Minimising the risk of breaching antitrust rules in Research and Development (R&D) collaboration

by Alec Burnside and Michael I Okkonen, Dechert LLP

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The European Commission formally charging car manufacturers in Germany with potential collusion raises the question of how companies can minimise the risk of breaching competition rules when collaborating on technical issues with competitors, such as when setting common safety or environmental standards for products.

This article discusses the issues and sets out some practical suggestions on how to minimise that risk.

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Introduction

On 5 April 2019, the European Commission (Commission) issued a Statement of Objections to several car manufacturers in Germany for possible collusion (see Commission Press Release, 5 April 2019, *https://ec.europa.eu/commission/presscorner/detail/en/IP_19_2008*). The Commission is of the preliminary view that the companies violated Article 101 of the Treaty on the Functioning of the European Union (TFEU) by agreeing to limit the development and roll-out of certain emissions control systems for petrol and diesel passenger cars sold in the European Economic Area (EEA).

The Statement of Objections is a strong signal to companies that the authority will look closely at technical collaborations to make sure that companies do not attempt to limit competition at any point during the co-operation. There is some comfort for companies that the Commission has limited the scope of its investigation by recognising the legitimacy of numerous areas of co-operation that had initially been under scrutiny. To reduce the risk of legitimate co-operation spilling over to improper areas under EU anti-trust rules, companies should, before engaging in technical collaboration, critically assess the need for co-operation and the benefits and detriments to competition, and seek to implement appropriate safeguards.

Background

The investigation represents only one out of more than a dozen Commission cartel probes into the automotive sector in the past decade which have already covered many different automotive components and systems, including:

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- Car glass (*COMP/39.125, Car Glass, 12 November 2008*).
- Automotive wire harnesses (*COMP/39748, Automotive Wire Harnesses, 10 July 2013*).
- Automotive bearings (*COMP/39922, Bearings, 19 March 2014*).
- Parking heaters (*COMP/40055, Parking Heaters, 17 June 2015*).

However, the current investigation differs from previous probes in several aspects.

First, it concerns collaboration at the research and development (R&D) or technology-setting phase, while the Commission's prior investigations have generally focused on product sales and pricing. EU cartel case-law is relatively undeveloped in relation to agreements which may prevent or restrict competition in relation to innovation.

Second, the Commission's allegations concern only those aspects of the co-operation that relate to clean emission technologies. Those aspects form only a relatively limited part of a wider and more extensive collaboration between the car manufacturers that has taken place over several decades. For example, the companies have engaged in standardisation agreements with the object of defining technical or quality requirements for new vehicles. Such agreements can be viewed as pro-competitive under EU anti-trust rules because they are likely to produce potential efficiencies with significant economic benefits. For example, manufacturers have pooled their technical expertise and development efforts to improve testing procedures for car safety.

According to media reports (see, Spiegel Online, 27 July 2017, *http://www.spiegel.de/international/germany/the-cartel-collusion-between-germany-s-biggest-carmakers-a-1159471.html*), the car manufacturers had regular, secret, technical meetings from the 1990s until 2017 to co-ordinate new technology, exchange competitively sensitive technical data and adopt common solutions. Employees were reportedly assigned to technical working groups and sub-working groups classified by reference to automotive components and systems. Over 60 working groups met several times per year. For example, over 1,000 meetings reportedly took place in the last five years.

According to the Commission, during these meetings the companies collaborated on numerous technical topics that the Commission has in the event excluded from its investigation, recognising them to be legitimate technical co-operation aimed at improving product quality. Such topics included:

- Common quality requirements for car parts.
- Common quality testing procedures.
- Exchanges concerning the manufacturers' own car models that were already on the market.

This also extended to safety matters, such as the maximum speed at which the roofs of convertible cars can open or close, or at which the cruise control would operate, as well as topics relating to crash tests and crash test dummies.

