have been found, the price was not merely above the relevant benchmark, but was significantly above it, ie it was sometimes many times over the respective benchmark. A minority of the Working Group have expressed strong reservations in this regard and consider that the test of "fair and reasonable" under Article 102 should meet at least the test of Article 102 for excessive pricing.

58. At present, the Draft Guidelines devote only two paragraphs (Paragraphs 284–85) to the assessment of whether a holder of standards-essential IPR abuses its market power gained by the standardisation process. This seems like an awkward compromise between two clear-cut solutions, namely (i) not saying anything at all about Article 102 in Guidelines devoted to Article 101 and (ii) giving meaningful guidance on what constitutes fair, reasonable and non-discriminatory licensing terms under Article 102.

59. Indeed, the concerns which standard setting gives rise to would appear not to be limited to instances where the behaviour would be caught by Article 102. Therefore, it is suggested that the Commission should avoid conflating the concept of "reasonable" fees within the terms of standard-setting under Article 101 with that of excessive pricing under Article 102.[14]

D. Environmental Standards

60. The omission of any specific statements on environmental standards is problematic. Adherence to such standards is often mandatory, especially in some Member States that encourage self-regulation by the industry, often with the implicit or explicit threat of imposing even stricter standards through legislation. Yet the Draft Guidelines suggest that any mandatory standard would be viewed as a restriction by object. Thus, there is a real need for guidance that the Draft Guidelines currently do not address.

III. Comments on R&D Block Exemption

A. Introduction

61. The system of the R&D Block Exemption is unchanged in that certain requirements must be met before undertakings can benefit from the safe harbour provided by the Block Exemption. These conditions are set out in Article 3 of the Draft R&D Block Exemption and relate to access to the results of joint R&D and the freedom of the parties to exploit the joint R&D results.

[14] See, in particular, Paras 280 and 284 of the Draft Guidelines.

62. Our comments will refer to terminology often used in industry to describe pre-existing information and IP rights of a party participating in a joint R&D project ("Background") and the results of an R&D project including IP rights ("Foreground").

63. The Draft R&D Block Exemption tightens the conditions set out in Article 3 in several ways. As set out in more detail below, we are concerned that these new, stricter requirements may discourage some useful R&D projects. We suggest that the need to tighten the current requirements be reconsidered and explained in more detail. We also note that the new requirements result in a regime that is stricter than the rules applying to the European Commission's Seventh Framework Programme (FP7). We suggest the R&D Block Exemption and Horizontal Guidelines should not deviate from the FP7 rules without evidence that the FP7 rules have caused or are likely to cause competitive or consumer harm.

B. New Requirements

64. Paragraph 2 of Article 3 of the Draft R&D Block Exemption provides that the parties must agree that prior to starting the research and development, "all the parties will disclose all their existing and pending intellectual property rights in as far as they are relevant for the exploitation of the results by the other parties". This requirement to disclose all Background IP is new.

65. Paragraph 3 of Article 3 of the Draft R&D Block Exemption provides that all parties must have "equal access" to the results of the joint R&D for the purposes of further research or exploitation (with the exception of research institutes, academic bodies or undertakings which supply R&D as a commercial services). The current Block Exemption only provides that all the parties must have "access to the results". The new rules would therefore turn "access" into "equal access".

66. Paragraph 4 of Article 3 provides that for agreements limited to the R&D stage, each party "must be granted access to any pre-existing know-how of the other parties, if this know-how is indispensible for the purposes of the exploitation of the results". The Block Exemption itself does not circumscribe the right to access. Recital 13 indicates that the party holding the know-how can request a reasonable fee before granting access[15] but that possibility is not repeated in Article 3 itself.

[15] Recital 13 provides: "The rates of any license fee charged must not be so high as to effectively impede access to the know-how by other parties".

67. The current Block Exemption is more liberal and merely provides that each party must be free to exploit Foreground and pre-existing know-how (ie a party's own Background).

68. The current Block Exemption allows the parties to allocate rights to exploitation which are "limited to one or more technical fields of exploitation where the parties are not competing undertakings at the time the research and development agreement is entered into". This possibility of allocating fields of use is now excluded altogether from the safe harbour provided by the Block Exemption.

C. Rationale for Stricter Rules?

69. From these changes, and from Recitals 11–13, it appears that the Commission is aiming at a new regime for R&D projects which provides for more IP disclosure, more access to Background and more competition concerning exploitation of Foreground. However, it is not clear either from the Recitals or the Draft Guidelines what problem the Commission is trying to solve. We note that none of the examples contained in the Draft Guidelines deals with competitive or consumer harm that has been raised or could be raised by the current rules.

