UK competition law:

The retained Horizontal Block Exemption Regulations – R&D and specialisation agreements

CMA's recommendation

28 June 2022
CMA160con

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1. Summary

1.1 The purpose of this document is to make a recommendation to the Secretary of State for Business, Energy and Industrial Strategy (Secretary of State) as to whether the existing two retained Horizontal Block Exemption Regulations, which have been retained from EU law (the retained HBERs) should be renewed or varied when they expire on 31 December 2022.[1] The two retained HBERs are the retained Research and Development Block Exemption (R&D BER)[2] and the retained Specialisation Block Exemption Regulation (Specialisation BER).[3]

1.2 On 8 April 2022, the Competition and Markets Authority (CMA) published a consultation document pursuant to section 8(1) of the Competition Act 1998 (the Act).[4] In the consultation document, the CMA sought views on its proposed recommendation to the Secretary of State to renew the block exemptions and to make certain amendments to improve those block exemptions. This consultation (the Consultation) ran until 6 May 2022, with the CMA receiving a limited number of responses from stakeholders.[5] The CMA has, however, also carried out additional stakeholder engagement, holding a number of bilateral meetings to better understand some of the views that stakeholders had expressed during our review of the two retained HBERs.

1.3 The responses to the Consultation will be published on the relevant CMA webpage in due course. Stakeholders suggested areas where the block exemptions could be improved or adapted, and we are grateful for the useful contributions from respondents to the Consultation.

1.4 Having carefully considered the various issues, the CMA is recommending that the Secretary of State replace the retained HBERs with a United Kingdom (UK) Specialisation Block Exemption Order and a UK R&D Block Exemption Order (the Specialisation BEO and the R&D BEO, respectively (together, the

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[1] The retained HBERs are two of the 'retained exemptions' from EU law that were retained in UK law after EU law generally ceased to have effect in the UK on 1 January 2021, as a result of a combination of the operation of the European Union (Withdrawal) Act 2018 and the Competition (Amendment etc.) (EU Exit) Regulations 2019, as amended by the Competition (Amendment etc.) (EU Exit) Regulations 2020.

[2] Regulation 1217/2010 on the application of Article 101(3) of the TFEU to categories of R&D agreements (see https://www.legislation.gov.uk/eur/2010/1217/introduction)

[3] Regulation 1218/2010 on the application of Article 101(3) of the TFEU to categories of specialisation agreements (see https://www.legislation.gov.uk/eur/2010/1218/introduction).

[4] Under section 8(1) of the Act, before making a recommendation under section 6(1), the CMA must publish details of its recommendation in such a way as it thinks most suitable for bringing it to the attention of those likely to be affected; and consider any representations about it which are made to it.

[5] The CMA received three written submissions, of which two were copies of the consultation responses provided by these stakeholders to the European Commission (Bristows and Baker McKenzie) and one was a response to the CMA Consultation (The Law Society of Scotland).

UK HBEOs)). The CMA is recommending that the UK HBEOs will be in place until 31 December 2035. Although the CMA does not consider it necessary to introduce fundamental changes to the retained HBERs, there are certain amendments that the CMA proposes the future UK HBEOs should incorporate to reflect market developments and to clarify the existing rules and improve their effectiveness.

2. Introduction

2.1 Horizontal agreements are agreements entered into between actual or potential competitors.[6]

2.2 The Act prohibits anti-competitive agreements between businesses (known as the Chapter I prohibition).[7] The prohibition applies to agreements and concerted practices between undertakings and to decisions by associations of undertakings (eg trade associations) which have as their object or effect the prevention, restriction or distortion of competition within the UK and which may affect trade within the UK.

2.3 However, section 9(1) of the Act provides that an agreement is exempt from the Chapter I prohibition if it:

(a) contributes to

i. improving production or distribution, or

ii. promoting technical or economic progress,

(b) while allowing consumers a fair share of the resulting benefit; and

(c) does not

i. impose on the undertakings concerned restrictions which are not indispensable to the attainment of those objectives; or

ii. afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products in question.

2.4 An agreement may be individually recognised as exempt by a competition authority or a court and, in addition, certain types of agreement will be treated as automatically exempt if they meet conditions set out in a 'block exemption' regulation or order applicable to that category of agreements.

2.5 Under UK law, there are currently two retained HBERs, which provide automatic exemptions for certain categories of horizontal agreements subject

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[6] Agreements are vertical when they are between businesses operating at different levels of the production or distribution chain, for example, between manufacturers and wholesalers. See the CMA's recommendation on Vertical Agreements.
[7] The Act, section 2.

to meeting specific conditions. These are the R&D BER and the Specialisation BER.

2.6 These BERs were retained in UK law[8] following the UK's withdrawal from the European Union (EU) and the end of the Transition Period,[9] and are due to expire on 31 December 2022.

2.7 Agreements between businesses that meet the conditions of the retained HBERs are automatically exempt from the Chapter I prohibition.[10] This means that the parties to an agreement covered by the block exemption would not need to conduct a further self-assessment as to whether the agreement might benefit from individual exemption under section 9(1) of the Act. In this way, the retained HBERs provide legal certainty for businesses.

2.8 The R&D BER relates to certain research and development (R&D) agreements that are entered into between two or more parties.[11] For example, two competitors may agree to carry out R&D together, or that one will carry out paid-for R&D that is financed by the other, to ensure that the R&D can benefit from their combined know-how, expertise and/or resources. Entering into such an agreement increases the likelihood that the competitors will achieve earlier breakthroughs in their research or product development, and helps the parties to allocate their resources more efficiently. Subject to meeting the conditions set out in the R&D BER,[12] and the agreement not containing any prohibited restrictions,[13] the R&D agreement may benefit from the block exemption.

2.9 The Specialisation BER relates to certain unilateral and reciprocal specialisation agreements, alongside joint production agreements. For example, this could involve a situation where two competitors work together to produce certain products (goods or services)[14] jointly (for these purposes,

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[8] The exemptions were retained in UK law by a combination of the operation of the European Union (Withdrawal) Act 2018 and the Competition (Amendment etc.) (EU Exit) Regulations 2019, as amended by the Competition (Amendment etc.) (EU Exit) Regulations 2020.
[9] Previously, the EU Horizontal Research and Development Block Exemption Regulation (EU BER R&D) and the EU Horizontal Specialisation Block Exemption Regulation (EU BER Specialisation) applied in the UK and provided an automatic exemption for horizontal agreements meeting their conditions. The block exemptions set out in these Regulations are substantively the same as the retained HBERs except that they apply to the EU rather than the UK.
[10] Unless the block exemption has been cancelled, varied or revoked in accordance with the Act.
[11] Article 1(1)(a) of the R&D BER includes a definition of the R&D agreements that can fall within the scope of the R&D BER.
[12] Conditions such as (i) the competitors' combined market shares not exceeding certain thresholds and (ii) on the kind of access they each need to give each other to the R&D results.
[13] Such as certain restrictions on the parties carrying out R&D independently or with third parties or certain limits on output or sales.
[14] The definition of product in the Specialisation BER includes goods and services, with the exception of distribution and rental services.

'Product A' and 'Product B'[15]) in a way that will enable them to lower their costs, which in turn could lead to lower prices for consumers of Products A and B. Alternatively, they may agree on a reciprocal basis that one of them will cease producing Product A and buy it instead from the other, while the other ceases producing Product B and buys it from the other. Subject to meeting the conditions set out in the Specialisation BER,[16] and the agreement not containing any prohibited restrictions,[17] such specialisation agreements may benefit from the block exemption.

2.10 In accordance with the Act, the CMA has reviewed the retained HBERs for the purpose of making a recommendation to the Secretary of State about whether to replace the retained HBERs when they expire on 31 December 2022.

2.11 The CMA's review has:

(a) Gathered evidence relating to the application of the retained HBERs in the UK. This evidence was gathered by the CMA in response to its Call for Inputs ('CFI') launched on 24 November 2021, and includes input from:

i. businesses with operations in the UK that rely on the retained HBERs (for example, firms active in research and development-intensive industries such as communications technology).
ii. law firms and economists advising businesses on the application of competition law to horizontal agreements in the UK; and
iii. relevant trade and industry associations.

(b) Held meetings with certain stakeholders[18] in order to clarify their responses to the CFI and comments on the EU's draft revised HBERs and draft revised Guidelines on Horizontal co-operation agreements (the EU draft revised Horizontal Guidelines).[19]

(c) Considered the responses to the Consultation (see paragraph 1.2 above).

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[15] Or 'Service A' and 'Service B'.
[16] For example, the competitors' combined market shares not exceeding certain thresholds.
[17] Such as certain restrictions on fixing prices, allocating customers or markets and certain limits on output or sales. An example of a prohibited restriction in this context could include where two companies enter into a reciprocal specialisation agreement under which they agree not to cross-supply the relevant products to each other and cease to sell the other's product (having previously manufactured it); this could qualify as market allocation, a hardcore restriction under Article 4(c) of the Specialisation BER.
[18] Dentons, Eversheds Sutherland and Bristows.
[19] See the European Commission press release here. The EU draft revised Specialisation BER, draft revised R&D BER and draft revised Horizontal Guidelines can be found on the EC's consultation page.

(d) Drawn on relevant evidence from the European Commission's (EC) evaluation (the Evaluation) of the EU HBERs and the EU Guidelines on Horizontal co-operation (EU Horizontal Guidelines).[20] [21]

(e) Since the CFI, we have also conducted targeted stakeholder engagement with UK Research and Innovation ('UKRI') to understand the impact of the R&D BER on the universities sector and small and medium-sized enterprises (SMEs).[22] UKRI is the UK public body that directs research and innovation funding. It has drawn on views from relevant higher education representative groups and other relevant organisations.

2.12 A number of stakeholders commented that divergence between the UK and EU rules can lead to increased compliance costs, particularly for those businesses with activities both in the UK and the EU. Consequently, we considered the EC's proposed approach to horizontal agreements as set out in the EU's draft revised HBERs and draft revised EU Horizontal Guidelines published on 1 March 2022.[23] In deciding what approach to recommend, we have sought to be guided by what is best for UK consumers and businesses. In this context, we note that a number of the EC's proposals seem to the CMA to offer a sensible and proportionate basis to address issues raised by UK stakeholders.

2.13 The CMA also envisages preparing guidance to accompany the UK HBEOs (CMA HBEOs Guidance). The CMA intends to consult on a draft proposal for the CMA HBEOs Guidance later in 2022.

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[20] Communication from the Commission - Guidelines on the applicability of Article 101 of the TFEU to horizontal co-operation agreements (published in the Official Journal of the European Union on 14 January 2011).
[21] The Evaluation was launched in September 2019. The CMA and UK stakeholders have contributed actively to this Evaluation as the EU HBERs were fully applicable in the UK during most of the period under review and since then have been applicable in retained form. In its Evaluation, the EC has gathered evidence relevant to the UK, including to businesses operating in the UK and to UK consumers. In this recommendation, we cite summaries of the evidence gathered in the Evaluation in a Staff Working Document published by the EC (available here) and an Evaluation support study on the EU HBERs and EU Horizontal Guidelines also published by the EC (available here). The EC published an inception impact assessment on 7 June 2021. The EC also published experts' support studies which it had requested on specific topics regarding the HBERs (these can be found here).
[22] We have also had some engagement with the UK Intellectual Property Office.
[23] See the EC press release here. The EU draft revised Specialisation BER, draft revised R&D BER and draft revised Horizontal Guidelines can be found on the EC's consultation page.https://ec.europa.eu/competition-policy/public-consultations/2022-hbers_en

3. The CMA's recommendation

3.1 The CMA's recommendation to the Secretary of State is that it would be appropriate to replace both the Specialisation BER and the R&D BER when they expire on 31 December 2022 with, respectively, a Specialisation BEO and an R&D BEO that are tailored to the needs of businesses operating in the UK and UK consumers.[24] The CMA's proposal is that the two UK HBEOs would be similar to the retained HBERs that expire at the end of 2022 in order to ensure the continuity of the current regime for businesses while making some amendments in response to market developments and to clarify the existing rules and improve their effectiveness.

3.2 Overall, the evidence gathered[25] indicates that the Specialisation BER and the R&D BER are relevant and useful tools for businesses that increase legal certainty compared to a situation where businesses would have to rely solely on self-assessment.[26]

3.3 The evidence confirmed that R&D agreements can lead to significant efficiencies and accelerate and improve the pace and quality of innovation, that can then benefit consumers.[27] The evidence also confirmed that specialisation agreements can lead to significant improvements to production processes and/or cost efficiencies which can in turn lead to lower prices for consumers.[28]

3.4 Block exemptions have several benefits for businesses. First, they provide legal certainty to businesses as they enable them to know in advance how to ensure that their agreements comply with competition law. Second, they avoid placing on businesses the burden of scrutinising a large number of agreements that are likely to satisfy the requirements for exemption under section 9(1) of the Act. Third, the existence of a block exemption also ensures

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[24] The replacement will result in the adoption of a UK block exemption order under section 6 of the Act (Part I of the Act), the provisions of which will be interpreted in accordance with section 60A of the Act (see the CMA's *Guidance on the functions of the CMA after the end of the Transition Period* (Brexit Guidance), paragraphs 4.18–4.24).

[25] See paragraph 2.11 above.

[26] See responses received to our CFI. See also the evidence published by the EC in the Evaluation (which, as set out above in paragraph 2.11, includes evidence relevant to the UK and UK businesses) which found that overall, the EU HBERs and EU Horizontal Guidelines have made it easier for companies to cooperate in ways which are economically desirable and without adverse effects from the point of view of competition policy. However, the Evaluation found that the HBERs had not fully lived up to their potential and there were a number of areas where effectiveness could be improved.

[27] This included, for example, the CFI response from Ericsson that innovation in mobile communication critically depends on collaboration in R&D and the submission from Bristows that most R&D agreements bring together parties with complementary skills and technologies, with a view to creating new technologies and products.

[28] This included, for example, the CFI response from Dentons, which acknowledged 'the efficiency-enhancing effects of specialisation agreements'.

consistency of approach by providing a common framework for businesses to assess their horizontal agreements against the Chapter I prohibition.

3.5 Block exemptions also help to ensure that the CMA does not need to spend time scrutinising these essentially benign agreements, and so is able to concentrate its resources on other matters that are more likely to give rise to significant competition concerns. In this regard, the CMA notes that the various conditions, hardcore and excluded restrictions and other provisions[29]contained in the current block exemptions are designed to ensure that they are unlikely to apply to agreements that may give rise to significant competition concerns.

3.6 Respondents to the Consultation agreed with the CMA's proposed recommendation that both the R&D BER and the Specialisation BER be replaced when they expire on 31 December 2022. In particular, respondents emphasised that the R&D BER and Specialisation BER provide legal certainty. They were further concerned that businesses would be exposed to significant uncertainty should the 'safe harbour' of the R&D BER and the Specialisation BER cease to exist under UK law after 31 December 2022.

3.7 However, the evidence we have seen indicates that the current regime for the horizontal agreements block exemptions should be revised in certain respects and that greater clarity was needed in relation to certain aspects of the retained HBERs. In respect of the Specialisation BER, various stakeholders considered that the following could be improved: its scope; the market share thresholds and their application; the clarity of the definitions; and the conditions to be met to benefit from the exemption. In respect of the R&D BER, various stakeholders considered that improvements could be made to the market share thresholds and their application; the treatment of innovation markets; the access requirements in Article 3, and the clarity of certain definitions.

3.8 In addition to considering the scope for making recommendations to address the areas identified above, the CMA has also considered whether clarity is needed on certain definitions and provisions in the retained HBERs and, if so, on a case-by-case basis whether it would be best to provide this clarity through amendments to the retained HBERs themselves or through guidance.

3.9 It is important that the block exemptions are effectively targeted to avoid dampening competition and removing the incentive on firms to innovate to develop new products and improve existing ones. Competition between firms

[29] For example, the market share threshold.

operating in the same market and between potential competitors drives innovation and pushes businesses to find new and better ways of meeting the needs of consumers through new products, improvements to existing products or cheaper/more efficient ways of producing products. This is because existing competition and/or the threat of competition from potential competitors can incentivise businesses to make improvements to their products to try to limit the loss of future sales that may occur.

3.10 While R&D and specialisation agreements can facilitate innovation, including the development of new products or improvements to existing ones, they can also give rise to horizontal unilateral effects when they eliminate or reduce significantly a competitive constraint. An R&D or specialisation agreement has the potential to remove an alternative that customers could switch to as there may only be one new product or innovation brought to market rather than more if the businesses had not entered into an agreement and, therefore, innovated individually to develop new products or improve existing ones thereby giving consumers more choice and alternatives to switch to. It is important, therefore, that the UK HBEOs strike an effective balance between encouraging innovation beneficial to consumers that would not occur or be unlikely to occur absent the UK HBEOs while also safeguarding against the competition risks that can accompany horizontal cooperation. That is also why they are tools that should be available principally to undertakings with limited market power – as in such cases, alternative offers or efforts remain available to customers.

3.11 More broadly, the CMA has carefully considered how any new Specialisation BEO and R&D BEO could best support the UK government's Innovation Strategy, given that R&D and specialisation agreements can be closely interlinked with innovative activity and believe that the introduction on a new test in the R&D BEO[30] will help with achieving this objective.[31]

3.12 Lastly, and as outlined in the Introduction, the CMA has also been mindful of the approach proposed by the EU. A relevant consideration for the final recommendation has been that respondents to the Consultation have indicated that in some instances divergence from the EU regime could result in compliance costs for some firms.

[30] Test relating to undertakings competing in innovation.
[31] Under its strategy, the UK government has committed to encouraging a significant increase in private sector investment in innovation, alongside increasing direct public expenditure on R&D to £22 billion per year.

4. Specialisation BER

Overview of block exemption

4.1 The Specialisation BER was originally introduced because of specialisation agreements' potential to improve production processes, lower costs, and lead to lower prices for consumers.

