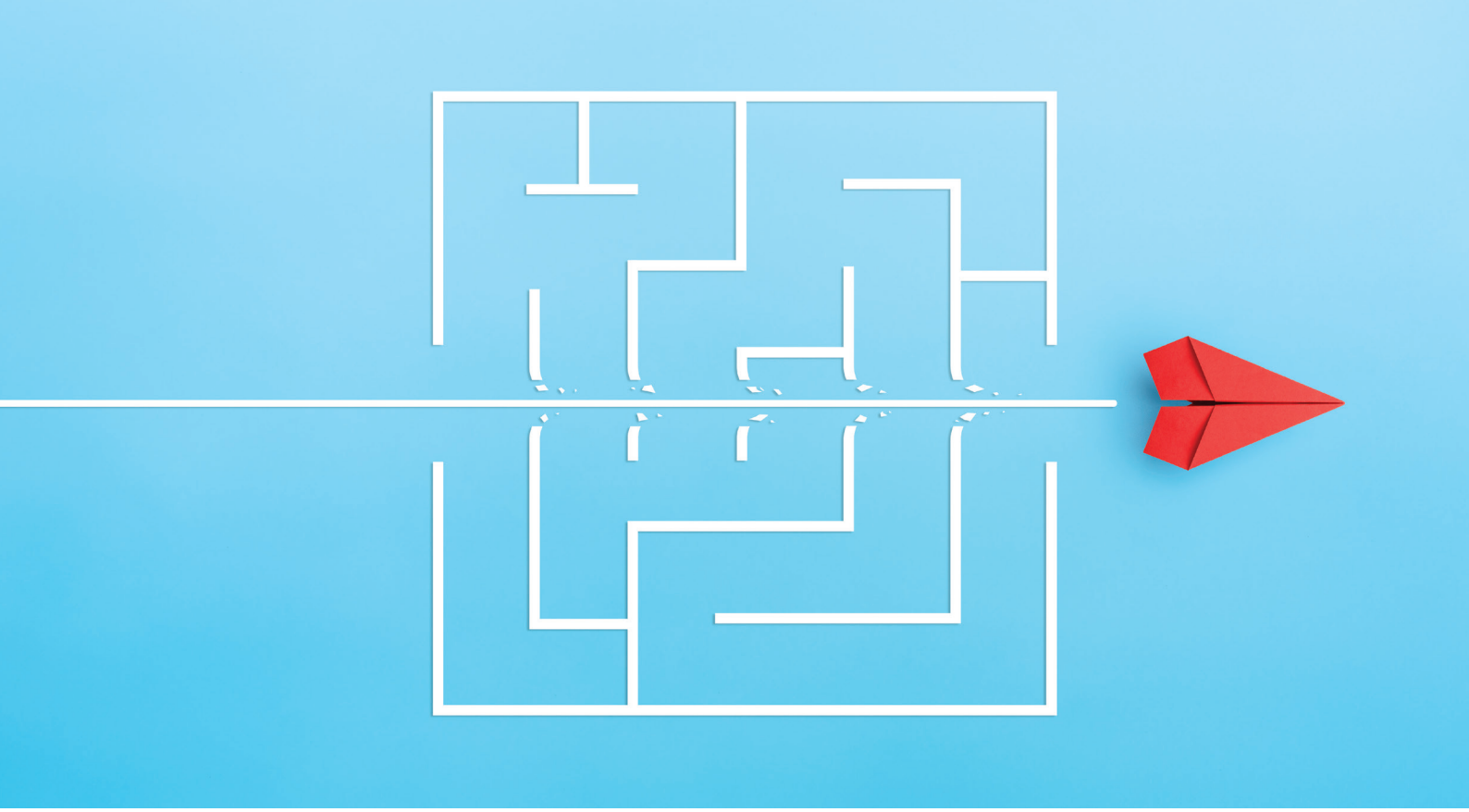


HORIZONTAL AGREEMENTS
THE NEW UK AND EU REGIMES

Sarwenaz Kiani of Vorys, Sater, Seymour and Pease LLP outlines the new UK and revised EU legal frameworks for horizontal agreements, focusing on the block exemption for research and development agreements.

Horizontal agreements are agreements that are made between two or more parties that operate at the same level of a production, supply or distribution chain. Interactions between independent companies that manufacture or sell competing products attract scrutiny by competition authorities because the mere fact that competitors are interacting is considered a risk to competition. At the same time, legislators and competition authorities recognise that horizontal agreements are part of business reality, are often necessary to achieve important business goals and do not necessarily create appreciable detriment to consumers or the market. Therefore, many competition regimes provide exemptions for certain horizontal agreements so that they are not subject to the general prohibition against anti-competitive agreements.