70. With regard to disclosure, it appears from the section on Standardisation that the Commission is generally keen on companies disclosing their IP rights. In the context of standardisation, this appears to be motivated by standard-specific concerns such as "patent ambush". However, it is not clear when and why such concerns would arise for R&D projects. Would it not make sense to start from the assumption that parties entering into a joint R&D project would request appropriate levels of disclosure as a condition for participation (see paragraphs 73 *et seq* on FP7 below)? It is not clear to us why market forces would not result in sufficient disclosure already. Further explanation of the motives for this new requirement and/or examples of cases where competitive or consumer harm could be expected would be welcome. We also note that the disclosure requirement may be difficult to comply with in practice. As the Draft Guidelines note at Paragraphs 139–40, the competition law assessment must be made when the R&D agreement is signed. At that time it is difficult, if not impossible, to determine what IP may be relevant to the—unknown—outcome of the joint R&D project.

71. With regard to access, it is not clear why companies would generally need to gain access to Background of other parties merely because that would be necessary to exploit all or part of the Foreground. Taken together with the new requirement of "equal access" to Foreground and the deletion of the possibility to award fields of use between non-competitors, the new access requirement would seem to entail that a company entering into a joint R&D project gives up

competitive advantages it may have enjoyed prior to the project due to extensive know-how in particular fields of use. It is true that the Block Exemption appears to allow reasonable fees to be charged for disclosure of Background.[16] However, we are concerned that increased access requirements could discourage participation R&D projects which might have benefited consumers.

72. For the same reasons, it is unclear why parties need to be given "equal" access to the results. It may well be that one party brings more to the table than other parties and may wish to have a larger share of the results. In view of the above, further explanation why access needs to be "equal" would be welcome.

D. Compatibility with FP7

73. Our reservations with regard to the proposed new regime may be illustrated by comparing them to the European Commission's Framework Programme, which is now in its seventh instalment (the Seventh Framework Programme, or FP7).[17] In the context of FP7, the European Commission awards significant sums of money to encourage European R&D projects. Before granting funds, the European Commission reviews the agreements concluded between consortium partners.

74. The rules setting out how to deal with IP rights and know-how in FP7 projects are set out in the FP7 Model Grant Agreement and in particular Annex II.[18] The Commission has also published a "Guide to Intellectual Property Rights for FP7" (hereinafter FP7 Guide) ,which further explains the FP7 rules on IP.[19]

75. The FP7 Guide does not contain a general obligation of prior disclosure of know-how/IP rights. Parties participating in an FP7 project must, however, disclose what Background they are willing to grant access to. This can be done by means of either a "positive list" (Background available for access by consortium partners) or a "negative list" (Background not available for access by consortium partners). In practice, companies participating in FP7 projects go through these lists carefully and then consider whether they are willing to participate.

76. The FP7 rules do not provide for universal rights to access other companies' Background either. Parties can request access to another Party's Background on a case-by-case basis, but only for the purpose of (i) carrying out the project or (ii) using Foreground to the extent they have rights to use such Foreground.[20] Article

16 Recital 13 of the Draft R&D Block Exemption.

17 See http://cordis.europa.eu/fp7/home_en.html (accessed on 7 July 2010).

18 See ftp://ftp.cordis.europa.eu/pub/fp7/docs/fp7-ga-annex2-v5_en.pdf (accessed on 7 July 2010).

19 See ftp://ftp.cordis.europa.eu/pub/fp7/docs/ipr_en.pdf (accessed on 7 July 2010).

20 See Para 8.1 of the FP7 Guide: "It should be noted that under the EC grant agreement access to another participant's foreground or background is only to be granted if the requesting participant needs that access in order to carry out the project or to use its own foreground."

II.34 of the Model Grant Agreement correctly notes that the grant of access rights is subject to the condition that the holder of these rights "is entitled to grant them".[21]

77. The FP7 Guide also permits allocation of rights to use Foreground and Background ("exclusive licences for specific foreground or background may be granted subject to written confirmation by all the other beneficiaries that they waive their access rights thereto" (see Model Grant Agreement, paragraph II.32.7)). The FP7 Guide recommends a specific competition law analysis only for "advanced IPR strategies" such as patent pools, setting up specific legal entities for exploiting IP rights and clustering expertise to minimise knowledge management/technology transfer or product development cost.[22] The proposed R&D Block Exemption does not appear to provide the same freedom.