4.2 The Specialisation BER defines three types of specialisation agreement that can benefit from exemption, subject to meeting certain criteria:

- **Unilateral specialisation agreements**: these are agreements between (no more than) two parties that are active on the same product market and where one party agrees fully or partly to cease production of certain products, or to refrain from producing those products and purchase them from the other party (which agrees to produce and supply those products).
- **Reciprocal specialisation agreements**: these are agreements between two or more parties that are active on the same product market and agree, on a reciprocal basis, fully or partly to cease or refrain from producing certain (but different) products, and to purchase these products from the other parties (which agree to produce and supply them).
- **Joint production agreements**: these are agreements between two or more parties that agree to produce certain products jointly.

4.3 Chapter 4 of the EU Horizontal Guidelines complements the Specialisation BER and provides guidance on the circumstances in which production agreements (which include the three types of specialisation agreement covered by the BER as well as a few other types of agreement) may restrict competition and, if they do, whether they can benefit from an individual exemption in the absence of an applicable block exemption.

General recommendation

4.4 The CMA recommends that there should continue to be a safe harbour for some specialisation agreements and that letting the Specialisation BER expire without providing for a replacement is currently not appropriate in the UK.

4.5 The CMA has also concluded that changes could be made to update the terms of the Specialisation BER to provide greater clarity to businesses and to make the block exemption a more effective tool. In particular, the CFI,

Consultation and Evaluation identified areas of the Specialisation BER which stakeholders considered could be improved. These relate to the scope of the BER, the market share thresholds and their application, and more broadly, the clarification of some definitions and the conditions to be met to benefit from the exemption.[32]

4.6 The CMA therefore recommends to the Secretary of State that the Specialisation BER be replaced with a Specialisation BEO, including some changes compared to the existing BER. The specifics of these changes and proposed clarifications to guidance are set out in greater detail below. While the CMA is making suggestions on legal drafting below, we acknowledge that any Specialisation BEO may need to differ in some respects and that it will be down to BEIS to draft this final text.

Detailed recommendations

Definitions included in Article 1

Current regime

4.7 Article 1 of the Specialisation BER provides definitions for the key terms used, thereby setting out the scope of the BER. A 'specialisation agreement' is currently defined as (1) a unilateral specialisation agreement, (2) a reciprocal specialisation agreement or (3) a joint production agreement. Specialisation agreements concern production of goods or services.

4.8 The CMA had previously received a number of responses to its CFI that commented on certain definitions. The feedback it received in response to its Consultation on its proposed recommendation raised similar points. These are set out in more detail below.

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[32] The Evaluation (page 50 of the Staff Working Document) also identified certain aspects that could be improved. The EU's draft revised Specialisation BER includes the following changes:
(i) amending the definitions of 'unilateral specialisation agreement' to also cover agreements between more than two parties, 'reciprocal specialisation agreement', 'potential competitor', 'actual competitor', 'competing undertaking', 'exclusive supply obligation', 'exclusive purchase obligation', 'production', 'downstream product', and 'distribution';
(ii) clarifying that the block exemption can apply even if the parties have not accepted exclusive purchase or exclusive supply obligations;
(iii) clarifying that the market share threshold applies if an agreement concerns intermediary products;
(iv) simplifying the grace period that applies if market shares increase above the exemption threshold;
(v) introducing an alternative timeframe and method for the calculation of market shares (by reference to the average of the parties' market shares of the last three preceding calendar years);
(vi) explicitly setting out the framework for a withdrawal of the benefit of the Specialisation BER (formerly contained in Recitals 13 and 14 of the BER).

Recommendation

4.9 The CMA recommends:

- expanding the scope of any Specialisation BEO to include 'unilateral specialisation agreements' concluded between more than two parties (currently, only agreements between two parties are covered by the Specialisation BER); and
- clarifying certain defined terms in Article 1 and modifying the definition of 'potential competitor' to take out the reference to 'a small but permanent increase in relative prices'.

4.10 We explain each of these proposals in more depth below, summarising the stakeholder feedback on which our proposals are based.[33] We also set out some of changes to the Specialisation BER that were suggested in our proposed recommendation, but that the CMA is now not recommending.

Changes to the scope of any Specialisation BEO

Unilateral specialisation agreements between more than two parties

4.11 Our recommendation is that unilateral specialisation agreements entered into by more than two parties should fall within the scope of any new Specialisation BEO.

4.12 Under Article 1 of the Specialisation BER, unilateral specialisation agreements entered into by more than two parties are not block exempted, while reciprocal and joint production specialisation agreements are.

4.13 We received submissions in response to the CFI that the scope of the Specialisation BER should be amended so that agreements concluded between more than two parties could also be block exempted. Stakeholders argued that such agreements could produce the same types of efficiency-enhancing effects as specialisation agreements entered into between two

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[33] See paragraphs 3.8-3.33 of the consultation document. See Section 4.1.3 of Annex 4 of the Staff Working Document, which notes that '*Several concepts included in the Specialisation BER and/or in Chapter 4 of the Horizontal Guidelines raise issues for several respondents due to their lack of clarity, including the notions of 'reciprocal specialisation agreements', 'joint production', 'joint distribution' and 'price fixing' in the context of joint distribution. Some respondents also consider that unilateral specialisation, as defined in Article 1(1)(b) of the Specialisation BER, should not be restricted to agreements between two parties. In addition, the application of the definitions of the Specialisation BER to different types of specialisation agreements was considered difficult.*' The EC's subsequent Inception Impact Assessment document noted that the Evaluation '*identified questions regarding horizontal sub-contracting agreements with the aim of expanding production, which are currently not explicitly exempted*'.

parties.[34] A response to the Consultation welcomed the expansion of the unilateral specialisation definition to more than two parties. The respondent noted that the expansion of the definition is balanced by the requirement for multiple parties to continue to satisfy the market share threshold.[35]

4.14 Our view is that there do not seem to be strong reasons for unilateral specialisation agreements to be treated differently from reciprocal specialisation agreements and joint production agreements and that unilateral specialisation agreements between more than two parties are likely to be beneficial, just as agreements between two parties are.

4.15 In particular, unilateral specialisation agreements entered into between more than two parties are also likely to contribute to improving the manufacture of goods or the preparation of services or their distribution while having a limited restrictive impact on competition (as a result of the 20% combined market share requirements the parties must satisfy to benefit from the block exemption). Like other specialisation agreements covered by the Specialisation BER, when the parties have complementary skills, assets or activities and are, as a result of the agreement, able to focus their efforts on the manufacture of those goods or the preparation of those services, they are likely to be able to operate more efficiently and supply the products more cheaply. These agreements also have the potential to enable the production of higher quality products.

4.16 Furthermore, the evidence gathered in the Evaluation indicated that the definition of unilateral specialisation agreements (limited to agreements between two parties) may stand in the way of concluding pro-competitive agreements.[36]

Sub-contracting agreements

4.17 We do not recommend any amendments be made in the new Specialisation BEO in relation to sub-contracting agreements. This is because we have not seen sufficient evidence to suggest that Article 1 of the Specialisation BER should be modified to explicitly include such agreements and because we consider that addressing this issue through the CMA HBEOs Guidance would be more appropriate.

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[34] Eversheds Sutherland, Dentons, American Bar Association Antitrust Law and International Law Sections.
[35] Law Society of Scotland.
[36] See page 2 of the EC's Inception Impact Assessment.

4.18 The issues raised by stakeholders[37] relate to the fact that sub-contracting agreements are not expressly exempted under the Specialisation BER. This does not mean that sub-contracting arrangements can never benefit from the block exemption, but that they can only benefit in limited circumstances (eg if the agreement falls within the definition of specialisation agreement).

4.19 The feedback to our CFI and responses to our Consultation related to the following two issues:

- first, whether sub-contracting agreements in general should be included in the scope of the Specialisation BEO, and
- second, whether the current text in the EU Horizontal Guidelines in relation to sub-contracting with a view to expanding production should be broadened and whether, in any case, this specific category of agreements should be included in the scope of the Specialisation BEO.

4.20 In relation to the first issue, stakeholders submitted that in most situations, sub-contracting agreements raised similar competitive risks to unilateral specialisation agreements, which are covered by the Specialisation BER.[38] It was also noted that it was not clear if a sub-contracting agreement between a contractor and a sub-contractor, who were also competitors, was included in the definitions of the Specialisation BER,[39] and whether a sub-contracting arrangement constituted a specialisation agreement in the form of a joint production agreement and could therefore be block exempted.

4.21 In relation to the second issue, submissions related to a provision in the EU Horizontal Guidelines, which states that when the parties' combined market share does not exceed 20%, it is likely that the horizontal sub-contracting agreements with a view to expanding production would fulfil the conditions for individual exemption.[40] A stakeholder raised the point that such agreements are assessed in a manner similar to agreements falling within the scope of the Specialisation BER, and queried the rationale for their exclusion from the scope of the Specialisation BER.[41] A stakeholder compared sub-contracting with a view to expanding production with a joint production agreement and found it difficult to understand why a sub-contracting arrangement to increase the production of goods is also not block exempted given that neither arrangement requires a reduction in the production of goods by the parties.[42]

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[37] American Bar Association Antitrust Law and International Law Sections, Dentons.
[38] American Bar Association Antitrust Law and International Law Sections.
[39] Meeting between Dentons and the CMA.
[40] Paragraph 169 of the EU Horizontal Guidelines.
[41] American Bar Association Antitrust Law and International Law Sections.
[42] Law Society of Scotland.

When raising concerns with the lack of explicit exemption for horizontal sub-contracting agreements with the aim of expanding production, stakeholders suggested that Article 1 of the Specialisation BER should be modified to include horizontal sub-contracting agreements with a view to expanding production.

4.22 Our view is that it is not appropriate for sub-contracting arrangements[43] to be expressly included within the scope of the Specialisation BER, as a new category of agreements. This is because sub-contracting encompasses a broad array of agreements, some of which may not always contain the same collaborative approach to production or the same efficiency objectives envisaged to benefit from the exemption afforded by the Specialisation BER. As such, the CMA's view is that sub-contracting is more appropriately addressed in the CMA HBEOs Guidance.

4.23 When reaching this conclusion, we considered the following:

- Specialisation agreements are about actual competitors or, in the case of joint production, also potential competitors, agreeing to concentrate (individually or jointly) on the production of certain goods or services and therefore to operate more efficiently. The Specialisation BER block exempts certain specialisation agreements which, as a general rule, give rise to economic benefits in the form of economies of scale or scope or better production technologies, while allowing consumers a fair share of the resulting benefits.

- Sub-contracting agreements, on the other hand, are not typically agreements aimed at specialisation. They do not tend to involve both parties agreeing to concentrate their efforts on one aspect of the production, thereby specialising, and can in practice cover a broad range of situations. Sub-contracting can, for example, be used by a sub-contractor to increase the flexibility of its operation, or to address capacity constraints. In such cases, the agreement is not about both parties wanting to operate more efficiently but about one party purchasing 'support' in the form of a good or a service from another party. In such an arrangement the role of the party carrying out the sub-contracting tends to be limited to the provision of the required good or service.

- It remains possible that businesses engaged in specialisation produce the goods or services by way of sub-contracting, in which case the block

[43] Including sub-contracting with a view to expanding production.

exemption would apply to the production regardless of whether it is done by sub-contracting or not.[44]

- Similarly, sub-contracting agreements can also benefit from the Specialisation BER if they fall within the scope of the definition of specialisation agreement.

4.24 Lastly, even though sub-contracting agreements do not necessarily fall within the scope of the block exemption, parties engaging in a horizontal sub-contracting agreement may benefit from individual exemption. This is to be explained further in the CMA HBEOs Guidance.[45]

Distribution and rental services

4.25 In response to our CFI, a stakeholder suggested that the scope of the Specialisation BER should be expanded by removing the current exclusion of distribution and rental services from the definition of 'product' in Article 1(1)(f). It was argued that rental and distribution services companies may wish to enter into arrangements with actual or potential competitors to deal with capacity constraints or the requirements of a tender.[46]

4.26 The stakeholder outlined that there were challenges when advising clients in sectors where these agreements were prevalent and queried why the block exemption was not extended to this category of agreement.[47]

4.27 No other stakeholder made a similar suggestion. In response to the Consultation, we also received no further submission on this point, although this was an opportunity to provide feedback on the proposed recommendation not to remove the exclusion of distribution and rental services from the definition of 'product' in Article 1(1)(f) of the Specialisation BER that was included in the Consultation.

4.27 Given the limited evidence received suggesting that the current carve out from the definition of 'product' that applies to distribution and rental services results

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[44] This is the situation captured in the definition of production under the Specialisation BER.
[45] For example, the EU Horizontal Guidelines provide for a safe harbour for subcontracting with a view to expanding production might (subject to the parties' combined market share not exceeding 20%). See paragraph 169 of the EU Horizontal Guidelines.
[46] Dentons, noting that rental/distribution services companies may wish to enter into arrangements with actual or potential competitors to deal with capacity constraints or the requirements of a tender (which in their view are effectively 'joint production' of services, sometimes implemented by way of sub-contracting arrangements between actual or potential competitors).
[47] Meeting with Dentons following their CFI engagement.

in inefficient outcomes and should be abandoned, we are not recommending a change to this definition in the Specialisation BEO.[48]

Clarifications to the defined terms in Article 1 and modification of the definition of 'potential competitor'

4.29 The evidence in the stakeholder responses indicated that the effectiveness of the Specialisation BEO could be improved by providing greater clarity about the application of certain definitions.[49]

Clarificatory changes in Annex A

4.30 We recommend that BEIS consider making a number of clarificatory changes to definitions currently in Article 1 when drafting any Specialisation BEO. We will also consider what further we can do by way of guidance to support stakeholders' understanding of the definitions.[50]

4.31 We received feedback in the response to the CFI that there was a case for clarifying some of the definitions currently in Article 1, with the particular suggestion that, while Article 1 of the Specialisation BER provided basic legal certainty, it would be helpful to simplify the definitions to make them more accessible for non-legal professionals, perhaps by offering specific examples of what each type of agreement is intended to cover.[51] A respondent to the Consultation outlined its view that legal certainty is best served by mirroring the reforms made by the EC, subject to changes that would bolster legal certainty for companies and other undertakings in the UK.[52]

4.32 We note that the EC has made a number of clarificatory changes to the wording of certain definitions in its draft revised Specialisation BER.[53] Such changes are likely to improve the effectiveness of the block exemption by removing ambiguities and making it easier to be relied upon by businesses. Our view is that it would be beneficial if certain similar clarificatory changes

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[48] This approach is consistent with the one the EU is taking in its draft revised Specialisation BER (Article 1(1)(c)).
[49] CFI responses: Baker McKenzie, Eversheds Sutherland, Dentons. Meeting with Dentons following their CFI engagement.
[50] The CMA notes that in any Specialisation BEO, the numbering of the articles is likely to differ from the current numbering. So, any proposed change to Article 1 in this recommendation on Specialisation is to be understood as meaning a change to the article(s) that will include definitions in any Specialisation BEO.
[51] Eversheds Sutherland.
[52] Law Society of Scotland.
[53] See the EU's draft revised Specialisation BER. The EC has, for example, proposed that clarificatory changes be made to the definitions of 'specialisation agreement', 'unilateral specialisation agreement', 'reciprocal specialisation agreement', 'joint production agreement', 'potential competitor', 'actual competitor', 'relevant market', 'exclusive supply obligation', 'distribution', 'downstream product', 'production', and 'joint' (in the context of distribution).

were considered by BEIS when drafting any Specialisation BEO (see Annex A).

Potential competitor

4.33 Over and above those changes mentioned in paragraphs 4.30 to 4.32, the definition of 'potential competitor' could be modified to take out the reference to 'a small but permanent increase in relative prices'.

4.34 The removal of 'a small but permanent increase in relative prices' from the definition should simplify and in turn facilitate the assessment by companies of what may constitute a potential competitor.[54]

4.35 We note in this context that one of the reasons for deleting the concept of 'a small but permanent increase in relative prices' is that it is more relevant to the assessment of market definition and is a less relevant criterion for identifying a potential competitor (and consequently is not generally used in antitrust cases for such purposes).

4.36 This recommended change would align, to a large extent,[55] the definition of potential competitor in the Specialisation BEO with the one used in The Competition Act 1998 (Vertical Agreements Block Exemption) Order 2022 (VABEO). This change would reflect the change that we are also recommending in relation to the definition of 'potential competitor' in the R&D BEO (see paragraph 5.30 below).

4.37 It was submitted in response to the CFI that more clarity regarding the meaning of 'potential competitor' [56] would be welcome. Concerns were raised that the test under the current Horizontal Guidelines for assessing whether a company constitutes a 'potential competitor' is difficult to apply in practice. It was suggested that the ability of the potential competitor to enter into the market in the short term needs to be evidence-based rather than speculative and that there should be evidence of a clear commercial strategy within the business, supported by internal documents showing a clear plan to invest in entering the market.[57] We consider that the most appropriate way of providing

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[54] The EC has also made the same change in the EU draft revised Specialisation BER.
[55] The definition of potential competitor in the EU HBERs and the VABEO have differing timeframes due to differing levels of investment.
[56] Article 1(1)(n): defines 'potential competitor' as an undertaking that, in the absence of the specialisation agreement, would, on realistic grounds and not just as a mere theoretical possibility, in case of a small but permanent increase in relative prices be likely to undertake, within not more than 3 years, the necessary additional investments or other necessary switching costs to enter the relevant market'. Baker McKenzie suggest that the current test set out in paragraph 10 of the EU Horizontal Guidelines and accompanying footnotes is essentially based around market definition and can be difficult to apply in practice.
[57] Baker McKenzie.

greater clarity in relation to these points is through guidance, and therefore propose to address these points in the CMA HBEOs Guidance.