The Commission's concern is that a limited part of the extensive, legitimate co-operation among the car manufacturers spilled over into improper areas. In particular, the Commission's preliminary view is that the companies colluded to reduce the development and roll-out of systems to clean the emissions of petrol and diesel passenger cars sold in the EEA, such as:

- Selective catalytic reduction systems that reduce harmful nitrogen oxides emissions from diesel passenger cars through the injection of urea (also called "AdBlue") in the exhaust gas stream. The Commission alleges that the car manufacturers co-ordinated their AdBlue dosing strategies and AdBlue tank size and refill

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ranges between 2006 and 2014 with the common understanding that they limited AdBlue-consumption and exhaust gas cleaning effectiveness.

- "Otto" particulate filters (OPFs) that reduce harmful particle emissions from the exhaust gases of petrol passenger cars. The Commission alleges that the car companies co-ordinated to avoid, or at least to delay, the introduction of OPF in their new (direct injection) petrol passenger car models between 2009 and 2014, and to remove uncertainty about their future market conduct.

The Commission's investigation is distinct from the so-called "Dieselgate" scandal in which Volkswagen installed "defeat" devices in vehicles to recognise when the vehicle was being tested for emissions and reduce emissions for the duration of the tests, allowing the vehicles to pass. In late 2015, the US Environmental Protection Agency (EPA) uncovered the devices and issued a notice of violation of the US Clean Air Act to Volkswagen, alleging that it had circumvented the EPA emissions standards. Currently the Commission has no indications that the companies co-ordinated with each other in the use of illegal defeat devices to circumvent regulatory testing.

This investigation appears to be part of the Commission's continuing focus on the automotive industry as a strategy to boost EU competitiveness. It comes immediately after Commission fines were imposed in 2018 on spark plug and braking systems producers, as well as on maritime car carriers (see Commission Press Release, 21 February 2018, *http://europa.eu/rapid/press-release_IP-18-962_en.htm*).

Commission's focus on innovation competition

The investigation into possible collusion in relation to R&D and technology comes at the time when the Commission has shown an increased interest in pursuing cases relating to innovation competition.

The Commission has signalled that it will pay much closer attention than previously to the impact of transactions subject to merger control on innovation. In the landmark *Dow/DuPont* case, (*COMP/M.7923, Dow/DuPont, 27 March 2017*), the Commission analysed the likely effects of a merger between two large suppliers of crop protection chemicals on future innovation in pesticides. It has been routine practice for many years (notably in pharmaceutical cases) for the Commission to look at future competition between pipeline products not yet on the market, but the approach in the Dow/DuPont merger looks at the much earlier stage of basic R&D efforts from which future products might be created. Based on several factors, including that the market was characterised by five global integrated R&D players and that Dow and DuPont were each other's important and close innovation competitors, the Commission found that Dow/DuPont's merger would result in a structural reduction of incentives and the ability to achieve the same level of innovation as the parties would achieve separately in the absence of a merger. The Commission concluded that there would be a significant loss of subsequent innovation in the industry and approved the merger only on condition of, among other things, the divestment of DuPont's global R&D organisation.

The Commission also assessed the impact on innovation competition in the more recent *Bayer/Monsanto* case (*COMP/M.8084, 21 March 2018*), which saw a large chemical and pharmaceutical company, Bayer, acquire an agricultural giant, Monsanto. The Commission expressed concerns about, among other things, the transaction stifling competition in innovation in genetically modified and non-genetically-modified broadacre traits that confer herbicide tolerance or insect resistance, and herbicides and herbicide systems (herbicides combined with a trait conferring herbicide tolerance on a crop). To address these concerns, Bayer committed to divest its R&D organisation relating to global broadacre seeds and traits and three important lines of research for non-selective herbicides.