78. One may conclude that the regime set out in the Draft R&D Block Exemption is significantly stricter than the FP7 regime. It is not clear why this is necessary or appropriate. We suggest it would be useful to consider whether the new R&D Block Exemption and Horizontal Guidelines can be brought into line with FP7 rules.

IV. Annex 1: ECLF Horizontal Agreements Working Group

Submitted on behalf of the ECLF by the Horizontal Agreements Working Group:

John Boyce, Slaughter and May
Vincent Brophy, Jones Day
Christopher Cook, Cleary Gottlieb Steen & Hamilton
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[21] See also the FP7 Guide, para 8.10, page 28.
[22] FP7 Guide, para 18, page 39.

V. Annex 2: Law Firms Represented by the ECLF

The ECLF aims to be the principal interface between specialist competition lawyers and the European Commission's Directorate General for Competition. It provides a forum through which members may express views on a range of policy and practice issues. Its current active membership includes competition specialists from the following firms:

Allen & Overy
Arnold & Porter
Baker & McKenzie
Bonelli Erede Pappalardo
Bredin Prat
Cleary Gottlieb Steen & Hamilton
Clifford Chance
De Brauw Blackstone Westbroek
DLA Piper
Freshfields Bruckhaus Deringer
Garrigues
Gianni, Origoni, Grippo & Partners
Gibson, Dunn & Crutcher
Gide Lovrette Nouel
Gleiss Lutz
Hengeler Mueller
Herbert Smith
Homburger
Howrey
Hunton & Williams
Janezic & Jarkovic
Jeantet Associes
Jones Day
Kemmler Rapp Böhlke
Latham & Watkins
Lett Advokatfirma
Linklaters
LMR
Lovells
Mannheimer Swartling
McCann FitzGerald
McDermott Will & Emery
Monckton Chambers
Morrison & Foerster
Nauta Dutilh
Norton Rose
O'Melveny & Myers LLP
Olswang
Orrick
Panagopoulos Vainanidis Schina
PLMJ
Procopé & Hornborg
Raidla Lejins & Norcous
Reed Smith
Roschier
S J Berwin
Schuette-Law
Schulte Riesenkampff
Shearman & Sterling
Sidley Austin
Simmons & Simmons
Skadden Arps Slate Meagher & Flom
Slaughter and May
Squire, Sanders & Dempsey
Stibbe
Sullivan & Cromwell
Advokatfirmaet Thommessen AS
Thompson Hine
Uria Menendez
Van Bael & Bellis
Vieira de Almeida
Vinge
Wardynski and Partners
White & Case
Willkie Farr & Gallagher
WilmerHale

VI. Annex 3: Application of Article 101 to Joint Ventures

1. The Concept of an "Undertaking"

1. Article 101 is only applicable to restrictive agreements if they are between two or more independent "undertakings"; accordingly, agreements between entities which form part of the same undertaking are not caught by the Article 101(1) prohibition. The concept of undertaking is not affected by the identity of the corporate entities involved; rather, it focuses on the economic scope and autonomy of the businesses concerned. This means that a corporate group comprising a number of different legal entities (which may or may not have legal personality and/or limited liability) can be treated as one undertaking for EU competition law purposes.[23]

2. Determining whether two entities are part of the same or distinct undertakings is relevant to the application of the EU competition rules to various different situations, such as: (i) when applying Article 101 to a horizontal or vertical agreement between related or affiliated companies; (ii) when considering whether the anticompetitive conduct of a subsidiary can be imputed to a parent company (eg in the context of fines for cartel activity or abuse of dominance); (iii) when evaluating whether a change in ownership or control of an entity results in a "concentration" between distinct undertakings (subject to notification under the EU Merger Regulation) or merely an intra-group reorganization; and (iv) when considering whether the turnover or market shares of associated companies are relevant for the purpose of calculating applicable regulatory thresholds (eg under a block exemption regulation or the Merger Regulation). It may be in the interest of a particular company to argue that it is part of the same undertaking as its subsidiary or a sister company in some situations (eg that its intra-group agreements do not need to be assessed for compliance with Article 101) but to argue otherwise in other situations (eg that the parent company should not be fined for cartel activity engaged in by a

[23] See, eg J Faull and A Nikpay, *The EC Law of Competition* (New York, Oxford University Press, 2nd edn, 2007), para 3.87:

> "two or more legally separate entities may be treated as a single undertaking under the competition rules if their relationship justifies regarding them as a single economic unit. In this case agreements between them, even legally enforceable ones, will usually be regarded as an internal allocation of functions within a corporate group rather than an agreement between independent undertakings capable of falling with the prohibition of Article [101(1)]. This means that Article [101] will not apply to arrangements between them, however anticompetitive they may seem to be. However, it also means that parent companies, including those based outside the [EU], can be held liable under Article [101] for the behaviour of their subsidiaries operating within the EU, since the undertaking as a whole is active there."

subsidiary). However, this concept of "undertaking" must be applied consistently and without distinction between these different situations.[24]

3. Paragraph 11 of the Draft Guidelines briefly addresses this concept of "undertaking" under EU competition law in the context of two fundamentally different scenarios—parent–subsidiary relationships and joint venture relationships. It does so as follows:

(a) Parent–subsidiary (and other intra-group) relationships: the first part of Paragraph 11 observes that:

> Companies that form part of the same "undertaking" within the meaning of Article 101(1) are not considered to be competitors by these guidelines. Article 101 only applies to agreements between independent undertakings. When one company (the "parent company") exercises decisive influence over another company (the "subsidiary") they form a single economic entity and, hence, are part of the same undertaking.[6] The same is true for sister companies, ie subsidiaries over which decisive influence is exercised by the same parent company. They are consequently not considered to be competitors even if they are both active on the same relevant product and geographic markets.
>
> [6] See, eg Case C-73/95, *Viho*, [1996] ECR I-5457, paragraph 51. The exercise of decisive influence by the parent over the conduct of a subsidiary can be presumed in case of wholly owned subsidiaries; see, eg Case 107/82, *AEG*, [1983] ECR-3151, paragraph 50; Case C-286/98 P, *Stora*, [2000] ECR-I 9925, paragraph 29; or Case C-97/08 P, *Akzo*, [2009] ECR I not yet reported, paragraphs 60 et seqq. Where there are several parent companies, the exercise of decisive influence by them can be presumed where they control all the shares in the joint venture, and where, on the basis of factual evidence, they have joint management power; see Case T-314/01, *Avebe*, ECR II-3085, paragraphs 138 and 139.

(b) Joint venture relationships: Paragraph 11 then goes on to assert that:

> As a joint venture forms part of one undertaking with each of the parent companies that jointly exercise decisive influence and effective control over it[7], Article 101 does not apply to agreements between the parents and such a joint venture, provided the creation of the joint venture did not infringe EU competition law. Article 101 could, however, apply to agreements between the parents outside the scope of the joint

[24] See P Roth and V Rose (eds), *Bellamy & Child "European Community Law of Competition"* (New York, Oxford University Press, 6th edn, 2008), para 2.003:

> "The word 'undertaking' is not defined in the [Treaty on the Functioning of the European Union]. In the context of competition law, it appears in Articles [101 and 102] and is of fundamental importance under the Merger Regulation, and it should receive a consistent interpretation."

See also para 2.017. Faull and Nikpay, *ibid*, observes (at para 3.89) that: "Determining whether related firms are independent can, in practice, be difficult. The Commission's decisions under the EC Merger Regulation, and its Notice on the concept of concentration, provide perhaps the best guidance on this issue."

venture and with regard to the agreement between the parents to create the joint venture.

[7] See Case T-314/01, *Avebe*, cited in note 6 above, paragraphs 138 and 139. Regarding the notion of control, see Commission Consolidated Jurisdictional Notice, cited in note 2 above, paragraphs 11–82.

2. Parent–Subsidiary Relationships

4. We broadly agree with the Commission's observations reproduced at paragraph 3(a) above on parent–subsidiary relationships. Case law under Article 101 recognises that a subsidiary is to be treated as part of the same undertaking as its parent (eg to find that agreements between them fall outside the scope of Article 101, or to find a parent company liable for the competition law infringements of its subsidiary) if it is established that the subsidiary does not act autonomously. This can be done, for example, by demonstrating that the parent company actually exercised decisive influence over the subsidiary at the relevant time.[25] Although the level of influence necessary to trigger liability has been a matter of dispute in many cases (particularly those involving the imposition of fines), a number of factors have been identified as indicators of a lack of autonomy in such parent–subsidiary scenarios.[26]

5. Further clarity is provided by the ECJ judgment in *Akzo Nobel* upholding the General Court's conclusion that the Commission could address the decision (imposing fines) to the parent company because the subsidiary and parent constituted a single economic undertaking.[27]

[25] Case 107/82 *AEG v Commission* [1983] ECR 3151, para 50.