Joint distribution and joint production

4.38 We received feedback that 'joint' in the context of distribution, particularly the meaning of: 'carry out the distribution of the products by way of a joint team, organisation or undertaking' should be clarified.[58] In particular, it was noted that the definition suggested that joint distribution need not involve a corporate distribution joint venture, but it was unclear what level of formality, if any, was required in the absence of a corporate joint venture (for example, whether it was enough for the parties' respective sales teams to discuss and agree on distribution strategy and prices).[59]

4.39 We also received feedback that it would be helpful to clarify the meaning of 'joint' in the context of production, a term which is not currently defined in the Specialisation BER.[60] It was however highlighted by the respondent that this could be addressed in future CMA Guidance rather than in the text of any Specialisation BEO.

4.40 The CMA is not recommending any substantive changes to the definition of 'joint' in the context of distribution, but recommends that BEIS consider any clarificatory changes that may be appropriate when drafting any Specialisation BEO to address the issues that have been raised. We will also consider what further clarification we can provide in the CMA HBEOs Guidance, on the meaning of 'joint' both in the context of distribution and in the context of production.

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[58] Dentons. Article 1(1)(q): 'joint', in the context of distribution, means that the parties: (i) carry out the distribution of the products by way of a joint team, organisation or undertaking; or (ii) appoint a third-party distributor on an exclusive or non-exclusive basis, provided that the third party is not a competing undertaking. The CMA notes that the EU's draft revised Specialisation BER has made changes to this provision. It has now been reworded to read:
''joint', in the context of distribution, means activities where the work involved is: (1) carried out by a joint team, organisation or undertaking, or (2) undertaken by a jointly appointed third party distributor on an exclusive or non-exclusive basis, provided that the third party is not a competing undertaking' (Art. 1(1)(l) of the EU draft revised Specialisation BER).
[59] Dentons
[60] Meeting with Dentons following their CFI engagement.

Conditions for block exemption under Article 2

Current regime

4.41 Article 2 of the Specialisation BER sets out the exemption for specialisation agreements. Article 2(1) block exempts specialisation agreements (which are defined in Article 1 as unilateral, reciprocal and joint production agreements).

4.42 In addition, Article 2(2) provides that the exemption applies to specialisation agreements containing provisions which relate to the assignment or licensing of intellectual property rights to one or more of the parties, provided that those provisions do not constitute the primary object of such agreements, but are directly related to and necessary for their implementation.

4.43 Article 2(3) provides that the exemption also applies to agreements where the parties accept an exclusive purchase or supply obligation; and to agreements where the parties do not independently sell the specialisation products but jointly distribute those products. Recital 9 further explains that in order to ensure that the benefits of specialisation will materialise without one party leaving the market downstream of production entirely, unilateral and reciprocal specialisation agreements must provide for supply and purchase obligations between the parties or for joint distribution. Recital 9 adds that these supply and purchase obligations do not have to be exclusive. However, if they are exclusive, these will be block exempted by virtue of Article 2(3).

Recommendations

4.44 The CMA recommends that the Secretary of State make it clearer in any Specialisation BEO that the block exemption applies even where the purchase or supply obligations are not exclusive or where the parties are not jointly distributing the specialisation products.

4.45 We will also consider what further clarification we can provide in the CMA HBEOs Guidance on the application of Article 2, for example in relation to specialisation agreements between joint ventures and parent companies.

4.46 In response to the Consultation, we received feedback on Article 2(2) but no feedback on our proposed approach to Article 2(3).

4.47 In relation to Article 2(2), one respondent to our Consultation expressed concerns[61] that Article 2(2) 'comes close to implying' that licensing could

[61] Law Society of Scotland.

constitute the main aim of a specialisation agreement, which in its view did not make commercial sense. The stakeholder suggested that Article 2(2) should state that intellectual property licensing that is 'necessary' for the co-operation is covered by any Specialisation BEO.

4.48 In relation to Article 2(3) and as explained in the Consultation,[62] this provision does not seem to make it sufficiently clear that the block exemption can apply whether one or both parties have accepted exclusive purchase or exclusive supply obligations. Although, as explained above in paragraph 4.43, recital 9 clarifies that the block exemption can apply even when the supply or purchase obligations are not exclusive or where the parties are not jointly distributing the specialisation products, we agree that the current drafting could be made clearer. Stakeholders also suggested that further clarification of the scope of the exemption between joint ventures and parent companies is needed where the parties have not accepted any exclusive purchase or exclusive supply obligations (subject to all other conditions being met).[63] This is the recommendation we made in our Consultation and, given the absence of feedback on this point, our proposed recommendation remains unchanged.[64]

4.49 We have not, however, received sufficient evidence to suggest that the current rules in Article 2(2) should be amended. We are therefore not recommending any substantive changes to Article 2(2) in the Specialisation BEO.

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[62] Consultation document, paragraph 3.38.
[63] Dentons. The Evaluation Support Study Final Report provides more detail on the concerns raised about parent companies and joint ventures: '*respondents mentioned that issues arise from a lack of clarity and consistency for the assessment of the relationship between parent companies and joint ventures: namely, parent companies which created joint ventures and moved most activities to these joint ventures, whilst retaining some activities/areas in which they compete with the joint venture. The Specialisation BER and Chapter 4 of the Horizontal Guidelines do not specify if in such a case the companies are to be treated as competitors or as the same economic entity for the assessment of competition compliance*'.
[64] Consultation document, paragraphs 3.36 and 3.37.

Market share threshold under Article 3

Current regime

4.50 Article 3 of the Specialisation BER provides a safe harbour for specialisation agreements where the parties have a combined market share lower than 20% on any relevant market.

4.51 Recital 10 of the Specialisation BER explains that where the products manufactured under a specialisation agreement are intermediary products, which one or more of the parties then use as an input for their own production of downstream products (which they subsequently sell on the market), the exemption should also be conditional on the parties' share on the relevant downstream market not exceeding a certain level.

Recommendations

4.52 In relation to the market share threshold set out in Article 3, the CMA recommends that:

- the Specialisation BEO retain the current 20% market share threshold in relation to specialisation agreements;
- the Specialisation BEO clarifies that in relation to intermediary products, the 20% market share threshold also applies to the parties' market share on the relevant downstream market;
- the CMA considers what further guidance it can provide to help undertakings calculate their market shares. This would help all undertakings, but particularly SMEs that have had difficulty engaging with competition law, as it would increase their understanding of the requirements that they would need to meet in order to gain the benefit of exemption under the Specialisation BEO.

Market share threshold

4.53 In response to both the CFI and the Consultation, we received feedback from some stakeholders who considered that the market share threshold should be raised.[65] For example, one respondent recommended increasing the market

[65] The Staff Working Document (Section 4.1.3, Annex 4) also notes that 'several respondents consider that the current markets share threshold of 20% is too low to exempt pro-competitive horizontal specialisation agreements. Some respondents also consider that a safety margin should be introduced in case an agreement

share threshold to 25%.[66] Another suggested that a 25% or 30% market share threshold would not threaten competition.[67]

4.54 Arguments made in favour of increasing the market share threshold included:

- The current threshold is too low and discourages firms from entering into agreements.[68]
- A higher market share threshold would provide greater legal certainty for businesses.[69] The current 20% threshold can easily be met (ie market shares in the range of 10-15% for each undertaking involved would be sufficient) leading to complicated and legally uncertain self-assessment.

4.55 One respondent proposed an additional safe harbour based on the percentage share of production costs in relation to the overall variable costs of a good and/or service.[70]

4.56 The evidence the CMA has seen is not sufficient to conclude that a higher market share threshold would be appropriate, or indeed which alternative level would be appropriate. Similarly, the CMA has not seen sufficient evidence to recommend that an additional safe harbour would be appropriate. The market share threshold is an important safeguard against the risks of granting the benefit of a safe harbour to anti-competitive conduct.

Intermediary products

4.57 As set out in the Consultation,[71] we believe that it would add clarity and facilitate the use of the block exemption to consolidate the provisions that relate to the 20% market share requirement in one place. Specifically, Recital 10, which is relevant to the application of the market share thresholds, is not consolidated in Article 3. In addition, our view is that the rationale for the

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surpasses the threshold. A few respondents request to increase […] the market share threshold, while they also referred to issues concerning the calculation of the market shares, the implementation period during which the exemption continues to apply once the 20% share has been exceeded (up to 2 calendar years) or the coherence between the threshold of the Specialisation BER and other EU and national competition law regulations.' The EC's Inception Impact Assessment document noted that the Evaluation 'identified that SMEs have difficulty self-assessing their specialisation agreements in order to establish whether they qualify for exemption'. CFI respondents: Baker McKenzie, Eversheds Sutherland, Dentons. Consultation respondent: Baker McKenzie.

[66] Baker McKenzie.

[67] Dentons. Eversheds Sutherland also suggested an increase in the market share thresholds but did not provide a figure.

[68] Dentons, Eversheds Sutherland.

[69] Eversheds Sutherland.

[70] Baker McKenzie. This respondent submitted that as long as the ratio production cost/overall variable costs is limited, the risk of cost commonalities and price commonalities should be minor and not give rise to competition concerns.

[71] The Consultation document, paragraph 3.50.

requirement under Recital 10, which is to limit the potential risk of foreclosure or an increase in the price of the input for competitors at the downstream level, remains valid and important so we are not proposing that this should be changed.[72]

4.58 Accordingly, the CMA considers that when drafting any Specialisation BEO, BEIS may want to consider bringing together the provisions currently included in Recital 10 and Article 3 to add clarity and make the Specialisation BEO easier to use.

Small and medium enterprises (SMEs)

4.59 As set out in the Consultation, the evidence gathered highlighted that SMEs may find it difficult, in practice, to apply the threshold because of a lack of access to market data and a limited understanding of the requirements.[73] On that basis, we considered the possibility of carving out SMEs from the market share threshold requirement but provisionally concluded that this would not be appropriate given that SMEs may have market power.

4.60 We will instead consider providing further practical guidance within the CMA HBEOs Guidance to help SMEs establish their market shares, and note that any such guidance would also aim to assist undertakings which are not SMEs.[74]

4.61 We have not received any feedback on our proposed approach and are therefore confirming it.

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[72] The CMA notes that the EC in the EU draft revised Specialisation BER has changed Article 3 to incorporate the text from Recital 10.
[73] The EC Inception Impact Assessment notes that SMEs have difficulty self-assessing their agreements to establish whether they qualify for exemption, page 2. Furthermore, the EC expert report Specialisation Agreements and SMEs finds that SMEs may be insufficiently informed about the requirements that competition law imposes on horizontal cooperation and may face difficulties establishing with sufficient certainty whether they are below the 20% market threshold. Another source of difficulty for SMEs identified in this EC expert report is the identification of the relevant markets affected by a certain agreement and the calculation of the market shares, page 33.
[74] Eversheds Sutherland noted that necessary assessments and the detailed and often complex market analysis required to determine a market share cannot easily be undertaken by businesses (SMEs in particular), who have to rely instead on imprecise 'best guess' market share estimates.

Application of the market share threshold under Article 5

Current regime

4.62 Article 5 sets out the rules for the purposes of applying the market share threshold in Article 3. This includes in Article 5(b) a requirement that market shares should be calculated on the basis of the preceding calendar year.

4.63 In addition, Article 5(d) and (e) provide for grace periods that apply when the parties' combined market share, which is initially below 20%, rises above that level. Under this Article, if the market share is initially not more than 20% but rises to 25% without exceeding it, the grace period is for two years, but if it rises above 25%, then a one-year grace period applies.

Recommendations

4.64 In relation to the application of the market share threshold (Article 5),[75] the CMA recommends that:

- a single grace period of two years after the 20% market share threshold has been exceeded be introduced; and
- when the preceding calendar year is not representative of the parties' position on the relevant market(s), the market share should be calculated as an average of the parties' market shares of the three preceding calendar years.

Grace period

4.65 Concerns were expressed by stakeholders about Article 5 being difficult to apply, and one CFI respondent suggested that although Article 5 is a useful starting point, given the complexity of determining market share, the current rules do not provide sufficient guidance.[76] Similarly, the Evaluation indicated that the criterion is hard to apply, including in relation to the calculation of market shares and determining whether the implementation period continues to apply once the 20% market share threshold has been exceeded.[77] SMEs flagged concerns regarding the difficulty of conducting a self-assessment of

[75] The CMA notes that in the EU's draft revised Specialisation BER, the articles of that BER have been renumbered and what is Article 5 in the Specialisation BER is Article 4 in the EU draft revised Specialisation BER.
[76] Eversheds Sutherland.
[77] See page 117 of the Staff Working Document.

the application of the Specialisation BER.[78] However, not all stakeholders proposed a change: one respondent to the CFI argued that the terms remained sufficiently clear and appropriate.[79]

4.66 On balance, the CMA considers that there is merit in simplifying the provisions for the grace periods given the difficulties in applying them and recommends a simplification by having a single grace period of two years.[80]

4.67 The recommended change we consulted on is to have a single grace period that would apply where the market share (that was initially not more than 20%) subsequently rises above that level in at least one of the markets concerned by the specialisation agreement. In that case, the exemption would continue to apply for a period of two consecutive calendar years following the year in which the 20 % threshold was first exceeded.

4.68 This change should facilitate the implementation of the two-year grace period especially for businesses which exceeded the 20% market share but did not exceed the 25% threshold, as in that case they may have been monitoring their market shares during that period to ensure that they did not then exceed 25%.

4.69 In response to the Consultation, one stakeholder noted that the grace period was useful but suggested that a review mechanism be introduced in the Specialisation BEO to allow the CMA to examine, on a periodic basis, the necessity of increasing the market share safe harbour to consider 'competition posed by digital companies'.[81]

4.70 The CMA notes that such mechanisms do not seem necessary given that the Specialisation BEO will be subject to the periodic review (every 5 years) in any event.[82] While BEIS will be undertaking the review, it is expected that CMA expertise (including its understanding of any relevant developments in relation to digital markets through the work of its Digital Markets Unit) will be captured in its contribution to BEIS' periodic review.

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[78] Section A of the Inception Impact Assessment.
[79] Dentons.
[80] The CMA notes that the E has proposed this simplification of the grace period under Article 5 in the EU draft revised Specialisation BER, which the CMA considers to be helpful.
[81] Law Society of Scotland.
[82] Statutory review clauses impose a legislative duty to carry out and publish a post-implementation review of the measure within five years of it coming into force and then regularly on a five-year cycle, or more frequently if appropriate to the measure. See Section 28 Small Business, Enterprise and Employment Act 2015.

Period to consider for establishing parties' market shares

4.71 As set out in the Consultation, there is evidence that companies and law firms consider the calculation of market shares to be complex and burdensome due to the difficulty of gathering the information needed to make such assessments.[83] Concerns were raised that, for example, in bidding markets where procurements take place at irregular intervals, there may be a case for looking at market shares over a longer period but that this possibility is not expressly contemplated by the Specialisation BER.[84]

4.72 For this reason, we consider that it should help businesses making use of the block exemption if they could use an alternative to market share data from the preceding year when those are not representative of the parties' position in the relevant market(s).[85] The alternative we consulted on provides that, when the preceding calendar year is not representative of the parties' position in the relevant market(s), the market share should be calculated as an average of the parties' market shares of the three preceding calendar years. We are recommending that any new Specialisation BEO introduce this alternative.

'*Hardcore' restrictions listed in Article 4*

Current regime

4.73 Specialisation agreements containing certain 'hardcore' restrictions will not benefit from the 'safe harbour' outlined in Article 2. These restrictions, as set out in Article 4 of the Specialisation BER, are:

- fixing prices when selling the contract product to third parties other than immediate customers in the context of joint distribution;
- limiting output or sales, apart from provisions to agree amounts of products to be produced or supplied under a unilateral or reciprocal specialisation agreement; to set capacity and production volumes in a joint production agreement; or to set sales targets in the context of joint distribution; and

[83] See pages 40 and 74 of the Staff Working Document.
[84] Allen and Overy submission to the EC.
[85] The CMA notes that the EC in the EU draft revised Specialisation BER has introduced some flexibility for the situation where the preceding year's market share is not representative of their position in the relevant market(s). This flexibility is achieved by making it possible to calculate the market share on the basis of an average of the parties' market shares of the three preceding calendar years. The CMA considers that this is a sensible approach that should improve how the market share is calculated where the preceding calendar year is not representative of the parties' position.

- the allocation of markets or customers.

4.74 Unlike certain other block exemptions, the Specialisation BER does not contain any 'excluded restrictions', ie restrictions that are excluded from the benefit of the exemption and that must be individually assessed to establish whether they benefit from the individual exemption in section 9(1) of the Act.

Recommendation

4.75 The CMA recommends that:

- the Secretary of State should retain the hardcore restrictions currently included in Article 4 of the Specialisation BER[86] in a Specialisation BEO;

- the CMA should consider what further guidance it can provide to help stakeholders complying with Article 4.

4.76 Below we set out the evidence we considered in making our recommendation and provide more detail.

List of hardcore restrictions

4.77 The evidence gathered indicates that the majority of those consulted considered that the list of hardcore restrictions in the Specialisation BER provided legal certainty.[87] One CFI respondent specifically expressed the view that the hardcore restrictions are sufficiently clear and that the prohibitions on price-fixing, limitation of output and market sharing are well-understood.[88]

4.78 It should be noted that one respondent to the CMA's CFI queried whether the Specialisation BER, and the retained HBERs as a whole, required a list of hardcore restrictions at all. In particular, the respondent was concerned about the risk that such restrictions automatically mean that the block exemption will not apply (which in turn is interpreted as engaging in a hardcore practice that can never be defended or at least is very risky behaviour), when in some

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[86] Or equivalent provision, depending on how BEIS structures and drafts any Specialisation BEO.
[87] In relation to the Evaluation, see Section 5.1.2 of the Staff Working Document page 50. In particular: '*the majority of respondents (mainly business associations and law firms) to the public consultation that expressed a view considered that the explanations on the type of specialisation agreements to which the exemption applies under Article 2 of the Specialisation BER and the list of hardcore restrictions such as price fixing certain limitation of output sales or allocation of markets/customers (Article 4 of the Specialisation BER) allowed to identify agreements compliant with Article 101 of the Treaty*.'
[88] Eversheds Sutherland.

cases these restrictions could contribute to underpinning the beneficial pro-competitive nature of the agreement in question.[89]

4.79 In response to the Consultation, one stakeholder found the existing hardcore restrictions coherent, apart from the hardcore restriction in respect of allocation of markets or customers in Article 4(c).[90] It argued that it is difficult to understand how co-ordination on customers and markets which relates only to goods jointly produced and which would not cover (whether directly or indirectly) any goods the parties produce independently from each other, could constitute a hardcore restriction. The stakeholder suggested creating a carve-out from the market/customer allocation hardcore restriction in Article 4(c) in the context of joint production and to limit this carve-out to products jointly produced.