Anti-cartel enforcement

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The Commission has also tackled restrictions on innovation competition through its anti-cartel enforcement. A few years ago, the Commission fined several truck manufacturers EUR3.6 billion for colluding on, among other things, environmental improvements (see Commission Statement, 27 September 2017, *http://europa.eu/rapid/press-release_STATEMENT-17-3509_en.htm*). One of the findings was that manufacturers of medium and heavy trucks had delayed the introduction of environmentally friendly technology. MAN and five other truck manufacturers met regularly between 1997 and 2011 to discuss matters such as how to respond to increasingly strict EU emissions standards (from Euro III through to Euro VI) that were progressively reducing the acceptable limits for exhaust emissions from trucks. Instead of competing on which manufacturer could most quickly bring a better emission technology to the market, the truck manufacturers agreed to co-ordinate on when to introduce the new technology, and to pass the costs of the environmentally friendly technologies on to the customer.

Legal framework

In its current investigation, the Commission alleges that the companies violated Article 101 of the TFEU, which prohibits agreements that have as their object or effect the prevention, restriction or distortion of competition on price, output, product quality, product variety or innovation. The Commission will have to prove that the companies engaged in an anti-competitive agreement. Conversely, the companies will have to convince the Commission that their collaboration on clean emission technology was legitimate and not a restriction on competition.

At one end of the spectrum, cartel agreements between competitors are viewed as "hardcore" restrictions on competition, and are the primary target of competition authorities. These are the most obviously harmful anti-competitive agreements and there is a widespread consensus that they should be prohibited. They include agreements for:

- Fixing prices.
- Production or selling quotas.
- Sharing markets or customers.

A large number of the Commission's previous decisions in the automotive sector relate to classic cartels involving rivals choosing to co-operate rather than compete on prices. For example, Denso, Valeo, Behr, Sanden, Panasonic and Calsonic were found to have, among other things, co-ordinated prices and allocated customers for the supply of climate control components and engine cooling components to certain car manufacturers in the EEA (see Commission Press Release, 8 March 2017, *http://europa.eu/rapid/press-release_IP-17-501_en.htm*).

In more limited cases, the Commission has also sanctioned automotive companies for colluding on technology. The truck manufacturers who were found by the Commission to have co-ordinated the introduction of emissions technologies also agreed to pass on the cost of those technologies to customers. Despite the novelty of the issues raised by these findings, the EU Commission pursued the matter as a "by object" infringement. Restrictions on competition "by object" have the potential to restrict competition due to their innately serious nature, thereby doing away with any need for further assessment of whether the collusion resulted in any negative effect on the market or on innovation.

The current allegations appear to be more akin to the Commission's truck manufacturer investigations than classic cartels. If the Commission concludes that the companies co-ordinated to limit the development and roll-out of clean emissions technologies, the Commission is likely to view the collusion as a "by object" infringement, as with the infringement in the truck cartel.

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At the other end of the spectrum there are permissible areas of co-operation between rivals. One example of such co-operation are standardisation agreements, which the Commission recognises as generally pro-competitive and unlikely to violate the EU anti-trust rules, provided they meet certain criteria.

Standardisation agreements are defined as agreements that have as their primary objective the definition of technical or quality requirements with which current or future products, production processes, services or methods can comply, including standards relating to environmental performance. Standardisation agreements cover various issues, such as:

- Standardisation of different grades or sizes of a particular product.
- Technical specifications in product or services markets where compatibility and inter-operability with other products or systems are essential.

The potential efficiencies include significant positive economic effects increasing value for consumers, such as:

- The promotion of economic inter-penetration in the EU internal market.
- Encouraging the development of new and improved products or markets, and improved supply conditions.
- The maintenance and enhancement of quality.
- The provision of information and the guarantee of inter-operability and compatibility.

The EU rules recognise that in the absence of market power, standardisation agreements are not capable of producing restrictive effects on competition and therefore comply with the EU anti-trust rules. Even standard-setting agreements that risk creating market power are normally in line with the EU anti-trust rules if they meet the following criteria:

- Participation in the standard-setting is unrestricted.
- Standards are adopted on a basis of a transparent procedure.
- There is no obligation to comply with the standard.
- Access to the standard (that is, to the necessary intellectual property) is granted on fair, reasonable and non-discriminatory terms.