[26] Indeed, as recognised at footnote 6 to para 11 of the Draft Guidelines, there is a rebuttable presumption that a parent company exercises "decisive influence" over the conduct of its wholly owned subsidiaries (subject to its de iure control). However, in exceptional circumstances it may be possible to rebut this presumption. For example, a property company (A), with a wholly owned subsidiary (X) whose only asset comprises a hotel (X) in a European city, enters into a management contract with a hotel chain (B) which agrees to operate hotel X. B already owns another hotel (Y) in the same city. Under the arrangements, A still retains ownership of X but B acquires "sole control" (or "decisive influence") over X; this is in line with the analysis in Case M.126 Accor/Wagons-Lits (Commission Decision of 28 April 1992, para G). In these circumstances, if X and Y coordinate their prices that should not be an infringement of Article 101 as they are both part of the same "undertaking" (ultimately controlled by B). However, if X coordinates its prices with another hotel (Z) owned by another hotel management company (C), that agreement may infringe Article 101—for which B and C could be held liable. But A (even though X remains its wholly owned subsidiary) should be able to rely on the management contract with B to rebut the presumption that it is liable as the 100% owner of X.

[27] Case C-97/08 P *Akzo Nobel v Commission*, upholding Case T-112/05 *Akzo Nobel NV and others v Commission* (paras 57–66), where the General Court found:{DISP}"the concept of undertaking within the meaning of Article [101] includes economic entities which consist of a unitary organisation of personal, tangible and intangible elements, which pursue a specific economic aim on a long-term basis and can contribute to the commission of an infringement of the kind referred to in that provision . . . It is therefore not because of a relationship between the parent company and its subsidiary in instigating the infringement or, a fortiori, because the parent

3. Different Joint Venture Relationships

6. In contrast, we do not agree with the Draft Guidelines' wording reproduced at paragraph 3(b) above, proposing to extend parent–subsidiary principles to joint venture situations. This wording is controversial, lacks support from European Court case-law, and risks increasing confusion in an area where inconsistencies in Commission analysis in different cases already give rise to legal uncertainty. We therefore urge the Commission either to delete this wording or to replace it with more constructive guidance addressing the issues considered below.

7. The confusion arises in part because the Draft Guidelines refer to the somewhat ambiguous concept of a "joint venture" (JV). This concept is used by businesses to describe a range of different situations.[28] For EU competition law purposes, however, it is important to distinguish two fundamentally different types of JV:

(a) Structural joint ventures: ie where two or more independent undertakings establish a separate undertaking that is to be treated as distinct from its parent or shareholder undertakings. It is possible to distinguish various categories of such JV undertakings:[29]

- *Concentrative full-function JV undertakings*: It has long been recognised that the establishment of a "full-function" JV undertaking, performing on a lasting basis all the functions of an autonomous economic entity, falls outside Article 101.[30] Prior to the implementation of the Merger Regulation in 1990, the establishment of a JV undertaking was generally not subject to review by the Commission (although in exceptional cases such operations might raise issues under Article 102, or possibly Article 101 if there would be ongoing coordinative effects between undertakings which remained independent competitors). With the implementation of the Merger Regulation, however, their

company is involved in the infringement, but because they constitute a single undertaking in the sense described above that the Commission is able to address the decision imposing fines to the parent company of a group of companies."

28 See Roth and Rose, *supra* n 24, para 7.002:

> "The term 'joint venture' ('JV'), as used by industry, resists clear definition . . . Terms such as joint venture, strategic alliance and cooperative arrangement are loosely applied to commercial arrangements between two or more parties with a wide variety of objectives and economic effects. However, in the context of the [EU] competition rules, the Commission has applied the term 'joint venture' only to an undertaking that is (i) a separate business entity, and (ii) jointly controlled by at least two parents."

29 See Roth and Rose, *supra* n 24, para 7.004 *et seq*.

30 The current wording at para 11 of the Draft Guidelines seems to contradict this by asserting that "Article 101 could, however, apply . . . with regard to the agreement between the parents to create the joint venture". Para 11 does not distinguish between the various different categories of structural and behavioural "joint ventures" considered above.

establishment became subject to review by the Commission, provided that (i) they did not have as their object or effect the coordination of the competitive behaviour of the parent undertakings as between themselves or as between them and the JV undertaking (so-called "cooperative joint ventures"), and (ii) the undertakings concerned met the relevant turnover thresholds. Agreements between the JV undertaking and its parents may, however, be subject to assessment or review under Article 101 to the extent that they are not ancillary to (ie directly related and necessary to the implementation of) the concentration;[31]