The European Commission (the Commission) has recently revised and updated its legal framework on horizontal agreements. In parallel, the UK government issued legislation to create a new post-Brexit legal framework on horizontal agreements, and the Competition and Markets Authority (CMA) has recently published guidance on the application of the new UK regime. Both regimes provide for block exemptions that apply to certain categories of research and development (R&D) and specialisation agreements, creating a "safe harbour" from the general prohibition against anti-competitive agreements. The new and revised regimes are intended to increase clarity for companies in assessing whether their agreements benefit from the safe harbour and, for agreements that fall outside of the safe harbour, whether they comply with competition law (*see box "Key changes"*).

This article provides an overview of the UK and EU horizontal agreement legal frameworks, focusing on the rules that apply to R&D agreements.

NEW REGIMES

Both the UK and the EU competition regimes provide for a general prohibition of anti-competitive agreements, under Chapter I of the Competition Act 1998 (1998 Act) (Chapter I) and Article 101(1) of the Treaty on the Functioning of the European Union (Article 101), respectively. These provisions prohibit agreements, decisions and concerted practices between at least two independent undertakings that have as their object or effect the restriction, distortion or prevention of competition in the relevant market. Section 3 of the 1998 Act and Article 101(3) provide for exemptions from the general prohibition, either in respect of an individual agreement or in respect of a category of agreements in the form of a block exemption.

The UK and EU horizontal agreement frameworks focus on agreements between actual or potential competitors. Horizontal agreements are usually made in the areas of R&D, production (including specialisation), purchasing, commercialisation, information exchange and standardisation.

Agreements between companies that are not competing but operate on a different level of manufacture or trade can equally infringe the general prohibition on anti-competitive agreements but are dealt with by other frameworks, such as the vertical agreement legal frameworks (*see feature article "New vertical agreement block exemptions: fit for a digitalised decade", www.practicallaw.com/w-035-8990*).

Revised EU regime

In 2019, the Commission began a process of evaluating and consulting on the horizontal block exemption regulations (HBERs) that were originally adopted in December 2010 (*Regulation 1217/2010/EU; Regulation 1218/2010/EU*). On 1 June 2023, the Commission adopted revised and updated versions of the HBERs in the form of:

- Regulation 2023/1066/EU on the application of Article 101(3) to certain categories of research and development agreements (the Regulation).
- Regulation 2023/1067/EU on the application of Article 101(3) to certain categories of specialisation agreements.

On the same date, the Commission published revised guidelines on the applicability of Article 101 to horizontal co-operation agreements (the EU guidelines) (*https://ec.europa.eu/commission/presscorner/detail/en/IP_23_2990*).

New UK regime

Following the end of the Brexit transition period on 31 December 2020, the HBERs continued to apply in the UK as retained EU law. In November 2021, the CMA started a consultation process to consider whether the HBERs were still fit for purpose and, in particular, whether they took account of the UK economy's specific interests and served the interests of UK businesses and consumers. As a result of the CMA's recommendations, on 1 January 2023, two new horizontal block exemption orders (HBEOs) came into force:

- The Competition Act 1998 (Research and Development Agreements Block Exemption) Order 2022 (the Order).
- The Competition Act 1998 (Specialisation Agreements Block Exemption) Order 2022.

On 16 August 2023, the CMA published its long-awaited guidance on the application of the Chapter I prohibition to horizontal agreements (the UK guidance) (*www.gov.uk/government/publications/guidance-on-horizontal-agreements*). On 12 October 2023, the CMA published separate guidance on environmental sustainability agreements (*www.gov.uk/guidance/green-agreements-guidance-how-competition-law-applies-to-environmental-sustainability-agreements*) (*see Briefing "Green agreements: competition law guidance on sustainability collaboration", this issue*).

Comparing the regimes

The HBEOs are largely aligned with the revised HBERs, although there are some areas of divergence. In particular, under the UK regime, the R&D block exemption will only apply to innovation competition if there are at least three other actually or potentially competing and comparable R&D efforts (*see "Innovation competition" below*). It remains to be seen whether the additional language and assessment for innovative R&D projects will allow for more innovation to flourish or will have the opposite effect in the UK. Given that the UK adopted the Order six months before the Commission adopted the Regulation, it is open to debate whether the UK would have aligned the Order more consistently with the Regulation if timing had allowed the UK to assess the final EU versions before adopting the Order.