There is no presumption that the agreements are illegal if these conditions are not met. However, their anti-competitive and pro-competitive effects must be assessed on a case-by-case basis, and balanced against each other.

In the context of the Commission's current work, the German car companies seem to have successfully shown that numerous parts of their collaboration constituted legitimate co-operation that was in line with the EU anti-trust rules, such as standardisation agreements in respect of common quality requirements for car parts and common quality testing procedures. These have been explicitly excluded from the scope of the ongoing investigation. In relation to the emissions control systems that are the basis of the newly announced investigation, the companies would need to show that they worked together to improve clean emission technologies similarly to how they pooled technical expertise and development efforts in the area of crash tests and crash test dummies to improve testing procedures for car safety. They will also need to demonstrate that their collaboration did not restrain competition in relation to emission systems.

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Preliminary comment on the car company side argues that the Commission is wrongly criticising legitimate industry co-ordination. More specifically, it has been put forward that the car companies discussed the introduction of smaller AdBlue tanks as a function of ambitions to rely on planned filling infrastructure; but the companies decided not to compromise emission control efficiency once it became clear that the filling infrastructure would not be available. With respect to the OPF systems, it is argued that the car manufacturers' co-operation was by way of contribution to ongoing regulatory discussions on the definition of future, technically achievable limits. These are prima facie good arguments, but the Commission may have identified other factors leading it to bring charges on these points while other areas initially under examination have not been pursued by the Commission.

Good practice for technical collaboration

The fact that some areas initially triggering suspicion were not taken further, while other apparently comparable areas remain under investigation, highlights the need for caution in such industry contacts. Based on the Commission's recent investigation into the German car industry, there are several key takeaways for companies engaging in technical co-operation with rivals:

- Activities conducted with competitors in secret are more likely to be viewed with suspicion. If the activities represent bona fide collaborations, why not acknowledge their existence in public? A good example of such public co-operation in the automotive industry are joint purchasing agreements.
- Companies should critically assess the need for co-operation and the balance of benefits and detriments to competition. Is the area of intended co-operation one where they should better commit their resources unilaterally in bringing better products to the market?
- Even in areas of legitimate co-operation, good control of language and document creation is vital, whether in formal documents or in simple emails. It is important to record appropriately that co-operation efforts are underway, and to avoid language that might invite the suspicion of wrongdoing. More specifically:
    - anything written in the context of the technical collaboration should focus on the positive effects of the interaction with rivals from a competitive point of view, such as reducing costs, increasing efficiencies and facilitating the development of new or improved products;
    - comments should not suggest anti-competitive effects of the interactions, such as increasing the ability to raise prices, limiting the ability of customers to negotiate discounts, weakening or eliminating competitors, or increasing market share;
    - any competition-related data or analyses generated at the request of counsel (for example, for purposes of an anti-trust analysis) should be labelled as such, used only for that purpose, and not given to any person outside the company other than legal counsel, to preserve attorney-client privilege.
- Standard-setting is usually viewed as pro-competitive and is in line with the EU anti-trust rules in the absence of market power. However, companies should be careful not to enter into standard-setting agreements that are part of a broader restrictive agreement aimed at excluding actual or potential competitors. Such agreements are per se illegal.
- If a co-operation tends by its nature towards creating a de facto industry standard, companies should have regard to the proper rules and processes, including that:
    - participation in the standard-setting is unrestricted. All competitors in the market(s) affected by the standard must be able to participate in the process leading to the selection of the standard. There must

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be objective and non-discriminatory procedures for allocating voting rights, as well as, if relevant, objective criteria for selecting the technology on which a standard is based;

- the procedure for adopting the standard is transparent. There must be procedures that allow stakeholders to inform themselves effectively of upcoming, ongoing and finalised standardisation work in good time at each stage of the development of the standard;
- there is no obligation to comply with the standard;
- the standardisation agreement provides access to the results on fair, reasonable and non-discriminatory terms.