- *Cooperative full-function JV undertakings*: the establishment of cooperative (or coordinative) JVs continued to be subject to review under Article 101, rather than the Merger Regulation, up until 1998, when an amendment to the Merger Regulation came into force. This largely removed the distinction between concentrative and cooperative JVs, extending the Merger Regulation regime to all "full-function" JV undertakings where the relevant turnover thresholds are met. However, the coordinative aspects of such transactions are separately assessed (under Article 2(4) of the Merger Regulation) for compatibility with Article 101;
- *Partial-function JV undertakings*: a structural JV undertaking may be "partial-function" if it assumes only some but not all of its parent undertakings' functions (eg an undertaking focused only on joint R&D, joint production or joint sales—with the parents each retaining responsibility for other functions) such that it does not operate as an autonomous economic entity. Such JV undertakings are not subject to review under the Merger Regulation, but may be assessed or reviewed for compatibility with Article 101. Prior to May 2004 (and the implementation of Regulation 1/2003), such structural JVs could benefit from a fast-track notification process.

(b) Behavioural JVs: ie non-structural JVs or collaborative arrangements where two or more independent undertakings cooperate with one another without creating a separately identifiable new "undertaking". To reduce the scope for confusion, in the rest of this paper we do not use the label "joint venture" to describe such forms of horizontal and/or vertical cooperation. Such cooperation may be relatively loose or informal, or it may involve more extensive alliance-type arrangements. It may or may not include the establishment of legal entities (with or without legal personality) jointly owned by the parties and used as vehicles for certain functions within the cooperation. In the absence of the establishment of a

[31] See Commission Notice on Restrictions Directly Related and Necessary to Concentrations, [2005] OJ C56/24.

separate jointly controlled undertaking, however, the establishment of such a cooperation will be subject to assessment or review under Article 101.[32] If a third party were to enter into an agreement or understanding with a legal entity operating as a vehicle for such horizontal cooperation, for EU purposes one should "look through" the entity (ie not treat it as an "undertaking") and treat the agreement as being with the parent undertakings.

8. All of the categories of structural JV considered at paragraph 7(a) above (whether full- or partial-function) involve the establishment of a JV undertaking subject to the "joint control" of two (or more) parent undertakings—ie a distinct undertaking from each of its parents.[33] Such JV undertakings generally involve one or more clearly identifiable jointly controlled legal entities, although this is not essential for a finding that there is a distinct undertaking. Where a cooperation is found to involve such a distinct JV undertaking (rather than some less structural JV or collaboration of the type considered at paragraph 7(b) above), this has precisely the same consequences as any other finding that there is a distinct undertaking for EU competition law purposes. Accordingly, any agreements between the JV undertaking and one or other (or both) of its parent undertakings may be subject to review under Article 101, just like any other agreement between undertakings. In many cases, it should be relatively straightforward to conclude that the arrangements either (i) do not appreciably restrict competition or (ii) satisfy the Article 101(3) exemption criteria. That said, Paragraph 11 of the Draft Guidelines suggests that there should never be a need for such an Article 101 assessment (at least where the establishment of the JV undertaking was compatible with the merger control rules and/or Article 101) because such agreements should always fall outside Article 101 as the parties should be treated as a single undertaking.

4. Joint v Sole Control

9. Any JV undertaking of the structural type considered at paragraph 7(a) above—performing on a lasting basis all the functions of an autonomous economic entity—will be subject to the "joint control" (ie joint decisive influence) of two or more other undertakings. The Commission generally recognises that: "Joint control exists where two or more undertakings or persons

[32] See, eg the Commission's pending reviews of various transatlantic airline alliances: Case 37.984 *SkyTeam*, Case 39.595 *Continental/United/Lufthansa/Air Canada* and Case 39.596 *BA/AA/IB*.

[33] If, under any of the scenarios considered at para 7(a) above, it were found that one parent (A) could exercise "decisive influence" over the so-called "joint venture" (C) on its own (ie "sole control", with the other parent (B) being more akin to a minority shareholder or passive investor in C), then C and A should be viewed as part of one and the same economic undertaking (just as in a parent–subsidiary relationship), with B as a distinct undertaking. If that were the case, C would not be a "JV undertaking" for EU competition law purposes.

have the possibility of exercising decisive influence over another undertaking".[34] This "joint control" that the shareholders or parents of a JV undertaking can exercise is fundamentally different from the "sole control" (or decisive influence) that a parent company can exercise over its subsidiary. Joint control is not sufficient to treat the JV as being part of one and the same undertaking as one or more of its parents.