4.80 However, in the absence of more evidence as to why it is necessary to remove or amend the hardcore restrictions, the CMA does not consider it to be appropriate to make a change of this nature. Hardcore restrictions include some of the most serious restrictions of competition and the CMA considers that they should not benefit from an automatic safe harbour.

4.81 Concerning the respondent's submission that the presumption of illegality should be replaced by an effects-based analysis, given the serious nature of these restrictions, and in the absence of more evidence as to why such a change would be appropriate, we do not consider that the CMA has a sufficient basis to conclude that a change of this nature should be made either.

Hardcore restrictions and the EU Horizontal Guidelines

4.82 A number of stakeholders argued that:

- The current hardcore restrictions with their exceptions as, for example, set out in Article 4(b)(i) and 4(b)(ii) and in paragraph 160 of the EU Horizontal Guidelines, could be simplified and streamlined.[91]
- Examples used in the EU Horizontal Guidelines are currently unclear (for example, paragraph 188 on collusive outcomes).[92]

[89] Baker McKenzie (Baker McKenzie referred to the retained HBERs as a whole with regards to the need for hardcore restrictions).
[90] Law Society of Scotland.
[91] Baker McKenzie.
[92] Baker McKenzie.

- The customer allocation hardcore restriction can be more difficult to analyse in the context of non-poaching provisions which are common in sub-contracting arrangements;[93] further clarity on this area would be welcome.[94]

- More guidance is needed on how the CMA assesses the 'overall effects' of production agreements that also provide for the joint distribution of the jointly manufactured goods or other 'integrated commercialisation functions'[95]

- More guidance is needed on the conditions and circumstances which the CMA considers are required for a joint distribution agreement to be necessary for the joint production agreement.[96]

4.83 The points made in response to the CFI and the Consultation indicate that there are certain areas of Article 4 on hardcore restrictions on which stakeholders would value greater clarity. We will therefore consider what further guidance we can provide and engage with stakeholders to ensure that it addresses the issues they face in practice.[97] We recommend that BEIS consider any clarificatory drafting changes to Article 4 in any Specialisation BEO.[98]

[93] Such arrangements might involve the sub-contractor agreeing not seek to supply the contractor's customers outside the joint arrangement during the agreement and potentially for a period after.
[94] Dentons.
[95] Baker McKenzie.
[96] Baker McKenzie.
[97] Cf. paragraphs 280 to 283 of the EU draft revised Horizontal Guidelines in which the EC has provided guidance on the hardcore restrictions contained in the Specialisation BER. For example, this guidance includes a grouping of hardcore restrictions into three categories (paragraph 281), an explanation of how the restrictions can be achieved (paragraph 282), and a clarifying overview of the exemptions to the hardcore restrictions (paragraph 283).
[98] Or equivalent provision, depending on how BEIS structures and drafts any Specialisation BEO.

5. R&D BER

Overview of block exemption

5.1 The R&D BER provides an exemption for agreements pursuant to which two or more parties agree to collaborate in relation to the research and development (R&D) of products, technologies, or processes. The agreement may involve the joint exploitation of the results of the R&D, and it may also cover paid-for R&D (where one-party finances R&D conducted by the other).

5.2 The EU R&D BER was originally introduced because of the significant advantages that R&D cooperation agreements can bring, including the efficient allocation of tasks and resources and the likelihood of earlier breakthroughs.

5.3 For an R&D agreement to benefit from the block exemption, certain criteria need to be met during the period of R&D and then, if the products are jointly exploited by the parties, for up to 7 years from the time the contract products or technologies are first put on the market in the UK.

5.4 Chapter 3 of the EU Horizontal Guidelines complements the R&D BER and provides guidance on the circumstances in which an R&D agreement may restrict competition and, if it does, whether it can benefit from an individual exemption in the absence of an applicable block exemption.

5.5 The evidence we have gathered and reviewed suggests that the R&D BER, together with Chapter 3 of the EU Horizontal Guidelines, are overall useful instruments that increase legal certainty and support beneficial R&D agreements as compared to a situation without the BER.[99] However, as set out further below, stakeholders indicated that certain aspects of the R&D BER could be improved or clarified.

General recommendation

5.6 The CMA recommends that there should continue to be a safe harbour for some R&D agreements and that letting the R&D BER expire without providing for a replacement is currently not appropriate in the UK.

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[99] As reflected in CFI responses from Baker McKenzie, Eversheds Sutherland, Nokia, Dentons, Fraunhofer, The App Association and Ericsson. As regards the Evaluation – see main findings at Section 5.1.2 of the Staff Working Document. We also note that the EU is proposing to introduce a revised R&D BER, indicating that the R&D BER is a useful instrument. This was also reflected in the responses to the Consultation from the Law Society of Scotland and Baker McKenzie.

5.7 In reaching this recommendation, the CMA has taken into account the fact that none of the respondents disagreed with our recommendation that there was value in retaining the R&D BER.[100]

5.8 The CMA has also concluded that changes could be made to the terms of the R&D BER to provide greater clarity to businesses and make the block exemption a more effective tool. In particular, the CFI and Evaluation identified areas where stakeholders have suggested improvements to the R&D BER.[101] These relate to market share thresholds and their application; the treatment of innovation markets; issues with current full access requirements in Article 3, and a broader need for clarifying certain definitions. A number of respondents to the Consultation also supported the need for these improvements to the terms of the R&D BER.[102] As a result, the CMA has concluded that it would be appropriate to amend the terms of the R&D BER to reflect the feedback we have received rather than renew them without variation.

5.9 The CMA therefore recommends to the Secretary of State that the R&D BER should be replaced with a new R&D Block Exemption Order that would include some changes compared to the existing BER. The details of these changes and proposed clarifications to guidance are set out in greater detail below. While the CMA is making suggestions on legal drafting below, we acknowledge that any R&D BEO may need to differ in some aspects and that it will be down to BEIS to draft this final text.

Detailed recommendations

Definitions in Article 1

Current regime

5.10 Article 1 sets out definitions of key terms that are used in the R&D BER. These include, among other things, the definition of 'research and

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[100] All CFI respondents considered that there was value in retaining the R&D BER. These respondents were: Baker McKenzie, Eversheds Sutherland, Nokia, Dentons, Fraunhofer, The App Association and Ericsson. One law firm (Eversheds Sutherland), responding to the CFI, highlighted that COVID-19 had provided an important opportunity to note the importance of coordinated R&D of new pharmaceutical products and that common R&D efforts generally allowed the creation of new products and the emergence of new markets.
[101] The four respondents (Dentons, Baker McKenzie, Eversheds Sutherland and Nokia), who made detailed CFI submissions on the R&D BER qualified their view on the positive effect of the R&D BER and highlighted significant improvements they considered should be made. For example, Nokia said that it regularly consulted the R&D BER and the relevant section of the EU Horizontal Guidelines and had relied on the R&D BER previously, but noted that the R&D BER should be updated to reflect 'business realities of today' and 'should seek to better meet the demands of highly dynamic and innovative markets related to technological and digital industries in order to boost growth and competition'.
[102] Bristows and Baker McKenzie (and Dentons in their meeting with the CMA).

development agreement', definitions of 'actual' and 'potential' competitors and other definitions that impact the scope of the block exemption under the R&D BER.

Recommendation

5.11 In relation to the current Article 1, the CMA recommends a number of modifications to increase legal certainty for businesses and other undertakings seeking to benefit from the R&D BEO. The CMA also recommends the introduction of new definitions to clarify the block exemption and to explain the key concepts relating to the separate test for undertakings competing in innovation.[103]

5.12 The CMA recommends:

- the introduction of new definitions for 'R&D pole', 'competing R&D effort', 'not competing undertaking', 'undertaking competing in innovation' and 'new product or technology';
- amending the existing definitions of 'research and development agreement' and 'research and development';
- modifying the definitions of:
  - 'potential competitors' to take out the reference to 'a small but permanent increase in relative prices'; and
  - 'intellectual property rights' to avoid defining 'intellectual property rights' by itself ('intellectual property rights') and to clarify what intellectual property rights includes, namely: industrial property rights (such as patents and trade marks), copyright and 'neighbouring rights'.

5.13 We explain each of these recommendations in more depth below, summarising the stakeholder feedback on which our recommendations are based.

5.14 The evidence submitted in response to our CFI indicated that increased clarity in definitions would be of benefit in the UK.[104] Indeed, all CFI respondents

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[103] The CMA notes that in any R&D BEO the numbering of the articles is likely to differ from the current numbering. So, any proposed change to Article 1 in this recommendation on R&D is to be understood as meaning a change to the article(s) that will include definitions in any R&D BEO.
[104] One law firm (Baker McKenzie) noted that the R&D BER, and the corresponding section of the EU Horizontal Guidelines, were 'far too conservative in our view and are also difficult to apply in practice… legal certainty is

who made detailed submissions on the R&D BER emphasised that the definitions in Article 1 of the R&D BER would benefit from clarification. Furthermore, additional evidence also suggested that several definitions in the R&D BER (or concepts and terms used in the R&D BER but not yet defined in Article 1) could usefully be clarified.[105] One respondent to the Consultation[106] commented in relation to the proposed definition of 'potential competitor' that more guidance and further simplification would be appropriate with respect to the evidentiary burden placed upon the parties.

5.15 Drawing on the proposals made by the EC, we set out in Annex B some changes that BEIS might consider making.[107] The CMA recognises that there can be benefits in consistency between the EU and the UK block exemptions, particularly for businesses with activities in both the UK and the EU (for example, by reducing compliance costs), a point supported by responses to the CFI and the Consultation.[108] We therefore recommend BEIS consider making similar clarificatory changes and additions in any R&D BEO as set out in Annex B, given that, as highlighted above, a degree of consistency may benefit UK businesses. We also propose to consider what further we can do by way of guidance to ensure that stakeholders understand the definitions included in any R&D BEO. We have set out below an explanation of the new definitions that we recommend be added to any R&D BEO and we have also highlighted the key definitions that we recommend be modified.

Recommended new definitions to be added to any R&D BEO

5.16 The CMA recommends that the following new definitions be considered for inclusion in what is currently Article 1:

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accorded only to very obviously pro-competitive R&D efforts'. It considered that the current review process should focus on simplifying those texts, in particular by removing any disincentive against innovation and growth.

[105] See Section 4.1.2 of Annex 4 of the Staff Working Document, which notes that 'respondents requested the clarification of several notions addressed in the R&D BER and in Chapter 3 of the Horizontal Guidelines'. Two law firms (Baker McKenzie and Eversheds Sutherland) responding to the CMA's CFI indicated that it would be beneficial for the UK to adopt an approach to renewing or updating the R&D BER consistent with the EU's approach in renewing and updating the EU HBERs. One (Baker McKenzie) emphasised that this would provide legal certainty, efficiency and avoid complexity for businesses that want to engage in pan-European R&D agreements with competitors. However, it added that the UK could bring more clarity to the necessary assessments by building out the EU approach.

[106] Baker McKenzie.

[107] See also the EU draft revised R&D BER (EC's draft revised R&D BER can be found on the EC's consultation page).

[108] In addition to the comments noted in footnotes above, the Law Society of Scotland in its response to the Consultation submitted that legal certainty was best served by mirroring the reforms being made at the EU level into UK domestic law, subject to some changes that would bolster legal certainty for companies and other undertakings in the UK. It further submitted that legal certainty seemed to be the key consideration given the self-assessment nature of the EU HBERs and the EU Horizontal Guidelines and the paucity of decisional practice at both EU and UK law. In its meeting with the CMA, Dentons also noted that consistency with the EC's proposals was generally preferable for clients.

- ‘R&D pole’;
- ‘competing R&D effort’;
- ‘not competing undertaking’;
- ‘undertaking competing in innovation’;
- ‘new product or technology’.

5.17 The CMA recommends that the above terms be added as definitions in any R&D BEO on the basis of the evidence which suggested that there were concepts and terms used in the R&D BER that were not yet defined in Article 1 and could benefit from clarification.[109] We consider that such new definitions would add helpful clarity to the R&D BEO. In addition, we consider that some of the definitions we are proposing below are necessary as they are relevant to the separate test for undertakings competing in innovation. We have suggested below some possible approaches to drafting the definitions and what each is intended to achieve, acknowledging that the final legal drafting may need to differ in some aspects.

5.18 ‘**R&D pole**’ could be added as a new definition to address concerns raised by respondents on the lack of clarity as to the concept of an R&D pole.[110] One way to define ‘R&D pole’ would be to use the definition set out in Annex B.[111]

5.19 ‘**Competing R&D effort**’ could be added in the event that the CMA’s recommendation to adopt a ‘separate test’ for undertakings competing in innovation (see paragraphs 5.64 to 5.77 below)[112] is pursued. ‘Competing R&D effort’ is a key term in the recommended separate test. We consider that it would be beneficial to include a definition of ‘competing R&D effort’, to explain how the new test would apply.

5.20 A definition for ‘competing R&D effort’ should explain that it is in essence an R&D effort engaged in by a third party relating to the same or likely

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[109] See Section 4.1.2 of Annex 4 of the Staff Working Document, which notes that ‘respondents requested the clarification of several notions addressed in the EU R&D BER and in Chapter 3 of the EU Horizontal Guidelines, including the boundaries between joint R&D, paid-for R&D and agreements falling outside R&D, and the notions of ‘joint exploitation’, ‘field of use’ restrictions, ‘compensation’, ‘competition in innovation’, ‘R&D poles’ or ‘decisiveness’. Furthermore, the concept of ‘not competing undertaking’ seems to also raise issues.’

[110] The term ‘R&D pole’ is used in the EU Horizontal Guidelines currently. See also Section 4.1.2 of Annex 4 of the Staff Working Document, which notes that:
‘respondents requested the clarification of several notions addressed in the R&D BER and in Chapter 3 of the Horizontal Guidelines, including […] the notions of […] ‘R&D poles’’; and
‘A few NCAs, on the other hand, agreed with the respondents to the public consultation that there are certain areas where guidance is lacking, namely clarification of certain definitions (eg R&D poles).’.

[111] This definition is used in the EU draft revised R&D BER.

[112] The proposed ‘separate test’ asks whether ‘at the time the R&D agreement is entered into, there are three or more competing R&D efforts in addition to and comparable with those of the parties to the R&D agreement’.

substitutable new product and/or technology or R&D pole with substantially the same aim as the one to be covered by the R&D agreement. One way to define 'competing R&D effort' would be to use the definition set out in Annex B.[113]

5.21 '**Not competing undertaking**' could be added as a new definition to address concerns about lack of clarity raised by respondents in the Evaluation.[114] One way to define 'not competing undertaking' would be to use wording along the lines of the definition set out in Annex B.[115]

5.22 '**Undertaking competing in innovation**' could be added to address respondents' comments that the R&D BER does not make it sufficiently clear that early-stage R&D is covered by the block exemption.[116] It is also relevant to the operation of the recommended 'separate test' and we therefore consider that it is important to include a definition of this term.

5.23 An undertaking competing in innovation is intended to capture an undertaking that engages in or would be likely to engage in R&D efforts which concern the same or likely substitutable new products and/or technologies as the ones to be covered by the R&D agreement or which concern R&D poles with substantially the same aim as the ones to be covered by the R&D agreement. The definition should also capture that the undertaking should be able to carry out those efforts independently, that is they have, for example, the necessary technical capabilities, access to finance, skilled workers, technologies or other resources. One way to define 'undertaking competing in innovation' would be to use wording along the lines of the definition in Annex B.[117]

5.24 '**New product or technology**' could be added to address respondents' comments that the R&D BER does not make it sufficiently clear that early-stage R&D is covered by the block exemption. In addition, it is important to provide an explanation of what is meant by new product or technology as this appears in the definition of undertaking competing in innovation (and in other definitions).[118] One way to define 'new product or technology' would be to use the definition in Annex B.[119]

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[113] This definition is used in the EU draft revised R&D BER.
[114] See Section 4.1.2 of Annex 4 of the Staff Working Document, which notes that 'Furthermore, the concept of 'not competing undertaking' seems to also raise issues.'
[115] This definition is used in the EU draft revised R&D BER.
[116] Eversheds Sutherland. See also page 116 of the Staff Working Document, which note that 'the HBERs […] do not provide sufficient guidance on the early stages of R&D'.
[117] This definition is used in the EU draft revised R&D BER.
[118] Eversheds Sutherland. See also page 116 of the Staff Working Document, which note that 'the HBERs […] do not provide sufficient guidance on the early stages of R&D'.
[119] This definition is used in the EU draft revised R&D BER.

5.25 In addition, we recommend that the definitions of '**active sales**' and '**passive sales**' be added to the R&D BEO. We recommend using the same definitions as the ones included in the VABEO.

5.26 In our proposed recommendation, we recognised that these definitions may need to evolve to reflect market developments, especially to reflect the evolution of online markets. We therefore proposed to recommend defining those terms in the CMA HBEOs Guidance and cross-referring to the VABEO, on the basis that the VABEO had a shorter duration of six years and those terms would be reviewed at the end of that period. Our view was that this would ensure that any change to the definitions in the VABEO context would automatically apply in the R&D context.