- Even where these conditions are not met, the standard-setting agreement is not automatically deemed to violate Article 101 of the TFEU but must be assessed on a case-by-case basis taking into account the parties' market shares and, among other things, whether:
  - the participants to the standard-setting remain free to develop alternative standards or products that do not comply with the agreed standard;
  - the result of a standard is accessible or accessible on non-discriminatory terms for the participants or third parties;
  - the participation in the standard-setting process (that is, choosing and elaborating the standard) is open to all competitors (and/or stakeholders) in the market affected by the standard.

Contributor profiles

Alec Burnside, Partner

Dechert LLP
T +32 2 535 54 33
F +32 2 535 5400
E alec.burnside@dechert.com
W www.dechert.com

Professional and academic qualifications. England and Wales, Solicitor, 1986; Brussels, Avocat, 2018; BA Law, University of Cambridge, 1982; Solicitors' Final Examination, College of Law, 1983; licence spéciale en droit européen, Institut d'Etudes Européennes, Brussels, 1984

Areas of practice. Anti-trust/competition; cartel investigations; merger clearance; abuse of dominance; state aid; private enforcement/class actions; data/privacy.

Recent transactions

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- Aer Lingus on its defence of Ryanair's takeover bids, and investigations into Ryanair's minority shareholding; merger with IAG; State aid proceedings regarding Ireland's air passenger tax.
- Deutsche Post DHL as a third party in the prohibited UPS/TNT merger and the FedEx/TNT merger.
- Crown regarding the European Commission's investigations into metal packaging.
- Getty Images and Yelp in relation to the European Commission's Google investigations.
- A Japanese capacitor manufacturer in the Commission's electrolytic capacitor cartel investigation.
- Monsanto in relation to Bayer merger.
- SK hynix regarding its role in Bain Capital's acquisition of Toshiba Memory.

Languages. English, French, German

Professional associations/memberships. Associate, Chartered Institute of Linguists; International Bar Association (IBA); American Bar Association (ABA).

Publications.

- *Bob Dylan and Consumer Welfare, Oxford University, CCLP*
- *When the Chips are Down: EU Seeks to Impose Interim Measures in Broadcom, Competition Law Insight*
- *Wet Lease Agreements and Competition Law, Kluwer Law International*
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- *EU Merger Control Chapter, Chambers & Partners Practice Guide*

Michael I Okkonen, Associate

Dechert LLP
T +32 2 535 5416
F +32 2 535 5400
E michael.okkonen@dechert.com
W www.dechert.com

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Professional and academic qualifications. New York, US, Attorney and Counsellor at Law, 2014; England and Wales, Solicitor, 2015; Brussels, Avocat, 2019; LLB, University of Warwick, 2008; Legal Practice Course, College of Law, 2009; LLM, College of Europe, 2012; Postgraduate Diploma in Legal Practice, Economics in Competition Law, King's College London, 2017

Areas of practice. Anti-trust/competition; abuse of dominance; cartel investigations; merger clearance; state aid.

Recent transactions

- Crown in its acquisition of Signode from The Carlyle Group; and the EU cartel investigations into metal packaging.
- FMC on the sale of its Health and Nutrition business to DowDuPont in exchange for portions of DuPont’s global crop protection business, which were divested as a condition of DuPont's merger with Dow.
- Huhtamaki in its appeal before the General Court of an EU cartel decision in the packaging sector.
- An international spark plug manufacturer in abuse of dominance litigation before the French courts.
- SK hynix Inc. on its role in Bain’s acquisition of Toshiba Memory Corp.

Languages. English, French, Russian, Finnish

Professional associations/memberships. American Bar Association (ABA).

Publications.

- *Recent EU Fines for Resale Price Maintenance Are Symptoms of Broader Challenges Faced by Today's Consumer-Goods Manufacturers, ECLR*
- *Crossed Wires: Private Equity Firms not Immune to Antitrust Risk, IFLR*
- *Pharmaceutical Antitrust: United Kingdom Chapter, GTDT*

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