10. Likewise, the existence of "joint control" over a JV undertaking by two or more shareholder undertakings is not sufficient to establish the actual exercise of decisive influence of the type needed to attribute "parental liability" to one or more of the JV undertaking's shareholders (as part of one single undertaking). There may be factual circumstances in which one or more of the shareholder undertakings is directly party to an agreement caught by Article 101 to which the JV undertaking is also party—in which case that shareholder may infringe Article 101 in its own right (not merely because it is a shareholder or parent). However, for the attribution of "parental liability" (of the type in a normal parent–subsidiary relationship), the companies involved must be part of the same economic entity such that they constitute a single undertaking for EU competition law purposes.

5. The Parent–Subsidiary Single Undertaking Presumption is not Relevant to JV Undertakings

11. In *Avebe* the General Court made clear that "when a parent company holds 100% of the shares in a subsidiary which has been found guilty of unlawful conduct, there is a rebuttable presumption that the parent company actually exerted a decisive influence over its subsidiary's conduct" and can therefore be held liable for such conduct.[35] It is, however, only in "the specific case of a parent company holding 100% of the capital of a subsidiary" that this presumption applies.[36] The various cases in which this presumption (ie a rebuttable presumption where the burden of proof is reversed) has been accepted by the European Courts have involved parental liability for the actions of a 100% owned subsidiary; this is on the basis that the parent and wholly owned subsidiary constitute a single undertaking for EU competition law purposes. This principle of parental liability could be extended to other single undertaking

[34] Commission's Consolidated Jurisdictional Notice under the Merger Regulation, para 62. This goes on to observe that:

> "Unlike sole control, which confers upon a specific shareholder the power to determine the strategic decisions in an undertaking, joint control is characterized by the possibility of a deadlock situation resulting from the power of two or more parent companies to reject proposed strategic decisions. It follows, therefore, that these shareholders must reach a common understanding in determining the commercial policy of the joint venture and that they are required to cooperate."

[35] Case T-314/01 *Avebe v Commission* [2006] ECR-II 3085, para 136.

[36] *Akzo Nobel NV and others v Commission*, *supra* n 27, para 60.

scenarios where it is clear that one shareholder or parent holds de iure sole control of its subsidiary (eg a majority stake of less than 100%, but more than 50%) or where it enjoys de facto sole control.[37]

12. That said, there is no credible basis for extending this single undertaking concept (and the related principle of parental liability) to a JV undertaking which, by definition, does not form part of the same economic undertaking as either of its parents. In contrast to the normal parent–subsidiary relationship, no one shareholder has de iure or de facto sole control of the JV undertaking; the fact that together the shareholders have "joint control" (for the purposes of the Merger Regulation) should not of itself give rise to Article 101 liability for any of them with regard to the conduct of the distinct JV undertaking. In such situations, three (or more) separate economic undertakings exist: the two (or more) parent undertakings and the JV undertaking.[38] The current assertion at Paragraph 11 of the Draft Guidelines—that "a joint venture forms part of one undertaking with each of the parent companies that jointly exercise decisive influence and effective control over it"—makes no sense, at least in the context of a JV undertaking which is distinct from its parent undertakings. Two distinct undertakings cannot at the same time be one single undertaking; indeed, it defies logic to assert that a JV can be part of the same undertaking as each of its parents, but without its parents being part of the same undertaking as each other.

13. In the context of structural cooperation between two or more undertakings conducted through another distinct JV undertaking, any agreement between the JV undertaking and one or more of its shareholder or parent undertakings may be subject to assessment or scrutiny under Article 101, just like any other agreement between undertakings. Depending on the facts, such agreements may fall outside Article 101(1) (eg because they are ancillary to the establishment of the JV undertaking or otherwise do not appreciably restrict competition) or may satisfy the criteria of Article 101(3). Likewise, a JV undertaking's shareholders or parents should not be presumed liable, merely in their capacity as a jointly controlling shareholder or parent, for anticompetitive conduct the JV undertaking may engage in, nor for any restrictive agreements it may have with third parties.

14. The Commission previously provided some guidance on these issues in its old Notice on the Concept of Full-Function Joint Ventures (Paragraph 16, third paragraph). This explained that the provisions of the Merger Regulation were

[37] See Faull and Nikpay, *supra* n 23, para 3.89, referring to guidance from cases under the Merger Regulation.