5.27 Following further consideration, however, our view is that it is important that those terms be incorporated in the R&D BEO for reasons of legal certainty rather than relying on the CMA HBEOs Guidance to explain their meaning by reference to the VABEO. Furthermore, there are review mechanisms that would allow these definitions to be amended, if appropriate, in any R&D BEO (for example, following any changes made to the terms resulting from a review of the VABEO to reflect market developments). In particular, it is open to the CMA to make a recommendation to the Secretary of State under section 8(3) of the Act to vary a block exemption order if at any time the CMA considers that it is appropriate to do so. In addition, as set out below at paragraphs 6.1 to 6.6, any R&D BEO would be subject to a periodic review (every five years) by BEIS.[120] Such a review would provide the opportunity to make recommendations to BEIS to change the definitions of active and passive sales if considered appropriate. Whichever mechanism is chosen, the Secretary of State would then be able to decide to amend any R&D BEO via secondary legislation.

5.28 In the light of this, our recommendation is that the definitions of 'active sales' and 'passive sales' used in the VABEO should be included in any R&D BEO.[121] The CMA considers that this approach would provide greater legal certainty in the R&D BEO than would be the case if the definitions were only included in the CMA HBEOs Guidance as proposed in the Consultation.

[120] Section 28 of the Small Business, Enterprise and Employment Act 2015.
[121] For the definitions of 'active sales' and 'passive sales', please refer to Article 8(7) of the VABEO.

Recommended modifications to existing defined terms in the current Article 1

5.29 The CMA recommends that modifications be made to the following existing definitions currently in Article 1.

- **'**research and development agreement';
- 'research and development';
- 'potential competitor';
- 'intellectual property rights'.

5.30 The responses received and the evidence we have gathered and reviewed indicate that the effectiveness of the R&D BER could be improved by providing greater clarity on these definitions. While, as noted above, the final drafting will be for BEIS to determine, we suggest clarifications along the following lines:

- '**Research and development agreement'**[122] could be amended to clarify the kind of agreements which are covered by the R&D BER, specifically that joint exploitation agreements which are separate from the original R&D agreement only qualify for exemption if they are exploiting the results of a prior R&D agreement (between the same parties) which met the conditions for exemption.[123]
- '**Research and development**' could be amended to address responses to the CFI regarding the desirability of inclusion of more speculative, earlier stage R&D where it may be far from clear whether the parties' cooperation will generate any tangible results.[124] More specifically, we recommend that the definition of 'research and development' could be amended to clarify that acquiring know-how relates to both 'new' as well as 'existing' products, technologies and processes is in scope. We also recommend including 'activities aimed at acquiring know-how' instead of 'the acquisition of know-how' in the modified definition.[125]
- The definition of '**potential competitor**' could be modified to take out the reference to 'a small but permanent increase in relative prices'. The removal of 'a small but permanent increase in relative prices' from

[122] Eversheds Sutherland submitted that this term should be clarified.
[123] The EU has also made the same change in the EU draft revised R&D BER.
[124] Eversheds Sutherland.
[125] The EU has also made the same change in the EU draft revised R&D BER

the definition should simplify and in turn facilitate easier assessment by companies of what may constitute a potential competitor.[126] This change increases the clarity of the definition and goes some way to addressing the concerns raised by respondents about the definition of 'potential competitor'.[127] This recommended change would align, to a large extent,[128] the definition of potential competitor in the R&D BEO with the one used in the VABEO. This change reflects the change that we are also recommending in relation to the definition of 'potential competitor' in the Specialisation BEO (see paragraphs 4.33 to 4.37 above). One respondent to the Consultation submitted that, while the change proposed by the CMA would address some of the concerns regarding this issue, more guidance and further simplification would be appropriate with respect to the evidentiary burden placed upon the parties. In the absence of any specifications on what further simplifications would be appropriate, we cannot make any specific recommendation on this point but encourage BEIS to consider the scope for further simplification in drafting the R&D BEO. The CMA will also consider the scope for providing further clarity on the issue by way of guidance.[129]

- The definition of '**intellectual property rights**' could be amended to avoid defining 'intellectual property rights' by itself ('intellectual property rights') and clarify what intellectual property rights includes, namely: industrial property rights (such as patents and trade marks), copyrights and 'neighbouring rights'.[130]

5.31 As noted above in paragraph 5.11, while the CMA is making drafting suggestions (as set out above) in respect of the modifications to certain definitions that it is recommending, we acknowledge that any R&D BEO may

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[126] We are proposing the same change to the definition of 'potential competitor' under the Specialisation BER and the EC has also made the same change in the EU draft revised R&D BER. As noted in paragraph 4.36 above, the recommended changes align, to a large extent, the definition of potential competitor in the EU HBERs with the one used in the VABEO.
[127] Baker McKenzie indicated that this issue is even more prominent when it comes to competition in innovation (R&D efforts), where even identifying actual competitors is far from easy. Their response cited the recent challenges/methodological issues in recent merger control cases in defining existing markets in light of future innovation. It highlighted that the implications of a mischaracterisation of actual or potential competition are significant, particularly if it unnecessarily prevents potential competitors from freely discussing their programmes to see whether a joint R&D effort makes sense, and in circumstances where it is unclear which technology data referred to at paragraph 86 of the EU Horizontal Guidelines could be considered strategic enough to create issues/require safeguards for information exchange. Nokia also identified 'potential competitor' under Article 1 of the R&D BER was not always straightforward in complex markets and which would benefit from further guidance.
[128] The definition of potential competitor in the EU HBERs and the VABEO have differing timeframes due to differing levels of investment.
[129] Baker McKenzie.
[130] The EU has also made the same change in the EU draft revised R&D BER.

need to differ in some respects and that it will be down to BEIS to draft this final text.

Conditions for block exemption under Article 3

Current regime

5.32 Article 3 of the R&D BER sets out the conditions that must be satisfied for the exemption for R&D agreements to apply.

5.33 These include:

- A requirement that the R&D agreement must stipulate that all the parties have full access to the final results of the joint research and development or paid-for research and development, including any resulting intellectual property rights and know-how, for the purposes of further research and development and exploitation, as soon as they become available (the **'**full access to results requirement') (Article 3(2)). In Article 3(2) there is a carve-out from the full access to results requirement, which provides that where either party limits its rights of exploitation in accordance with the R&D BER, in particular where they specialise in the context of exploitation, access to the results for the purposes of exploitation may be limited accordingly. Article 3(2) notes that research institutes, academic bodies, or undertakings which supply research and development as a commercial service without normally being active in the exploitation of results may agree to confine their use of the results for the purposes of further research.

- A provision that, without prejudice to the full access to results requirement, where the R&D agreement provides only for joint research and development or paid-for research and development, the R&D agreement must stipulate that each party must be granted access to any pre-existing know-how of the other parties, if this know-how is indispensable for the purposes of its exploitation of the results (the 'access to pre-existing know-how requirement'). The research and development agreement may foresee that the parties compensate each other for giving access to their pre-existing know-how, but the compensation must not be so high as to effectively impede such access. (Article 3(3)).

Recommendation

5.34 The CMA recommends that the conditions be clarified:

- by the Secretary of State retaining the substantive conditions currently included in Article 3 of the R&D BER in an R&D BEO, but considering making clarifying changes in order to make the conditions as clear as possible, including by restructuring the provisions of what is currently Article 3, for example, into three separate articles; and

- by the CMA considering what further guidance can be provided to help stakeholders understand and apply the conditions, including full access to results and pre-existing know-how, currently set out in Article 3.

5.35 We explain each of these recommendations in more depth below, summarising the stakeholder feedback on which our recommendations are based. In summary, the evidence we have reviewed and gathered indicates that the effectiveness of the R&D BER could be improved by providing greater clarity about the application of certain conditions (particularly, those relating to access to results and pre-existing know-how). We have not, however, received sufficient evidence of the benefits to competition of removing, or substantially broadening, these conditions.

Clarification of the application of the requirements for access to results and pre-existing know-how

5.36 Responses to the CFI indicated that UK stakeholders could benefit from greater clarity on the application of the requirements in Article 3 for full access to results and pre-existing know-how. For example, responses to our CFI included suggestions that:

- More clarity is needed on what the 'full access to results' requirement means in practice, in particular, it was unclear what would be considered sufficient to comply with the 'full access to results' requirement (for example, whether the condition requires parties to transfer/license any IP rights to each other, or whether other, more informal arrangements suffice).[131]

- More clarity is needed on how 'full access to results' requirement can be limited by exclusive licensing to one party.[132]

[131] Eversheds Sutherland

[132] Dentons.

- More clarity on when know-how might be 'indispensable' for the purposes of exploitation of R&D results and on what the access requirement for pre-existing know-how would comprise.[133]

5.37 Evidence gathered in the Evaluation also indicated that stakeholders found several aspects of the conditions in Article 3 to be unclear and that there could be a risk that these conditions would not allow the correct identification of R&D agreements compliant with Article 101 TFEU.[134]

5.38 One stakeholder[135] thought clarification would be helpful, including having examples in the CMA HBEOs Guidance, of what full access means in practice, what conditions are required for the transfer of intellectual property rights and the meaning of 'indispensability' in relation to pre-existing know-how. On sub-licensing rights, which the stakeholder considered were implied by the term 'full access', it was submitted that the CMA HBEOs Guidance should provide clarification and guidance, as current ambiguities created complications for commercial agreements.

Need for access to results and pre-existing know-how

5.39 A number of stakeholders raised concerns on the conditions requiring full access to results and access to pre-existing know-how, with some stakeholders recommending that these conditions be removed from the R&D BER.[136] Issues raised included:

- By requiring one party to give the other party full access to results or access to pre-existing know-how on penalty of losing the benefit of the exemption, the R&D BER potentially has a chilling effect on R&D projects that provide for less-than-full access, but which are nonetheless pro-competitive; this is particularly problematic as it might be uncertain which

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[133] Eversheds Sutherland.
[134] See Section 4.1.2 of Annex 4 to the Staff Working Document. The EC notes that several aspects were considered unclear, namely the requirement of 'full access' rights, the access to 'pre-existing know-how' and the notion and calculation of 'compensation' among the parties to the agreement.
[135] Eversheds Sutherland (meeting with the CMA).
[136] Bristows; Ericsson; American Bar Association Antitrust Law and International Law Sections. The last of these respondents considered that removing these conditions in the R&D BER would also benefit SMEs, research institutes and academic institutes and that no specific rules for these entities were warranted.
The CMA notes that the EU has not removed the requirement of full access to the final results of the R&D or for access to pre-existing know how. Article 3 of the EU draft revised R&D BER continues to require that R&D agreements 'stipulate that all the parties have full access to the final results of joint or paid-for research and development for the purpose of exploitation' and Article 4 of the EU draft revised R&D BER continues to require that R&D agreements 'stipulate that each party must be granted access to any pre-existing know-how of the other parties if this know-how is indispensable for the purposes of its exploitation of the results'. The provisions of Article 3 have now been split into three separate sub-articles, seemingly for greater clarity.

'results' the project may generate in the future and how those results might be 'exploited'.[137]

- Parties' incentives will generally be aligned to exploit the results of their collaboration and bring about the associated efficiencies; these incentives should be relied on rather than reserving the BER's benefit to those R&D projects that involve full access.[138] Another stakeholder suggested that a case-by-case approach, depending on the type of arrangement between the parties, was preferable.[139]

- Agreements that assign the exploitation of the R&D results to one party are simpler from a legal, commercialisation and management perspective and may be more efficient and attractive to parties.[140]

- Where one party is funding the entire R&D effort, a requirement to give other parties access to the results is, in effect, a requirement to allow free-riding.[141] In high innovation sectors, pre-existing intellectual property (including know-how) is many undertakings' most valuable asset, and these requirements were often used by large organisations against smaller counterparties to extract rights that may not be required.[142]

- The pro-competitiveness of joint R&D does not depend on future R&D efforts based on the results of this cooperation.[143]

- Respondents to the Evaluation suggested that strict access requirements could give rise to commercially unreasonable requirements,[144] and were often not reasonable in vertical R&D scenarios.[145] Under the current rules, an intellectual property licence under future intellectual property rights

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[137] Ericsson.
[138] Ericsson.
[139] Dentons.
[140] Fraunhofer.
[141] Bristows. This respondent also submitted that there is also no clear legal basis for these requirements, which, the respondent submitted, effectively require some parties to an exempted agreement to subsidise competitive entry by the other parties. The respondent referred to a decision by the EC that even a dominant undertaking is under no obligation to subsidise competition to itself (*BBI/Boosey & Hawkes* OJ L 286, 1987, page 36, paragraph 19).
[142] Bristows. Another respondent (Dentons) noted that requirement for access to pre-existing know-how is difficult to assess objectively, as the commercial arrangements may reflect the negotiating strength of the parties rather than indispensability of pre-existing know how to future exploitation.
[143] These respondents to the Evaluation (ERT and the In-House Competition Lawyers' Association) suggested future competition in innovation should be safeguarded by the R&D BER's prohibition of any limitation on R&D activities in the same or a connected field after the completion of R&D. (Article 5(a) R&D BER).
[144] ICC submission to the Evaluation.
[145] CMS submission to the Evaluation; see also the Commeo and Allen & Overy submissions to the Evaluation for details of the practical limitations associated with these requirements.

with a field of use designation might, it was alleged, erroneously not qualify as 'full access'.[146]

- There is a lack of clarity on the circumstances in which the R&D BER will cover specialisation following on from R&D.[147]

- In any event a respondent submitted that the 25% market share threshold contained in Article 4 R&D BER provided a sufficient safeguard against the loss of substantial pre-existing competitive rivalry, rendering the conditions of full access in Article 3 of the R&D BER superfluous.[148]

5.40 However, other stakeholders argued that the conditions requiring full access to results and access to pre-existing know-how played an important role. For example, a technology company noted that these conditions are important to allow the parties to exploit the results of the R&D. If these access rights were limited, this would possibly lead to making the cooperation agreements less attractive for large companies because this could negatively impact the exploitation potential of the results of any cooperation. That technology company preferred that full access rights to R&D results continue to be required if needed for the exploitation of the results as provided under the R&D agreement.[149] Similarly, one law firm stated that it was 'not in principle' opposed to the full access condition and noted that requiring parties to R&D agreements to share intellectual property rights and know-how between them helped minimise any anti-competitive effects that R&D agreements could entail and ensured a fair balance of power between parties.[150]

5.41 In other cases, stakeholders sought greater clarity. For example, stakeholders noted that the notion of 'compensation' in exchange for access is not clear and may be difficult to calculate.[151]

5.42 A respondent also submitted, as noted above in paragraph 5.36, that the exception to full access rights could be clearer, in particular, how it can be limited by exclusive licensing to one party.[152] Other stakeholders submitted that the exception in the R&D BER concerning research institutes and academic bodies appeared to be based on an (allegedly incorrect) assumption that they are not normally active in exploiting the results, which

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[146] Ericsson. On the pro-competitive benefits of field of use designations, the respondent pointed to the following example: U.S. Dept. of Justice Business Review Letter re the Avanci patent licensing platform at pages19-20.
[147] For example, see the Commeo and Allen & Overy submissions to the EC in the context of the Evaluation.
[148] Bristows.
[149] Nokia, noting that it is standard practice for the know-how contributed to the cooperation to be listed in an annex to the cooperation agreement, so a party could always choose to not list any know-how.
[150] Eversheds Sutherland.
[151] See Section 4.1.2 of Annex 4 to the Staff Working Document.
[152] Dentons.

could mean they were unable to benefit from the BER.[153] The CMA has considered these submissions carefully and notes that while in some cases submissions were made to remove the requirements for full access to results and access to pre-existing know-how (or to reduce their scope), in other cases the requirements were welcomed. The CMA notes that the purpose of these requirements is to support and encourage research and development and its exploitation for the benefit of consumers by ensuring that the results of the R&D can be fully exploited by each of the parties to the R&D agreement. Given this purpose and the mixed nature of the feedback, the CMA is not persuaded that there is a case to remove the requirements for full access or to make significant substantive changes to those requirements. However, a key theme that emerges across the evidence is that stakeholders could benefit from a better understanding of how to apply the conditions. It therefore seems appropriate for BEIS to make clarificatory changes to the requirements in the R&D BEO. In addition, some of the issues raised above could be addressed through further explanation in guidance.

5.43 Below we address certain of the specific comments in relation to the requirements.

5.44 Firstly, in relation to the requirement to give access to the results of R&D, the CMA considers that the principle remains that there should be full access under any R&D BEO, as we consider that the benefit of the block exemption should only be available for agreements that will ensure meaningful competition between the parties to the agreement after the R&D efforts have concluded. However, as recognised in paragraph 140 of the EU Horizontal Guidelines there may be circumstances where granting all parties full access to R&D results may not be commercially feasible, in which case granting exclusive access to one party or the other will not prevent the deal being lawful and pro-competitive. This will be the case where: 'exclusive access rights are economically indispensable in view of the market, risk and scale of the investment required'. This therefore complements the R&D BER by giving reassurance to businesses that there may be situations where full access to results is not appropriate. We propose considering whether it would be helpful for the guidance to identify those R&D agreements where the requirements of full access to results and access to pre-existing know-how are not necessary because there are unlikely to restrict competition and the R&D BER does not apply to them.

5.45 In relation to the access to pre-existing know-how, we note that there is no requirement for this access to be provided in all circumstances. The

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[153] See Section 4.1.2 of Annex 4 to the Staff Working Document.

requirement only applies where the know-how is 'indispensable' for the purposes of its exploitation of the results. As such, the purpose of the provisions is to support and encourage research and development and its exploitation by ensuring that the results of the R&D can be fully exploited by each of the parties to the R&D agreement where the results of the R&D alone are not sufficient to enter into production.

5.46 Some respondents raised the possibility of one party to an R&D agreement free-riding on the know-how of the other party. We note that the R&D BER does provide for potentially unequal contributions between parties and allows for compensation to be agreed between the parties to reflect this. We will consider whether there is merit in any further guidance on this and will keep this provision under review in the future.

5.47 One respondent noted that the exception concerning research institutes and academic bodies appears to be based on an (allegedly incorrect) assumption that they are not normally active in exploiting the results, which can mean they are unable to benefit from the BER. The CMA has not, however, seen evidence to suggest that such organisations should not continue to be treated in the same way as all other undertakings involved in exploitation. We also note the feedback which we received, including from universities (through UKRI)[154] did not propose any changes in this regard.

