

## COMPETITION ASSESSMENT OF RESEARCH AND DEVELOPMENT

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Cooperation in research and development (“R&D”) is generally beneficial to both undertakings, in particular, to small and medium-sized enterprises (the “SMEs”) and to the consumers, as they promote technical and economic progress by avoiding duplication of R&D work. On a negative balance, however, cooperation in R&D may lead over time to the demise of existing industries.<sup>1</sup> In particular, R&D agreements between powerful competitors may reduce the competition in innovation, and may facilitate coordination of prices.

R&D agreements benefit from certain exemptions under both European Union (“EU”) and Turkish competition laws, as it is presumed that the positive effects of R&D cooperation would outweigh any negative effects on competition. The Turkish Block Exemption Communiqué No. 2003/2 Concerning the R&D Agreements (the “Communiqué”) and the EU Regulation No. 2659/2000 of 29 November 2000 on the Application of Article 81/3 of the Treaty to Categories of R&D Agreements (the “Regulation”) are intended to provide certain exemptions to R&D agreements.

Both the Regulation and the Communiqué provide that those R&D agreement which fulfill certain conditions and which do not include certain hardcore restrictions are not subject to the restrictions required under competition law. For instance, in order for an R&D agreement to benefit from the exemption, all the parties must have access to the results of the joint R&D, and each party must be free independently to exploit the results of the joint research and development and any pre-existing know-how necessary for the purposes of such exploitation.

### **Relevant Market with respect to R&D Agreements**

The identification of products, technologies or R&D efforts, which are subject to cooperation in R&D, is of cardinal importance in the determination of relevant market with respect to such agreements.

Firstly, the innovation may result in a product or technology, which compete in an existing product or technology market. In that case, possible effects concern the market for existing products. Existing relevant market may also be divided into sub-categories of product and technology markets.

Secondly, innovation may result in a new product that creates its own new market. In this case, the cooperation concerns the development of new products or technology, which either replace existing ones or create a completely new demand.

In all cases, where it is required to define the market, the European Court of Justice and the EU Commission intend to use an extremely narrow definition of product and geographical markets, particularly to facilitate findings of dominance. However, such a narrow determination, in the words of Greaves, is particularly worrying for owners of intellectual property rights since the ownership of intellectual property becomes a particularly significant factor in assessing dominance in the defined relevant market.<sup>2</sup>

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<sup>1</sup> Byrne, N., *Research and Development Contracts*, [1995] 8 I.C.C.L.R. at pp. 272-276.

<sup>2</sup> Greaves, R., *Article 86 of the EC Treaty and Intellectual Property Rights*, [1998] E.I.P.R. at 383.

Under the Communiqué, the relevant market is defined as the relevant geographic and product markets, but it is not provided any means to determine the relevant geographic and product markets. However, the definition of the relevant market under Turkish law is provided in the Communiqué No. 1997/1 on the Control of Mergers and Acquisitions (the “Communiqué No. 1997/1”), which defines the geographic market as any area within the country, where enterprises are involved in the supply and demand of products and services, the conditions of competition are sufficiently homogenous, and can easily be distinguished from neighboring areas due in particular to the conditions of competition which are appreciably different in those areas. In determining the relevant product market, the market comprising all products or services, which are regarded as substitutable by consumers by reason of their characteristics, prices and intended use are taken into account, together with the products or services that are subject matter of the merger concerned.

### **Market Share Threshold and Duration of Exemption**

Pursuant to the Regulation, where two or more of the participating undertakings are competing undertakings, the exemption shall apply only if the combined market share of the participating undertakings does not exceed 25 % of the relevant market for the products capable of being improved or replaced by the contract products. By virtue of the Communiqué, however, where two or more of the participating undertakings are competing undertakings and the results of the R&D shall be jointly exploited, the exemption only applies if the combined market share of the participating undertakings does not exceed 40 % of the relevant market.

The Communiqué also stipulates that where the distribution right of the products subject to R&D agreement is exclusively granted to one of the parties or to a subsidiary of the parties, or to a third party, the combined market share of all parties must not exceed 20 % of the relevant market. The Regulation, however, does not make such a distinction between R&D agreements where the distribution right of the products subject to R&D agreement is exclusively granted to one person, and apply the 25% market share threshold to such R&D agreements as well.

Under the Regulation, where the participating undertakings are not competing undertakings, the exemption shall apply for the duration of the R&D, and where the results are jointly exploited, the exemption shall continue to apply for seven years from the time the contract products are first put on the market within the common market.

The Communiqué also provides that where the R&D agreements do not include joint exploitation of the results, the exemption shall apply for the duration of the R&D. But, the Communiqué does not stipulate the condition of not being competing undertakings to grant the exemption for the duration of the R&D. By virtue of the Communiqué, where the R&D agreement includes joint exploitation of the results, the exemption shall apply for five years from the time the contract products are first put on the market within Turkey.

### **Market Share Calculation in R&D Cases**

The calculation of market shares is based on the distinction between different form of relevant market explained above, namely existing markets and competition in innovation. Both the Regulation and the Guidelines adopt that methodology and deal with various possibilities:

Firstly, if the R&D agreement only aims at improving or refining existing products, this market includes the products directly concerned by the R&D. Market shares can thus be calculated on the basis of the sales value of the existing products.

As a second possibility, if the R&D aims at replacing an existing product, the new product will, if successful, become a substitute to the existing products. To assess the competitive position of the parties, it is again possible to calculate market shares on the basis of the sales value of the existing products. For an automatic exemption, this market share may not exceed 25 percent.

Finally, if the R&D aims at developing a product which will create a completely new demand, market shares based on sales cannot be calculated, and it is only possible to analyze the effects of the agreement on competition in innovation. Therefore, the Regulation exempts these agreements irrespective of market share for a period of seven years after the product is first put on the market.

Contrary to the Regulation and the Guidelines, the Communiqué does not provide any methodology regarding the calculation of the market shares.

### **Concluding Remarks**

R&D is essential for undertakings to remain and compete in the market. It is widely accepted that strong economies are based on research and technology.<sup>3</sup> Having appreciated the contributions of the Regulation, the Guidelines and the Communiqué in terms of technological development and consumer protection, however, they have a number of shortcomings.

Firstly, the Guidelines are subject to serious criticism for not meeting the expectations<sup>4</sup>. Firstly, although they increase the legal certainty, they are criticised for leaving a number of issues intact. For instance, they establish that the “centre of gravity” rule shall be applied to agreements that combine various levels of cooperation. According to this rule, the system to be applied to the agreement in question will be determined by the main activity. However, any solution is not indicated for the situation where it is not possible to establish the main activity. Secondly, the Guidelines are criticised for being long and complex. They cover a great number of theoretical and minor cases, while they should rather concentrate on the main ones.

There are certain shortcomings of the Communiqué as well. For example, as stated above, the Communiqué does not provide any methodology regarding the calculation of the market shares. Moreover, any explanatory note similar to the Guidelines has not yet been issued under Turkish law, although certain issues regulated in the Communiqué need clarification. For example, the determination of the relevant geographic and product markets as regards the R&D agreements is clearly made in the Guidelines, but no such clarification exists under the Communiqué.

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<sup>3</sup> e.g. the increase of High-Technology sector in the US, see Kirkbride, J. & Xiong T., *Controlling Research and Development Co-operation through EC Competition controls: Some Concerns*, 1998 *The Company Lawyer* 19, pp. 296-301.

<sup>4</sup> e.g. the EU committee of the American Chamber of Commerce and the International Chamber of Commerce