[38] *Ibid*, para 3.90 (referring to *Gosme/Martell-DMP* [1991] OJ L185/23) and para 3.91 (referring to *Ijsselcentrale* [1991] OJ L28/32), observing that a JV undertaking jointly controlled by two or more companies is an "independent undertaking" and "not part of the same economic unit as its parents".

not applicable for the assessment of restrictions of competition that are neither ancillary to the establishment of a JV undertaking nor a direct consequence of it; rather, any such restrictions fall to be assessed under Article 101. A finding that a JV functions as an autonomous undertaking (for the purposes of the Merger Regulation) is equally relevant when appraising whether or not agreements to which it is party are subject to review under Article 101 or when appraising whether to attribute liability for infringements of Article 101 or 102 to any of its shareholders.

6. JV–Shareholder Relationships are Fundamentally Different from Parent–Subsidiary Relationships

15. The relationships between a JV undertaking and its shareholder or parent undertakings are not like those between a normal subsidiary and its parent or majority shareholder. A normal subsidiary is one whose conduct can be controlled by its parent company exercising "sole control";[39] an agreement between a parent company and a subsidiary, or between two companies which are under the common control of a third party, does not fall within Article 101 if the companies form an economic unit within which the subsidiary has no real freedom to determine its course of action on the market.[40] As considered at paragraph 9 above, a structural JV undertaking—subject to the "joint control" of two (or more) other undertakings—is in a fundamentally different situation; it is an undertaking distinct from each of its shareholders, neither of which has the ability to exercise "sole control" over it. Accordingly, such a JV undertaking is not one or the other—it is neither part of one parent undertaking nor part of the other parent undertaking. That does not mean that it must therefore be part of both undertakings—but that seems to be what Paragraph 11 of the Draft Guidelines infers: "a joint venture forms part of one undertaking with each of the parent companies that jointly exercise decisive influence and effective control over it".

16. Paragraph 11 of the Draft Guidelines appears to regard the *Avebe* case as a basis for treating any JV as part of a single undertaking with its parents—even if it involves a JV undertaking distinct from each of its parents. In doing so, the

[39] The concept of "sole control" is considered in the Commission's Consolidated Jurisdictional Notice under the Merger Regulation (2007), which replaced inter alia the old Notice on the Concept of Full-Function Joint Ventures and provides (at point 54) that "sole control is acquired if one undertaking alone can exercise decisive influence on an undertaking". The Notice explains that sole control can be achieved either in situations where a parent company holds a majority of voting rights (ie what could be characterised as a "normal subsidiary") or where "only one shareholder is able to veto strategic decisions in an undertaking" (so-called "negative sole control").

[40] Case T-102/92 *Viho* [1995] ECR II-17, as upheld on appeal in Case C-73/95P *Viho* [1996] ECR I-5457 (as mentioned at footnote 6 of the draft Guidelines). The Opinion of AG Lenz in that case reviewed the conflicting strands in previous case law.

Draft Guidelines fail to recognise the fundamental differences between the *Avebe* case and the scenario of a JV undertaking with legal personality. The facts in *Avebe* concerned a JV (Glucona) without separate legal personality; it was essentially a partnership-type vehicle for cooperation between its two shareholders which continued to perform some of the operational functions themselves. Glucona was at most a partial function JV undertaking (and possibly merely a vehicle for behavioural cooperation of the type considered at paragraph 7(b) above). As highlighted in *Akzo Nobel*, it is necessary to identify an entity having legal personality as the addressee of a decision.[41] Accordingly, the General Court found that the Commission was entitled to "look through" Glucona and impose liability directly on its two shareholder undertakings which were legally responsible for its conduct.

17. In *Rubber Chemicals* the Commission accepted that a JV undertaking was distinct from its parents.[42] Although it initially addressed the statement of objections to the JV undertaking (Flexsys) and its two parents (Akzo Nobel and Solutia), it subsequently discontinued proceedings against the parents as Flexsys had been established "as a concentrative full-function joint venture, which was approved by the Commission [under the EU] merger control rules [and that the] parent companies transferred all their relevant assets to the joint venture . . . and withdrew entirely from the rubber chemicals market".[43] It expressly recognised that:

> "the situation of Flexsys with regard to its parent companies is radically different from that of Repsol with regard to GQ. In the case of a joint venture, jointly owned by its parents (and over which none of the parents has de facto or de jure sole control) the joint venture can be presumed to be autonomous from its parent companies (ie can be presumed to constitute a separate undertaking with respect to its parents)".[44]

[41] *Akzo Nobel NV and others v Commission*, *supra* n 27, para 59.
[42] Case COMP/F/38.443 *Rubber Chemicals* (Commission Decision of 21 December 2005).
[43] *Ibid*, para 12.
[44] *Ibid*, para 263.