5.48 Finally, certain stakeholders argued that there should be more scope for limiting access (for example by allowing parties to impose field of use conditions on each other). We note, however, that the R&D BER already makes certain provision for field of use restrictions to be imposed in relation to specialisation in the context of exploitation. We have not seen sufficient evidence to warrant further limiting access. However, we will consider whether further guidance would be appropriate and will keep the requirements for access under review.

5.49 The CMA recommends clarifying the conditions currently contained in Article 3.[155] In particular, we recommend that the R&D BEO includes clarifying

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[154] UKRI reported its perception that the horizontal agreements as set out in the Consultation document were not typically entered into by universities. Although there were a large number of research collaboration agreements between universities and also contract R&D agreements between universities and businesses, neither of these types of agreement was perceived to be between actual or potential competitors, so it was difficult to see how such arrangements could be deemed to be anti-competitive. UKRI also noted that the vast majority of university spin-out companies were small and would hold only a very small market share (in the case of those that had matured sufficiently to be selling products and services), so these issues might be of limited relevance to them.
[155] In this context, we note that the EU has, in its parallel review of the EU R&D BER, proposed changes to the R&D BER itself to retain but clarify the articulation of, the 'full access' requirements and the other conditions included in Article 3, having received similar feedback to that which we received in our CFI. However, these changes are primarily to restructure and simplify the articulation of the requirements that are currently contained

changes to ensure that the 'full access' requirements and other requirements in Article 3, are articulated clearly. Specifically, we recommend that BEIS considers how best the drafting of any R&D BEO could provide clarification. This would be achieved, for example, by splitting the provisions of Article 3 into three separate articles (one dealing with access to the final results; another with access to pre-existing know-how; and a third with joint exploitation) and reworded, where appropriate, for greater clarity. The changes will address the fact that the current wording of Article 3(2) is dense and difficult to follow.

5.50 Assuming these changes were to be made, we would also complement them with practical guidance that would be provided in the course of our review of the EU Horizontal Guidelines. This guidance would be intended to help businesses better understand the application of the proposed recommended R&D BEO and the concepts and definitions used in the BEO. In addition to practical guidance to complement any changes made, we will also consider whether practical guidance can be provided on provisions which would be unchanged, but which would nevertheless benefit from further guidance being given.

Market share threshold, duration of exemption under Article 4 and proposal for a separate test for undertakings competing in innovation

Current regime

5.51 Under Article 4 of the R&D BER, where parties are actual or potential competitors, their combined market share must not exceed 25% to benefit from the exemption set out in Article 2.[156]

5.52 Where the parties are not competing undertakings, the exemption applies for the duration of the research and development irrespective of their market shares. In addition, if the R&D is aimed at developing a product which will create a completely new demand, the R&D BER treats those agreements as agreements between non-competitors and exempts them irrespective of market share for the duration of the joint R&D, although the benefit of the

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in Article 3 rather than to include additional conditions. The EU has proposed to complement this with additional guidance in the EU draft revised Horizontal Guidelines on how to apply the conditions in practice. In light of the feedback we received from CFI respondents that it could raise compliance costs for businesses if any UK BEO were to diverge from its EU equivalent, we can see benefits in following a similar approach.

[156] Where the agreement is for 'paid-for R&D', the market share thresholds apply to the combined market share of the financing parties and all parties with which the financing party has entered into R&D agreements in relation to the relevant products or technologies.

block exemption may be withdrawn if the agreement eliminates effective competition in innovation.[157]

5.53 Where results are jointly exploited, the exemption applies for seven years from the point at which the contract products or contract technologies are first put on the market within the UK.[158] After this period of time, the 25% market share threshold applies and the R&D BER provides for grace periods (see further details on grace periods in paragraphs 5.81 to 5.89 below).

Recommendations

5.54 In relation to the current market share threshold and the current provisions for not competing undertakings (currently Article 4), the CMA recommends that:

- The current market share threshold should not be raised (or abolished) for undertakings competing or in potential competition for existing products or services;
- The current provisions for not competing undertakings should be retained except for agreements between undertakings competing in innovation (ie not in relation to existing products or services); and
- A separate test for R&D agreements between undertakings competing in innovation should be introduced.

Raising or abolishing the current market share threshold

5.55 CFI responses on these provisions were mixed. A number of respondents engaged with our CFI question on the market share threshold and duration of exemption provisions in Article 4 of the R&D BER.[159] One respondent stated that the current market share threshold remained appropriate.[160] However, a significant majority of these respondents argued that the market share threshold should, at the very least, be raised.[161] For example, one respondent argued that the 25% threshold is not sufficient to indicate market power since

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[157] Paragraph 26 of the EU Horizontal Guidelines. See also Recital 18 of the R&D BER, which states that 'Agreements between undertakings which are not competing manufacturers of products, technologies or processes capable of being improved, substituted or replaced by the results of the research and development will only eliminate effective competition in research and development in exceptional circumstances. It is therefore appropriate to enable such agreements to benefit from the exemption established by this Regulation irrespective of market share and to address any exceptional cases by way of withdrawal of its benefit.'.
[158] Recital 14 of the R&D BER explains that the exemption should continue to apply, irrespective of the parties' market shares, for this period after the commencement of joint exploitation, so as to await stabilisation of their market shares, particularly after the introduction of an entirely new product, and to guarantee a minimum period of return on the investments involved.
[159] Baker McKenzie, Eversheds Sutherland, Nokia, Dentons.
[160] Dentons.
[161] Baker McKenzie, Eversheds Sutherland, Nokia.

market shares at that level are unlikely to raise significant antitrust concerns and that the 25% cap should be increased or abolished.[162] One respondent argued that the market share threshold should be raised or preferably removed entirely, and that this would 'materially contribute to the UK government's Innovation Strategy'.[163]

5.56 Additional issues with the current market share threshold were raised by respondents and included the following:

a) Applying the threshold was difficult (especially when market share needs to be calculated on the basis of total licensing income) as usually no real data is available to advisors.[164]

b) Information on market shares or volumes necessary can be unavailable in certain industries, complicating the application of the threshold in practice.[165]

c) R&D agreements often relate to markets 'that do not exist or whose boundaries are not well defined', making it difficult to rely on market shares to determine whether the exemption applies.[166]

d) There is no need for market share tests given the 'overwhelmingly positive effects of joint R&D'.[167]

e) In relation to SMEs, a specific 'SME exemption' for R&D ventures was requested by one respondent to the CFI, in order to provide legal certainty.[168] This echoed feedback gathered in the Evaluation, which surveyed SMEs.[169] The CFI respondent suggested that the SME exemption could be based on market shares, revenues or agreement duration. One respondent[170] to the Consultation proposed that SMEs

[162] Baker McKenzie. This respondent also noted that it would be beneficial for the UK to adopt an approach that was consistent with the EU approach as this will provide legal certainty and efficiency for business and that if the UK adopted a different approach, this would create complexity for businesses that want to engage in pan-European R&D agreements with competitors.
[163] Baker McKenzie.
[164] Baker McKenzie.
[165] Nokia.
[166] Nokia.
[167] Baker McKenzie.
[168] The App Association. In addition to arguing for a specific exemption for R&D agreements involving SMEs, the App Association provided some brief comments indicating that if the UK should discard the R&D BER, small businesses like the ones it represented, would be increasingly discouraged from entering into R&D agreements.
[169] EU Evaluation Support Study Final Report.
[170] Baker McKenzie.

be exempted under the R&D BER irrespective of whether they fall above or below the market share threshold.[171]

5.57 Evidence from the Evaluation raised similar concerns to the ones highlighted by responses to our CFI.[172]

5.58 One stakeholder submitted that it would be appropriate to raise the market share threshold as it seemed too low.[173] The respondent noted that while the market share thresholds should in practice provide a clear safe harbour that parties could rely upon, it was hard to settle on accurate market share figures when it came to R&D agreements, which made the BER difficult to use in practice given this low threshold.[174] However, the respondent did not propose any specific level for the increased market share threshold or provide specific evidence on this point.

5.59 As noted above, the concerns raised about the current market shares thresholds are that they are too low (or should be abolished). The main advantage of abolishing the market share threshold is that this would provide certainty and avoid issues around the practicability of defining markets and calculating market shares.

5.60 The main disadvantage of raising or abolishing the market share is that it would remove an important safeguard against the risks of granting the benefit of a safe harbour to agreements likely to have anti-competitive effects. This is particularly the case for agreements between competitors or potential competitors. Raising the market share threshold or removing it would risk undermining the effectiveness of this safeguard.[175]

5.61 Although stakeholders challenged the current market share threshold in the R&D BER, the evidence that the CMA has reviewed and gathered is not sufficient for the CMA to conclude that a higher market share threshold (or no market share threshold at all) would be appropriate, particularly given its

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[171] This was on the basis that, it submitted, the collaboration of small market players in R&D generally does not have a negative effect on competition.
[172] See Section 5.1.2 of the Staff Working Document. Respondents included business and legal associations, companies and several law firms. Respondents also mentioned similar difficulties to those raised in the CFI about defining markets and identifying competitors (with SMEs noting that this was particularly difficult given the administrative burden and their lack of technical skills).
[173] Eversheds Sutherland.
[174] Eversheds Sutherland (meeting with the CMA).
[175] We note that the EU is retaining the 25% market share threshold. A market share threshold is needed because R&D agreements are only likely to give rise to restrictive effects on competition where the parties to the R&D cooperation have market power. While the EU has not identified an absolute threshold above which it can be presumed that an R&D agreement creates or maintains market power and thus is likely to give rise to restrictive effects on competition within the meaning of Article 101(1), it has set this market share threshold at 25% for the purposes of the EU R&D BER and draft revised R&D BER.

importance as a safeguard against exempting potentially anti-competitive agreements.

SMEs

5.62 In relation to SMEs, there is currently limited UK evidence to warrant an SME market share exemption. Although we understand from stakeholders' feedback that identifying markets and calculating market shares may present difficulties for smaller and medium-sized businesses who may not be well resourced to undertake a market definition exercise or have significant access to market data, we note that this requirement applies to existing markets where more market information is likely to be available, and that removing SMEs from the market share test would remove an important safeguard and allow a relatively small player with significant market power to benefit from the block exemption even though this could harm competition in the relevant market. Further, the CMA notes that many SMEs will continue to be able to exempt themselves through the standard rules, that is the *de minimis* market share rules for competing undertakings, rather than through an SME-specific exemption.[176]

5.63 In view of the factors above, the CMA does not think that a specific SME-based exemption from the market share threshold for undertakings competing for an existing product and/or technology is justified and, accordingly, the CMA is not recommending such a specific SME-based exemption.[177]

Introduction of a separate test for R&D agreements between undertakings competing in innovation to foster dynamic competition.

5.64 Dynamic competition describes a situation where firms that are making efforts or investments (for example through R&D) that may eventually lead to their entry or expansion are motivated by the opportunity to win new sales and profits. Dynamic competition is important because it drives innovation by increasing the likelihood of new products being made available. Under the influence of dynamic competition, firms that may not compete today seek to innovate (including through R&D) to develop new products or services that will compete with existing products and services. The threat of this 'future'

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[176] For agreements between competing undertakings, the *de minimis* market share threshold is 10% for their collective market share on each affected relevant market. See Notice on agreements of minor importance.
[177] The CMA notes that the EU has reached the same conclusion in its proposals for an EU draft revised R&D BER.
An EC expert report on R&D cooperation agreements concluded by SMEs – Exempted under the EU R&D Block Exemption Regulation? by Björn Lundqvist had suggested that the EU consider a separate test, or an abolition of the market share threshold, in relation to SMEs, but this suggestion was not taken up by the EC. The EU does not propose to introduce any separate SME test or to abolish the market share test for SMEs.

competition also motivates incumbents in markets to improve their current products to try to mitigate the risk of losing future profits to potential entrants, which has a benefit for consumers in the shorter term. Ultimately therefore dynamic competition is a key driver for the wider evolution of competition in many markets,[178] and creates future benefits for consumers through better products and keener prices.

5.65 Dynamic competition therefore needs to be protected to ensure that consumers can reap the benefits associated with innovation and this is why we think it is important to introduce a test which helps to avoid the R&D block exemption dampening dynamic competition.

5.66 Such a test should ensure that the block exemption is not available to R&D agreements that bring together the only players who could independently conduct the R&D effort that is the subject matter of the agreement.

5.67 A test based solely on market shares is not appropriate in the case of competitors in innovation since the whole purpose of the R&D subject to the agreement is likely to give rise to a new market. In addition, stakeholders in response to our CFI have raised concerns about the practicability of defining markets and calculating market shares in order to assess whether the R&D BER might apply. Based on the feedback received, these issues are likely to be most pressing where R&D may be giving rise to entirely new markets, and/or may present particular difficulties for SMEs who may not be resourced well enough to undertake a market definition exercise or have significant access to market data.

5.68 On that basis, we explored in our proposed recommendation the following two solutions:

- introducing a separate test for R&D agreements that would apply where the R&D effort is focused on innovation (ie an R&D effort that may create new products or technologies – including R&D poles, and new markets), rather than R&D in relation to existing products or technologies. This is the approach followed by the US DOJ and the FTC and proposed by the EC (see below); [179] and/or

[178] This is particularly the case in markets where the process of entering takes place over a long time and involves significant costs or risks, or where key aspects of competition are set during the investment phase, for example. Examples of industries may include digital platforms or pharmaceutical markets, both of which involves years of investment without any guarantee of future success.
[179] We note that in the EU draft revised R&D BER, 'competing R&D effort' is defined in article 1(1)(19) as 'an R&D effort in which a third party engages, alone or in cooperation with other third parties, or in which a third party is able and likely to independently engage and which concerns: (a) the R&D of the same or likely substitutable

- in relation to SMEs specifically, exempting them from the proposed new separate test for undertakings competing in innovation or introducing a separate test.[180]

5.69 The new separate test we consulted on would apply to undertakings competing in innovation (see proposed definition in paragraph 5.22 above) and would mean that such undertakings would no longer be treated as non-competing undertakings. Currently, by being treated as non-competing undertakings, competing undertakings in innovation can benefit from the block exemption without being subject to a market share requirement or equivalent measure of market power in relation to their R&D activities or any other market. However, R&D agreements between undertakings competing in innovation can result in a potential loss of dynamic competition at the pre-market stage (ie before a market exists for the product that is the subject of the R&D). In our view, the current provisions are overly permissive in allowing such agreements to be block exempted automatically without any conditions, and in practice, they are likely to undermine competition in developing innovative new products.

5.70 The new separate test would require undertakings competing in innovation to demonstrate that, at the time the R&D agreement is entered into, there are at least three competing and comparable R&D efforts, in addition to theirs, to be able to benefit from the block exemption for the duration of the R&D. A test like this should, in principle, be able to ensure that parties face sufficient competition when entering into an R&D agreement benefiting from the R&D block exemption, and that dynamic competition is not significantly dampened. In the event the parties cannot meet the new test, it would still be open to them to self-assess their agreement to assess whether it meets the conditions for exemption under section 9(1) of the Act.

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new products and/or technologies as the ones to be covered by the R&D agreement; or (b) R&D poles pursuing substantially the same aim or objective as the ones to be covered by the R&D agreement. These third parties must be independent from the parties to the R&D agreement.' The CMA also notes that the US DOJ and FTC have introduced a similar 'safety zone' for R&D agreements in innovative markets in paragraph 4.3 of their 'Antitrust Guidelines for Collaborations Among Competitors' (April 2000) (the FTC and DoJ Guidelines).

[180] 'R&D cooperation agreements concluded by SMEs – Exempted under the EU R&D Block Exemption Regulation?' by Björn Lundqvist. C. This expert report considers, among other things, whether SMEs should be granted special status under the R&D BER to promote SMEs' involvement in horizontal R&D cooperation agreements and discusses options to identify pro-competitive horizontal R&D agreements concluded by SMEs to trigger the applicability of the exemption under the R&D BER.
One of the tests the report identifies is one whereby SMEs would have to show that they are not amongst the largest firms on the relevant market. This test suggests using a number of factors such as access to financial support, access to intellectual property, skilled personnel, or other specialised assets to show that the SME is not part of the largest firms on the market.

5.71 Respondents to the Consultation raised a number of concerns about how in practice the test could be met. In particular, respondents[181] noted that parties would:

- find it hard or impossible to identify and count third-party R&D efforts, as these would usually be covered by confidentiality; and
- struggle to assess whether any given R&D effort is 'comparable' (and at what stage of the R&D effort comparability should even be assessed), as the end result of an R&D effort may not always be clear from the start.

5.72 Another respondent expressed the view that – if adopted – the new separate test could discourage innovation, as the first two or three innovative projects in a particular field would not receive the benefit of the R&D block exemption.[182]

5.73 In response specifically to the concern about the new test discouraging the first few movers in new product and/or technology, the CMA notes that this test is only intended to apply to agreements where two or more of the parties to the R&D agreement are undertakings competing in innovation – by undertakings competing in innovation we mean those which independently engage in or, in the absence of the R&D agreement, would be able and likely to independently engage in necessary R&D efforts.[183] Thus, where there is an agreement between two parties who could not independently engage in the R&D, the agreement would not be subject to the three competing R&D efforts test. Such an agreement would not normally restrict competition, so the parties would not even need to determine whether their agreement can be exempted under the block exemption or via self-assessment under section 9(1) of the Act.

