

The Commission's new Specialisation Block Exemption Regulation and Horizontal Guidelines – Key aspects for production agreements

On 1 June 2023, the European Commission ("Commission") adopted the final version of its new horizontals package, comprising revised Block Exemption Regulations on Research and Development Agreements and Specialisation Agreements and revised Guidelines on horizontal cooperation agreements ("Horizontal Guidelines"). The new Block Exemption Regulations and Horizontal Guidelines have replaced the existing equivalent instruments dating from 2010/11, and became effective as of 1 July 2023.

In a series of VBB Client Alerts, we examine key aspects of the Commission's new horizontals package. In this Client Alert, we focus on the Block Exemption Regulation on Specialisation Agreements (the "Specialisation BER") and chapter of the Horizontal Guidelines related to production agreements. The new rules provide slightly more flexibility and clearer guidance for companies wishing to cooperate in production. However, the way these arrangements are treated by the Commission has not substantially changed under the new rules, and competitors without market power remain free to engage in extensive forms of cooperation involving production without – subject to only limited caveats – attracting significant risk.

What rules apply to production agreements?

The Horizontal Guidelines and Specialisation BER set out the framework for the assessment of production agreements under EU competition law (specifically under Article 101 TFEU). By applying the Specialisation BER and the principles set out in the Horizontal Guidelines, companies can assess whether they may lawfully engage in production agreements and whether the specific terms of their agreements are likely to be compliant with competition law. The Specialisation BER and Horizontal Guidelines are therefore an important source of legal guidance for companies and their advisors considering production agreements.

- **Specialisation BER.** The Specialisation BER covers a broad range of production agreements, including agreements covering *joint production* (e.g., a joint venture operating one or more production facilities) and *specialisation in production* (a form of sub-contracting under which one or more parties limit their own production of a product in favour of purchasing that product from another party). The BER provides legal certainty by block exempting these types of production agreements, including the restrictions they may contain on the conduct of the parties (for example, exclusivity obligations and obligations related to output and pricing), provided that the requirements of the BER are met (most importantly that (i) the relevant market shares of the parties do not exceed 20% and (ii) the agreement

does not include any 'hardcore' restrictions). As the BER covers production arrangements that extend to joint distribution of the products (whether produced jointly or produced by one party by way of specialisation), it covers extensive forms of joint ventures with a direct market presence.

- **Self-assessment under the Horizontal Guidelines.** If a production agreement does not benefit from the Specialisation BER, its compliance with Article 101 TFEU should be assessed with the benefit of the relevant guidance provided by the chapter in the Horizontal Guidelines dedicated to production agreements. This assessment may be needed because the 20% market share threshold of the BER is exceeded or because the agreement is of a type that cannot fall within the scope of the BER (in particular, sub-contracting agreements between producers of the same products which do not involve a limitation of production by the contractor fall outside the scope of the BER). The assessment involves first determining whether the agreement sufficiently restricts competition so as to trigger the application of Article 101(1) (which, assuming 'by object' restrictions are avoided, typically requires the parties to have market power and for the arrangement to result in a significant degree of commonality of costs) and, if the agreement does have such a restrictive effect, whether it generates sufficient efficiencies to meet the demanding conditions to benefit from the exception provided by Article 101(3) TFEU.

Do companies need to be concerned about these rules?

As acknowledged in the Commission's consultation documents, production agreements are among the types of horizontal cooperation agreements which have been subject to the most scrutiny by competition authorities, at least at national level. In addition, non-compliance with the rules may have the effect that key provisions in production agreements are not legally enforceable. In the event of a dispute between collaboration partners, a party may seek to rely on competition law to avoid complying with a contractual provision, or as a defence in litigation. It is therefore important for companies to check the compliance of the provisions in their production agreements with the requirements set out in the Specialisation BER and Horizontal Guidelines.

What are the key changes in the new rules?

The most notable changes brought by the new Specialisation BER and new chapter of the Horizontal Guidelines on production agreements are as follows:

- **Scope of the Specialisation BER.** As under previous versions of the Specialisation BER, the new BER applies to both '*unilateral*' and '*reciprocal*' specialisation agreements (as well as to joint production agreements). However, the scope of the new BER has been expanded in that the definition of unilateral specialisation agreements (i.e., agreements whereby one party agrees to fully or partly cease production and to purchase the products from the other, which in turn agrees to produce and supply them) is extended to cover also agreements between more than two parties. The definition of unilateral specialisation agreements is thus aligned in this respect with that of reciprocal specialisation agreements (i.e., agreements whereby the parties agree to fully or partly cease production of certain but different products and to purchase those products from one or more of the other parties) and joint production agreements (i.e., agreements to produce jointly in a joint venture, a joint team or a joint organisation). In effect, the legal safe harbour provided by the revised Specialisation BER now applies uniformly to all three types of production agreements, without distinction as to the number of parties.
- **New market share threshold for cooperation on intermediary products.** The Specialisation BER introduces a new market share threshold where the specialisation agreement concerns intermediary products, i.e., inputs used captively by at least one party to produce downstream products. In such a case, the BER only applies if the combined market share of the parties does not exceed 20% on each of the relevant market(s) for both the intermediary products and the downstream products.

- **Calculation of market shares under the Specialisation BER.** Two other changes in relation to market shares are introduced by the new BER: (i) if the parties' market shares in the preceding calendar year are not representative of their market position, their market share must now be calculated as an average of the shares for the three preceding calendar years; and (ii) slight modifications are made to the "grace period" that applies if the parties' market shares increase above the threshold for exemption (the Specialisation BER will continue to apply for a period of two consecutive calendar years following the year in which the 20% threshold was first exceeded).
- **Scope of the production agreements covered by the Horizontal Guidelines.** The revised chapter of the Horizontal Guidelines on production agreements now makes clear that the guidance applies to all types of horizontal subcontracting agreements, including those that aim to expand production but do not qualify as specialisation agreements within the meaning of the Specialisation BER because the contractor does not at the same time cease or limit its own production volumes.
- **Mobile Telecommunications Infrastructure Sharing Agreements.** A new section on mobile telecommunications infrastructure sharing agreements reflecting recent enforcement practice has been introduced in the chapter of the Horizontal Guidelines on production agreements. The Commission recognises that, in principle, these agreements do not restrict competition by object but need to be assessed based on their possible effects on competition and the Horizontal Guidelines provide specific guidance for this purpose.

The new Specialisation BER provides for a transitional period of two years (until 30 June 2025) to allow specialisation agreements already in force which meet the conditions for exemption under the former Specialisation BER (Regulation No 1218/2010) to be brought in line, if necessary, to meet the revised conditions of the new BER.

Are the rules the same in the EU and UK?

Following the departure of the UK from the EU, the UK adopted a new Specialisation Block Exemption Order, which came into force on 1 January 2023, replacing the retained (former) EU Specialisation BER. The new UK Specialisation Block Exemption Order is very similar to the new EU Specialisation BER. For instance, the UK Order has also expanded the scope of the block exemption to include unilateral specialisation agreements between more than two parties. On 16 August 2023, the CMA finally published its Guidance on Horizontal Agreements, the UK equivalent to the Commission's Horizontal Guidelines, which has an extensive chapter dedicated to production agreements which closely mirrors the EU equivalent.

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