5.74 The CMA recognises the concerns expressed about the practicability of the test. Nonetheless, the CMA considers that there are ways of identifying third-party R&D efforts. For example, the CMA notes that start-ups may need to publish business plans to secure financing. Some sectors may have elements of transparency, for example, pharmaceutical firms may provide visibility on

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[181] Bristows and Eversheds Sutherland.
[182] Dentons.
[183] For these purposes a party may not be able to carry out the R&D independently, for instance, where it has limited technical capabilities or limited access to finance, skilled workers, technologies or other resources. This is consistent with the EU draft revised Horizontal Guidelines (see paragraph 74). As noted in that paragraph if, on the basis of objective factors, the parties would not be able to carry out the necessary R&D independently, the R&D agreement will normally not have restrictive effects on competition.

their work at trial stage; and in the digital sphere there may be discussion on emerging industry trends. Further, it is assumed that parties proposing to enter into an R&D agreement are already conducting research (or should be able to do so) and are therefore likely be aware of the research landscape of industry they operate in and hold an understanding of which competitors would be able to pursue certain types of project. The CMA further notes that the proposed definition of 'competing R&D effort' includes not only the identification of R&D efforts in which a third party engages but also those R&D efforts in which a third party is able and likely to independently engage. This would therefore capture a wider set of R&D efforts than those currently being engaged in by third parties.

5.75 In response to concerns expressed about 'comparability', the CMA notes that any R&D BEO could include the following parameters to assess the comparability of competing R&D efforts: the size, stage and timing of the R&D efforts, third parties' access to financial and human resources, their intellectual property, know-how or other specialised assets, their previous R&D efforts and the third parties' capability and likelihood to exploit directly or indirectly possible results of their R&D efforts.

5.76 On that basis, our recommendation remains that a separate test for R&D agreements between undertakings competing in innovation be introduced in any R&D BEO, to protect dynamic competition and innovation. We recommend a test that would require undertakings competing in innovation to demonstrate that, at the time the R&D agreement is entered into, there are at least three competing and comparable R&D efforts, in addition to theirs, to be able to benefit from the block exemption for the duration of the research and development. We also recommend that any R&D BEO includes the parameters listed in paragraph 5.75 to support parties' assessment of comparable R&D efforts. The CMA will also seek to provide clarity in the CMA HBEOs Guidance to make the test as easy to use as possible (as expressed in particular in paragraphs 5.70 and 5.71 above).

5.77 We also recommend that the R&D BEO should retain the market share threshold in relation to R&D agreements between undertakings competing (or in potential competition) in relation to existing products and technologies. In addition, we recommend that the R&D BEO should retain the provisions relating to 'not competing undertakings', subject to undertakings competing in innovation being instead subject to the proposed separate test.

SMEs

5.78 In relation to SMEs, there is currently limited UK evidence to warrant an SME exemption from the proposed separate test for undertakings competing in innovation.[184]

5.79 Although we have not received any evidence that it would be more difficult for SMEs to use the new test, with a view to streamlining the approach for SMEs, we nevertheless explored whether they should be carved out from the new test. However, our view is that removing SMEs from the proposed separate test could remove an important safeguard and allow a relatively small player with significant market power to benefit from the block exemption even though this could harm competition in the relevant market. We also note that many SMEs will continue to be able to exempt themselves through the *de minimis* market share rules. This would involve SMEs exempting themselves through the standard rules, rather than through an SME-specific exemption.

5.80 In view of this and the factors above, the CMA is not recommending an SME exemption from the proposed separate test.

Application of the market share threshold under Article 7

Current regime

5.81 Article 7 sets out rules for the purposes of applying the market share threshold in Article 4. This includes a requirement that market shares should be calculated on the basis of the preceding calendar year.

5.82 In addition, Article 7 provides for grace periods that apply after the seven years of joint exploitation, which is when the 25% market share threshold starts to apply. If the parties' combined market share is initially below 25% but rises above that level, Article 7 of the R&D BER provides that parties can still receive the benefit of the block exemption for a grace period of a two years after they exceed the 25% threshold (if the parties' combined market share remains below 30%). If the parties' combined market share is initially not more than 25% but subsequently rises above 30%, the parties can still receive the benefit of the block exemption for a grace period of a year after their market share rises above 30%, starting from the point at which the parties' combined market share first exceeded 30%.

[184] Such an exemption would mean that agreements between those undertakings would be treated as agreements between not competing undertakings and accordingly the proposed separate test would not be applicable.

Recommendations

5.83 In relation to the application of the market share threshold (currently Article 7), the CMA recommends that:

- a single grace period of two years for joint exploitation after the 25% market share threshold has been exceeded be introduced; and
- when the preceding calendar year is not representative of the parties' position on the relevant market(s), the market share should be calculated as an average of the parties' market shares of the three preceding calendar years.

5.84 Stakeholders raised issues with the current regime being difficult to apply and are keen for it to be simplified. In addition, some stakeholders raised concerns that the market share thresholds in the R&D BER are difficult to apply and should seek to avoid assessments being made on the basis of unrepresentative data.

5.85 The CMA's proposal to allow more flexible methods for the calculation of market shares and the simplification of the grace period following the seven-year exemption were welcomed by one of the respondents to the Consultation.[185] One respondent however requested that the terms of Article 7 be made clearer to allow businesses to undertake market share analysis in order to determine whether they are covered by the R&D BER.[186]

5.86 In relation to the grace periods specifically, we consulted on a possible solution that simplifies the conditions for an agreement to continue to benefit from the block exemption when parties' combined market share moves from below 25% to exceed that threshold after the end of the seven years period. The proposal we consulted on is to remove the requirement for the parties' market shares to remain below 30%[187] in order to continue to benefit from the block exemption for 2 years after they first exceed 25%.[188]

5.87 As explained in our Consultation, the main advantage of this proposed solution is that it would further simplify the application of market thresholds to

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[185] Baker McKenzie.
[186] Eversheds Sutherland.
[187] As noted above in paragraph 5.82, Article 7 of the R&D BER allows that parties can still receive the benefit of the block exemption for a further two years after they exceed 25% (if the parties' combined market share remains below 30%) or for a further year after their market share rises above 30%, starting from the point at which the parties' combined market share first exceeded 30%.
[188] This is the approach the EU is proposing to adopt in the EU draft revised R&D BER. As noted in paragraph 5.57 above, respondents to the Evaluation mentioned similar difficulties to those raised in the CFI about defining markets and identifying competitors (with SMEs noting that this was particularly difficult given the administrative burden and their lack of technical skills).

the extent they still apply. The main disadvantage is that it might allow parties with significant market power (which quickly increases from below the 25% threshold) to benefit from the block exemption for up to two years without any additional safeguard beyond this time limit. However, the CMA would expect that it would typically be unlikely for market shares to rise so quickly that there could be significant harm to competition within this period.

5.88 In the absence of any objection from stakeholders in relation to this proposal, we are making a recommendation to the Secretary of State to adopt this approach in any R&D BEO.

5.89 We also did not receive any comments on our proposal to recommend an alternative to the current provision whereby market shares should be calculated on the basis of the preceding calendar year. The alternative we consulted on provides that, when the preceding calendar year is not representative of the parties' position in the relevant market(s), the market share should be calculated as an average of the parties' market shares of the three preceding calendar years (the R&D BER only foresees the preceding calendar year as calculation basis). In the absence of objections having been raised in relation to this proposal, our view is that the alternative we consulted on should be adopted in any R&D BEO.[189]

'Hardcore' restrictions listed in Article 5 and Excluded Restrictions in Article 6

Current regime

5.90 R&D agreements containing certain 'hardcore' restrictions will not benefit from the 'safe harbour' outlined in Article 2 of the R&D BER. These restrictions, as set out in Article 5 of the R&D BER, are:

- Restricting parties from carrying out R&D independently or with third parties in an unrelated field (or, after the completion of the R&D in question, in the same or a related field) (Article 5(a)).

[189] Respondents to the CFI did not propose the specific solution the EU has proposed (nor any other particular alternative approach or language). However, the CMA considers that the change which it is recommending would assist in addressing the concerns which were expressed by respondents to the CFI that market shares are difficult to calculate, particularly in R&D intended to create new markets or where little data is available.

- Limiting output or sales (subject to various exceptions set out in the Article)[190] (Article 5(b)).

- Fixing prices when selling the contract product or licensing the contract technologies to third parties (subject to certain exceptions for the fixing of prices or licence fees to immediate customers or licensees in certain circumstances)[191] (Article 5(c)).

- Restricting the territory in which, or of the customers to whom, the parties may passively sell the contract products or license the contract technologies (with the exception of the requirement to exclusively licence the results to another party) (Article 5(d)).

- Imposing a requirement not to make any, or to limit, active sales of the contract products or contract technologies in territories or to customers which have not been exclusively allocated to one of the parties by way of specialisation in the context of exploitation (Article 5(e)).

- Imposing a requirement to refuse to meet demand from customers in the parties' respective territories, or from customers otherwise allocated between the parties by way of specialisation in the context of exploitation, who would market the contract products in other territories within the UK. (Article 5(f))

- Imposing a requirement to make it difficult for users or resellers to obtain the contract products from other resellers within the U K. (Article 5(g))

5.91 The R&D BER also sets out several 'excluded restrictions' to which the benefit of the exemption will not apply, although the rest of the agreement can still benefit from the BER's safe harbour. The excluded restriction must be individually assessed to establish whether it benefits from the individual exemption under section 9(1) of the Act. These restrictions, as set out in Article 6, are:

a) Obligations that prohibit challenges to the validity of IP rights which the parties hold which have effect in the UK and which are relevant to

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[190] Not including certain exceptions set out in Article 5(b)(i) to (iv) which allow that, in certain specified circumstances, the setting of production or sales targets, specialisation in the context of exploitation, and certain restrictions relating to competing products or technologies during a period of joint exploitation will not be 'hardcore' restrictions.

[191] Subject to the exceptions in Article 5(c), which allow that the fixing of prices when selling or licensing to immediate customers or licensees where joint exploitation includes joint distribution of contract products or joint licensing of contract licensing will not be treated as 'hardcore' restrictions.

the R&D or, after the expiry of the R&D agreement, the validity of IP rights which the parties hold which have effect in the UK and which protect the results of the R&D. However, provisions which allow termination of the R&D agreement if such IP rights are challenged by one of the parties to the R&D agreement are not excluded, so could benefit from the block exemption (Article 6(a)).

b) Obligations not to grant licences to third parties to manufacture contract products or to apply contract technologies. If the agreement provides for the exploitation of the results of the joint R&D or paid-for R&D by at least one of the parties and such exploitation takes place in the UK vis-à-vis third parties this is not excluded, so could benefit from the block exemption (Article 6(b)).

Recommendation

5.92 The CMA recommends that:

- The Secretary of State retain the hardcore and excluded restrictions currently included in Articles 5 and 6 of the R&D BER in a revised R&D BEO.[192]
- The CMA consider what further guidance it can provide to help stakeholders complying with Article 5 and 6.

List of hardcore restrictions

5.93 The Evaluation suggested that the majority of the respondents considered that the lists of hardcore and excluded restrictions in the R&D BER provided legal certainty.[193] As noted in relation to the Specialisation BER (paragraph 4.77 above), one CFI respondent noted that the logic of both the hardcore and excluded restrictions was sufficiently clear and that businesses were familiar with the issues at play.[194]

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[192] The EU is not proposing to make any changes to the hardcore and excluded restrictions in the EU R&D BER. Thus, in view of the feedback we received from stakeholders about the cost of compliance arising from divergence from the EU block exemption, the UK R&D BEO adopting a different approach might give rise to such costs.
[193] See Section 5.1.2 of the Staff Working Document. In particular: 'the majority of respondents to the public consultation that expressed a view considered that the other provisions of the R&D BER provided legal certainty, namely the list of hardcore restrictions (Article 5 of the R&D BER), the list of obligations included in horizontal R&D agreement to which the exemption does not apply ('excluded restrictions') (Article 6 of the R&D BER) and, to a lesser extent, the duration (7 years) of the exemption applicable to R&D agreements between not competing undertakings where the results were jointly exploited. Respondents considered that these provisions contributed to identifying horizontal R&D agreements compliant with Article 101 of the Treaty.'.
[194] Eversheds Sutherland.

5.94 It should be noted that one respondent to the CMA's CFI queried whether the retained HBERs as a whole (so including the R&D BER), required a list of hardcore restrictions at all.[195] That same respondent raised this question again in response to the Consultation, where they suggested that the list of hardcore restrictions should be eliminated or reduced in light of the pro-competitive nature of most R&D agreements. Hardcore restrictions include some of the most serious restrictions of competition and, in the CMA's view, should not benefit from an automatic safe harbour.

Territorial restrictions

5.95 One respondent to the CMA's CFI queried whether territorial restrictions should continue to be treated as 'hardcore' (Articles 5(d), (e), (f) and (g)), given the EU Single Market rationale for these.[196]

5.96 In that respect, the CMA refers to its discussion and conclusion on this in its recommendations to BEIS on the Vertical Agreements Block Exemption Order.[197] For the same reasons as set out in that recommendation, the CMA recommends that territorial restrictions continue to be treated as 'hardcore' and considers that it will be appropriate to keep this under review in order to take into account any market developments, if and when they arise.

Further clarity on certain areas of Article 5 and 6

5.97 It was suggested that Articles 5 and 6 on hardcore and excluded restrictions could usefully benefit from further clarity, and in particular that it would be helpful to provide further clarity on excluded restrictions in the form of practical examples.[198] One respondent also stated that there was currently no guidance or analysis available for assessing the Article 5 hardcore restrictions.[199] We will consider what further guidance we can provide.

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[195] Baker McKenzie.
[196] Dentons.
[197] CMA Recommendation to the Secretary of State (publishing.service.gov.uk) – see paragraphs 5.40 to 5.42.
[198] Eversheds Sutherland.
[199] Baker McKenzie.

6. Duration of UK HBEOs

6.1 Under section 6(7) of the Act, a block exemption order may provide that the order is to cease to have effect at the end of a specified period. The CMA recommends that the UK HBEOs should include such a provision.

6.2 Part of the benefit of the UK HBEOs expiring after a specified period is that it provides the opportunity for the CMA to conduct a further review of the regime for horizontal agreements, taking account of market developments since the last review. In our Consultation, we proposed a 12-year duration for the UK HBEOs.

6.3 In response to our Consultation, we received a suggestion from a stakeholder[200] that a review mechanism could be introduced in the Specialisation BER and R&D BER to allow the CMA to re-examine on a periodic basis the necessity in certain markets of increasing the market share safe harbour to meet the competition posed by large digital companies.

6.4 In our review of the retained Vertical Agreements Block Exemption Regulation, we concluded that a shorter period of six years was necessary given recent market developments, such as the growth in online sales, the UK's withdrawal from the EU and the impact of the Coronavirus (COVID-19) pandemic. We do not consider that these market developments would have a similar impact on the UK HBEOs and therefore do not recommend reducing the period to 6 years.

6.5 Furthermore, we still think that a longer duration makes sense in relation to the UK HBEOs because it gives legal certainty to businesses and, as just explained, we do not think that the market developments that justified a shorter duration for VABEO would have a similar impact on UK HBEOs. We note however that there is a requirement to carry out a review every 5 years.[201] We consider this offers adequate opportunity to consider whether there have been any significant market developments which justify earlier changes to the UK HBEOs. Although these reviews would be the responsibility of BEIS, the CMA would be happy to provide advice relating to such market developments where appropriate. Furthermore, under section 8(3) of the Act, it is open to the CMA to make a recommendation to the Secretary of State to vary or revoke a block exemption at any point.

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[200] Law Society of Scotland.
[201] Statutory review clauses impose a legislative duty to carry out and publish a post-implementation review of the measure within five years of it coming into force and then regularly on a five-year cycle, or more frequently if appropriate to the measure. See section 28 of the Small Business, Enterprise and Employment Act 2015.

6.6 While the CMA initially consulted on a proposed 12-year duration for the UK HBEOs, following further review we consider that it would be more proportionate to increase this duration so that the UK HBEOs would expire on 31 December 2035, given these opportunities for earlier consideration of any necessary changes.

7. Other provisions common to both UK HBEOs

Transitional period

7.1 The CMA recommends that the UK HBEOs have a transitional period of two years to allow businesses that wish to take advantage of the 'safe harbour' to review and (if necessary) revise their existing horizontal agreements.

7.2 During the transitional period, existing agreements that meet the conditions of the retained HBERs could continue to benefit from its terms for two years after its expiry, whereas agreements entered into after its expiry would need to meet the conditions of any new UK HBEOs to benefit from the block exemptions.

7.3 For R&D agreements between undertakings competing in innovation, the CMA recommends that the proposed separate test in the UK R&D BEO should only apply to agreements that enter into force after 31 December 2023.

Cancellation in individual cases

7.4 Section 6(6)(c) of the Act provides that a block exemption order may provide that if the CMA considers that a particular agreement is not an exempt agreement,[202] it may cancel the block exemption in respect of that agreement. The CMA proposes that UK HBEOs should contain such a provision.

7.5 The CMA proposes that any cancellation, ie withdrawal of the benefit of the UK HBEOs in an individual case, should be in writing, and that the CMA should first give notice in writing of its proposal and consider any representations made to it before making a decision to cancel the block exemption in respect of that agreement. The CMA proposes that any notice should state the facts on which the CMA bases its decision or proposal and its reasons for making it. The CMA envisages that these provisions would be similar to those in the VBEO.[203]

7.6 The CMA considers that this provision is likely only to be used in exceptional circumstances and that the proposal to provide notice in writing and to

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[202] Exempt agreement means an agreement which is exempt from the Chapter I prohibition as a result of section 9 of the Act (the Act, section 6(8)).

[203] Competition Act 1998 (Vertical Agreements Block Exemption) Order 2022, Article 13.

consider any representations would ensure that the provision was used appropriately.

Obligation to provide information

7.7 Section 6(5) of the Act provides that a block exemption order may impose obligations subject to which a block exemption is to have effect and section 6(6)(b) of the Act provides that a block exemption order may provide that if there is a failure to comply with an obligation imposed by the order, the CMA may, by notice in writing, cancel the block exemption in respect of the agreement. The CMA recommends that the UK HBEOs should impose an obligation for parties to provide the CMA with information in connection with those horizontal agreements to which they are a party if requested to do so and that failure to do so without reasonable excuse should result in cancellation, ie withdrawal, of the block exemption.

7.8 The CMA recommends that the obligation should be for businesses to supply the CMA with such information in connection with those horizontal agreements to which they are a party as the CMA may require within ten working days from the date on which the party receives notice in writing of the request or within such longer period of working days commencing with the relevant day as the CMA may, having regard to the particular circumstances of the case, agree with the person in writing.[204] The CMA also recommends that if it proposes to cancel the block exemption for failure to comply with an information request, it should first give notice in writing of its proposal and consider any representations made to it. The CMA envisages that these provisions would be similar to those in the VABEO.[205]

7.9 The CMA therefore recommends that the UK HBEOs provide for an obligation to provide information to ensure that the CMA is in a position to assess whether an agreement that benefits from the block exemption is one that satisfies the conditions for exemption under section 9 of the Act. This provision would also enable the CMA to investigate instances where

[204] The CMA will consider clarifying in any future CMA HBEOs Guidance that where appropriate, it will seek to give recipients of large information requests advance notice so that they can manage their resources accordingly. The CMA will also consider clarifying that, in certain circumstances and, where it is practical and appropriate to do so, it may send the information request in draft.
[205] See Competition Act 1998 (Vertical Agreements Block Exemption) Order 2022, Articles 12 and 14.

competition law concerns arise from parallel networks of similar horizontal restraints.[206]

[206] The process for providing representations where a response contains commercially sensitive information or details of an individual's private affairs and the sender considers that disclosure might significantly harm their interests or the interests of the individual, is explained in Chapter 7 of the Guidance on the CMA's investigation procedures in Competition Act 1998 cases: CMA8, which the CMA will also have regard to when exercising the power in Article 12(1) VABEO.

The retained Horizontal Block Exemption Regulations – R&D and specialisation agreements

Annexes to the CMA's recommendation

Annex A: Proposed Definitions in the Specialisation BEO

Annex B: Proposed Definitions in the R&D BEO

Annex A: Proposed Definitions in the Specialisation BEO

The CMA recommends that BEIS consider the following modifications when drafting any Specialisation BEO:[207]

	Description	Old Definition	Proposed Definition
1	**'Specialisation agreement'** could be clarified and expanded by including the definitions of 'joint production agreement', 'unilateral specialisation agreement' and 'reciprocal specialisation agreement'. For the proposed amendments of the definitions of 'unilateral specialisation agreement' and 'reciprocal specialisation agreement', see *infra,* rows 2 and 3.	'a unilateral specialisation agreement, a reciprocal specialisation agreement or a joint production agreement'	'a unilateral specialisation agreement, a reciprocal specialisation agreement or a joint production agreement; (1) 'unilateral specialisation agreement' means an agreement between two or more parties which are active on the same product market and by virtue of which a party or parties agree to fully or partly cease production of certain products or to refrain from producing those products and to purchase them from the other party or parties, who agree to produce and supply those products; (2) 'reciprocal specialisation agreement' means an agreement between two or more parties which are active on the same product market and by virtue of which two or more parties, on a reciprocal basis, agree to fully or partly cease or refrain from producing certain but different products and to

[207] The proposed changes draw on the changes proposed by the EU in the EU draft revised Specialisation BER – 'Annex to the Communication from the Commission: Approval of the content of a draft for a Commission Regulation on the application of Article 101(3) of the TFEU to certain categories of specialisation agreements' C(2022) 1160 final (1 March 2022).

	Description	Old Definition	Proposed Definition
			purchase these products from the other parties, who agree to produce and supply them; (3) 'joint production agreement' means an agreement by virtue of which two or more parties agree to produce certain products jointly'
2	**'unilateral specialisation agreement'** could be amended to include agreements concluded between more than two parties (described in paragraphs 4.11 to 4.16 of the recommendation). Furthermore, it could be made a subsection of the definition of 'specialisation agreement' (see *supra*, row 1).	'an agreement between two parties which are active on the same product market by virtue of which one party agrees to fully or partly cease production of certain products or to refrain from producing those products and to purchase them from the other party, who agrees to produce and supply those products'	'an agreement between two or more parties which are active on the same product market and by virtue of which a party or parties agree to fully or partly cease production of certain products or to refrain from producing those products and to purchase them from the other party or parties, who agree to produce and supply those products'
3	**'reciprocal specialisation agreement'** could be amended by inserting the connector 'and' between the clauses and changing the punctuation. Furthermore, it could be made a	'an agreement between two or more parties which are active on the same product market, by virtue of which two or more parties on a reciprocal basis agree to fully or partly cease or refrain from producing certain but different products and	'an agreement between two or more parties which are active on the same product market and by virtue of which two or more parties, on a reciprocal basis, agree to fully or partly cease or refrain from producing certain but different products and to purchase these products from the other parties, who

	Description	Old Definition	Proposed Definition
	subsection of the definition of 'specialisation agreement' (see *supra*, row 1).	to purchase these products from the other parties, who agree to produce and supply them'	agree to produce and supply them'
4	**'joint production agreement'** could be made a subsection of the definition of 'specialisation agreement' (see *supra,* row 1).	'an agreement by virtue of which two or more parties agree to produce certain products jointly'	'an agreement by virtue of which two or more parties agree to produce certain products jointly'
5	'**potential competitor**' could be amended to remove the reference to 'a small but permanent increase in relative prices' (described in paragraphs 4.33 to 4.37 of the recommendation). Furthermore, it could be made a subsection of the definition of 'competing undertaking' (the latter could continue to be defined as 'an actual or potential competitor').	'an undertaking that, in the absence of the specialisation agreement, would, on realistic grounds and not just as a mere theoretical possibility, in case of a small but permanent increase in relative prices be likely to undertake, within not more than 3 years, the necessary additional investments or other necessary switching costs to enter the relevant market'	'an undertaking that, in the absence of the specialisation agreement, would, on realistic grounds and not just as a mere theoretical possibility, be likely to undertake, within not more than 3 years, the necessary additional investments or other necessary costs to enter the relevant market'
6	**'actual competitor'** could be made a subsection of the definition of 'competing undertaking' (the latter could continue	'an undertaking that is active on the same relevant market'	'an undertaking that is active on the same relevant market'

	Description	Old Definition	Proposed Definition
	to be defined as 'an actual or potential competitor').		
7	**'relevant market'** could be amended by replacing 'use captively for the production of downstream products' with 'use captively as input for downstream products'.	'the relevant product and geographic market to which the specialisation products belong, and, in addition, where the specialisation products are intermediary products which one or more of the parties fully or partly use captively for the production of downstream products, the relevant product and geographic market to which the downstream products belong'	'the relevant product and geographic market to which the specialisation products belong, and, in addition, where the specialisation products are intermediary products which one or more of the parties fully or partly use captively as input for downstream products, the relevant product and geographic market to which the downstream products belong'
8	**'exclusive supply obligation'** could be amended by changing the order of the words contained therein and using the plural of 'specialisation product'.	'an obligation not to supply a competing undertaking other than a party to the agreement with the specialisation product'	'an obligation not to supply the specialisation products to a competing undertaking other than a party or parties to the agreement'
9	**'distribution'** could be amended by including a cross reference to the definition of 'specialisation products'.	'distribution, including the sale of goods and the provision of services'	'the provision of the specialisation products'
10	**'downstream product'** could be amended to change	'a product for which a specialisation product is used by one or more of the parties as an	'a product for which a specialisation product is used as an input by one or more of the parties and which is sold

	Description	Old Definition	Proposed Definition
	the order of the words.	input and which is sold by those parties on the market'	by those parties on the market'
11	**'production'** could be amended to simplify the language of the definition.	'the manufacture of goods or the preparation of services and includes production by way of sub-contracting'	'the manufacture of goods or the preparation of services, including by way of sub-contracting'

Annex B: Proposed Definitions in the R&D BEO

The CMA recommends that BEIS consider the following modifications to current definitions and new definitions when drafting any R&D BEO:[208]

	Description	Current Definition	Proposed Definition
1	'**contract product**' could be amended to clarify that it includes 'products obtained through an R&D pole as well as new products' and products arising out of joint and paid-for R&D, and also to substitute the term 'manufactured' with the term 'produced'.	'a product arising out of the joint research and development or manufactured or provided applying the contract technologies'	'a product arising out of the joint or paid-for research and development or produced or provided applying the contract technologies. This includes products obtained through an R&D pole as well as new products'
2	'**contract technology**' could be amended to clarify that it includes 'technologies or processes obtained through an R&D pole as well as new technologies or processes' and technology or processes arising out of joint and paid-for R&D.	'a technology or process arising out of the joint research and development'	'a technology or process arising out of the joint or paid-for research and development. This includes technologies or processes obtained through an R&D pole as well as new technologies or processes'
3	'**competing R&D effort**' could be added as a new definition (see paragraph 5.19 to	No current definition.	'an R&D effort in which a third party engages, alone or in cooperation with other third parties, or in which a third party is able and likely

[208] Annex C of the Consultation. The proposed changes draw on the changes proposed by the EU in the EU draft revised R&D BER - 'Annex to the Communication from the Commission: Approval of the content of a draft for a Commission Regulation on the application of Article 101(3) of the TFEU to certain categories of research and development agreements' C(2022) 1161 final (1 March 2022).

	Description	Current Definition	Proposed Definition
	5.20 of the recommendation) in the event that the CMA's recommendation to adopt a 'separate test' for undertakings competing in innovation is pursued (see paragraph 5.64 to 5.77 of the recommendation for the details of that proposal).		to independently engage, and which concerns: (a) the research and development of the same or likely substitutable new products and/or technologies as the ones to be covered by the R&D agreement; or (b) R&D poles pursuing substantially the same aim or objective as the ones to be covered by the R&D agreement; These third parties must be independent from the parties to the R&D agreement.'
4	'**competing undertaking**' could be deleted, as it is proposed to be replaced by 'undertaking competing for an existing product and/or technology' which is a slight re-formulation, and 'undertaking competing in innovation', which is a proposed new definition.	'competing undertaking' means an actual or potential competitor'	No proposed definition.
5	'**exploitation of the results**' could be amended to replace the term 'manufacture' with the term 'production'.	'the production or distribution of the contract products or the application of the contract technologies or the assignment or licensing of intellectual property rights or the communication of know-how required for such manufacture or application.	'the production or distribution of the contract products or the application of the contract technologies or the assignment or licensing of intellectual property rights or the communication of know-how required for such production or application.'

	Description	Current Definition	Proposed Definition
6	'**intellectual property rights**' could be amended to avoid defining 'intellectual property rights' by itself ('intellectual property rights') and clarify what intellectual property rights includes, namely: industrial property rights (such as patents and trade marks), copyrights and neighbouring rights.	'intellectual property rights, including industrial property rights, copyright and neighbouring rights.'	'industrial property rights, in particular patents and trade marks; as well as copyright and neighbouring rights.'
7	'**know-how**' could be amended by absorbing the reworded definitions of 'secret', 'substantial' and 'identified' as subsections, and by removing the term 'non-patented'. 'Substantial' could be absorbed into the definition of 'know-how' and amended to replace the term 'manufacture' with the term 'production'.	'a package of non-patented practical information, resulting from experience and testing, which is secret, substantial and identified.'	'a package of practical information, resulting from experience and testing, which is: (a) 'secret', that is to say, not generally known or easily accessible; (b) 'substantial', that is to say, significant and useful for the production of the contract products or the application of the contract technologies; and (c) 'identified', that is to say, described in a sufficiently comprehensive manner so as to make it possible to verify that it fulfils the criteria of secrecy and substantiality.'
8	'**new product or technology**' could	No current definition.	'a product, technology or process that does not yet

	Description	Current Definition	Proposed Definition
	be added as a new definition to address respondents' comments that the R&D BER does not make it sufficiently clear that early-stage R&D is covered by the block exemption (see paragraph 5.24 of the recommendation). In addition, it is important to provide an explanation of what is meant by new product or technology as this appears in the definition of undertaking competing in innovation (and in other definitions).		exist at the time when the R&D agreement [falling under 1(a) or 1(b) of the definition of R&D agreement] is entered into and that will, if emerging, create its own new market and not improve, substitute or replace an existing product, technology or process.'
9	'**not competing undertaking**' could be added as a new definition to address concerns on lack of clarity raised by respondents in the Evaluation (see paragraph 5.21 of the recommendation).	No current definition.	'not competing undertaking' means an undertaking that is neither an undertaking competing for an existing product and/or technology nor an undertaking competing in innovation.'
10	'**potential competitor**' could be modified to take out the reference to 'a small but	'an undertaking that, in the absence of the research and development agreement, would, on	'an undertaking that, in the absence of the R&D agreement, on realistic grounds and not just as a

	Description	Current Definition	Proposed Definition
	permanent increase in relative prices*'* (see paragraph 5.30 of the recommendation). Furthermore, it could be made a subsection of the definition of 'undertaking competing for an existing product and/or technology' (the latter could be defined as 'an actual or potential competitor').	realistic grounds and not just as a mere theoretical possibility, in case of a small but permanent increase in relative prices be likely to undertake, within not more than 3 years, the necessary additional investments or other necessary switching costs to supply a product, technology or process capable of being improved, substituted or replaced by the contract product or contract technology on the relevant geographic market.'	mere theoretical possibility, would be likely to undertake, within not more than 3 years, the necessary additional investments or incur the necessary costs to supply a product, technology or process capable of being improved, substituted or replaced by the contract product or contract technology on the relevant geographic market.'
11	'**actual competitor**' could be amended and made a subsection of the definition of 'undertaking competing for an existing product and/or technology' (the latter could continue to be defined as 'an actual or potential competitor').	'an undertaking that is supplying a product, technology or process capable of being improved, substituted or replaced by the contract product or the contract technology on the relevant geographic market'.	'an undertaking that is supplying an existing product, technology or process capable of being improved, substituted or replaced by the contract product or the contract technology on the relevant geographic market'.
12	'**research and development**' could be amended to include 'activities aimed at acquiring know-how' instead of 'the acquisition of know-how'. We also propose the amendment of this definition to clarify that acquiring know-	'the acquisition of know-how relating to products, technologies or processes and the carrying out of theoretical analysis, systematic study or experimentation, including experimental production, technical testing of products or processes, the	'activities aimed at acquiring know-how relating to existing or new products, technologies or processes, the carrying out of theoretical analysis, systematic study or experimentation, including experimental production, technical testing of products or processes, the establishment of the

	Description	Current Definition	Proposed Definition
	how related to both 'new' as well as 'existing' products, technologies and processes are in scope (see paragraph 5.30 of the recommendation).	establishment of the necessary facilities and the obtaining of intellectual property rights for the results.'	necessary facilities and the obtaining of intellectual property rights for the results.'
13	'**research and development agreement**' could be amended to explain that the kind of agreements which are covered by the R&D BER, specifically that joint exploitation agreements which are separate from the original R&D agreement only qualify for exemption if they are exploiting the results of a prior R&D agreement (between the same parties) which met the conditions for exemption (see paragraph 5.30 of the recommendation).	'an agreement entered into between two or more parties which relate to the conditions under which those parties pursue: (i), joint research and development of contract products or contract technologies and joint exploitation of the results of that research and development; (ii), joint exploitation of the results of research and development of contract products or contract technologies jointly carried out pursuant to a prior agreement between the same parties; (iii), joint research and development of contract products or contract technologies excluding joint exploitation of the results; (iv), paid-for research and development of contract products or	'1. an agreement entered into between two or more parties which relates to the conditions under which those parties pursue: (a) joint research and development of contract products or contract technologies which: (i) excludes joint exploitation of the results of that research and development, or (ii) includes joint exploitation of the results of that research and development; or (b) paid-for research and development of contract products or contract technologies which: (i) excludes joint exploitation of the results of that research and development, or (ii) includes joint exploitation of the results of that research and development; or (c) joint exploitation of the results of research and development of contract

	Description	Current Definition	Proposed Definition
		contract technologies and joint exploitation of the results of that research and development; (v), joint exploitation of the results of paid-for research and development of contract products or contract technologies pursuant to a prior agreement between the same parties; or (vi), paid-for research and development of contract products or contract technologies excluding joint exploitation of the results.'	products or contract technologies carried out pursuant to a prior agreement falling under paragraph (1)(a) between the same parties; or (d) joint exploitation of the results of research and development of contract products or contract technologies carried out pursuant to a prior agreement falling under paragraph (1)(b) between the same parties.'
14	'**R&D pole**' could be added as a new definition to address concerns raised by respondents, and shared by national competition authorities in the Evaluation, on the lack of clarity as to the definition of an R&D pole (see paragraph 5.18 of the recommendation).	No current definition.	'R&D efforts directed primarily towards a specific aim or objective. The specific aim or objective of an R&D pole cannot yet be defined as a product or technology or involves a substantially broader target than R&D products or technologies on a specific market.'
15	'**undertaking competing in innovation**' could be added to identify	No current definition.	'an undertaking that is not competing for an existing product and/or technology and that independently

	Description	Current Definition	Proposed Definition
	the undertakings which would be subject to the proposed separate test.		engages in or, in the absence of the R&D agreement, would be able and likely to independently engage in R&D efforts which concern: (a) the R&D of the same or likely substitutable new products and/or technologies as the ones to be covered by the R&D agreement; or (b) R&D poles pursuing substantially the same aim or objective as the ones to be covered by the R&D agreement.'
16	'**undertaking competing for an existing product and/or technology**' could be added as a new definition and would absorb, as subsections, the modified definitions of 'actual competitor' and 'potential competitor'. The proposed definition is substantially similar to the previous definition of 'competing undertaking'.	No current definition.	'an actual or a potential competitor: (a) 'actual competitor' means an undertaking that is supplying an existing product, technology or process capable of being improved, substituted or replaced by the contract product or the contract technology on the relevant geographic market; (b) 'potential competitor' means an undertaking that, in the absence of the R&D agreement, on realistic grounds and not just as a mere theoretical possibility, would be likely to undertake, within not more than 3 years, the necessary additional investments or incur the necessary costs to supply a product, technology or

	Description	Current Definition	Proposed Definition
			process capable of being improved, substituted or replaced by the contract product or contract technology on the relevant geographic market.’