Key changes

The key changes arising from the new UK and the revised EU legal frameworks for horizontal agreements include:

- New definitions of certain terms to provide further clarity.
- Increased clarity and flexibility in calculating the market share threshold for research and development (R&D) and specialisation agreements.
- Simplified grace periods that apply when the parties' market shares increase above the market share thresholds.
- Increased protection of innovation competition in relation to R&D agreements; that is, where companies compete in innovating to win new markets.
- Clarification of the circumstances in which the European Commission or a national competition authority may assess and potentially withdraw the application of a block exemption to a particular agreement.
- A wider definition of unilateral specialisation agreements so that agreements between more than two parties may come within the scope of the specialisation block exemption.
- Under the UK regime only, a new provision that the R&D block exemption will only apply to innovation competition if there are at least three other actually or potentially competing and comparable R&D efforts.

ASSESSMENT PROCESS

As set out in the UK guidance and the EU guidelines, the starting point for the assessment of an arrangement between undertakings is whether companies are actual or potential competitors. If they are, the next consideration is whether the companies are interacting in a way that could restrict competition. If so, the general prohibition will apply unless a block or individual exemption applies.

In addition, the UK guidance and the EU guidelines set out market share thresholds under which specific agreements are usually

Market share thresholds

Type of agreement	Market share thresholds required by the block exemptions
Research and development agreements; that is, agreements that focus on the research and development of improved or new products and technologies, including the joint commercialisation of developed products and technologies.	Combined market share thresholds of all involved parties of 25%.
Production agreements; that is, agreements that focus on the production and manufacture of products, including the joint distribution of jointly produced goods.	Combined market share thresholds of all involved parties of 20%.
Purchasing agreements; that is, agreements that focus on the joint purchasing of input products.	Combined market share thresholds of all involved parties of 15% on purchasing and selling markets.
Commercialisation agreements; that is, agreements that focus on the joint distribution of products.	Combined market share thresholds of all involved parties of 15%.
Standardisation agreements; that is, agreements that focus on the definition of technical or quality requirements.	No market share threshold.
Standard terms; that is, terms that focus on developing industry-wide terms and conditions.	No market share threshold.

deemed not to have a significant anti-competitive effect and therefore fall outside of the general prohibition (*see box "Market share thresholds"*). However, if an arrangement includes a by object restriction, which is the most harmful restriction for the market, consumers and competitors, a block exemption will not be available. The UK guidance and the EU guidelines provide examples of conduct that is likely to be considered a by effect or by object restriction, both generally and for each type of agreement.

Block exemptions

If an agreement meets the conditions of a block exemption, no further individual exemption assessment is required (*see "Conditions for block exemption" below*). The benefit of a block exemption is that it grants a wide safe harbour. If an agreement falls within the scope of the safe harbour, the legal certainty as to the compatibility with competition law is much higher and more reliable than an individual exemption will be able to provide.

Individual exemptions

If an agreement does not meet the conditions for a block exemption, the parties should consider whether to amend it to bring it within the scope of a block exemption or whether an individual exemption may apply. Section 9(1) of the 1998 Act and Article 101(3) set out identical conditions that an agreement must cumulatively meet in order for it to benefit from an individual exemption. An agreement must:

- Contribute to efficiencies.
- Provide a fair share of the resulting benefits to consumers.
- Provide restrictions on competition that are indispensable to achieving those benefits.
- Not give the parties to the agreement the possibility of eliminating competition from a substantial part of the relevant products.

The HBEOs and HBERs cover particular categories of agreements that the CMA and the Commission, respectively, consider are likely to satisfy the conditions of an individual exemption. The UK guidance and the EU guidelines set out examples and scenarios for each type of agreement under which an individual exemption seems likely. However, given that the UK guidance and EU guidelines are "soft law", there is no guarantee that a competition authority other than the CMA or the Commission, or a court, would share the outcome of the individual exemption assessment made under them.

R&D AGREEMENTS

Companies undertake R&D in order to improve or replace existing products, or to develop entirely new ones. R&D is an area in which companies and organisations often seek to collaborate in order to promote innovation, accelerate research, pool complementary resources, eliminate duplicate processes, benefit from data sharing and save costs. The Order and the Regulation have been adopted to help companies self-assess whether any interactions or arrangements in relation to the R&D of products or technologies are compatible with competition law.

Scope of application

Both the UK and EU legal frameworks apply to agreements under which two or more parties co-operate jointly, or under which one or more of the parties finance R&D efforts that are carried out by one or more other parties, known as "paid-for" R&D (*see box "Key provisions"*). In addition, both frameworks apply to agreements covering the joint improvement of existing products and technologies, and agreements concerning the development of products and technologies that would create entirely new demand. Different forms of co-operation are possible; that is, the co-operation may be organised on a contractual basis, using a newly formed joint venture, or in a looser form such as by way of a workshop.

R&D agreements usually consist of two stages: the R&D stage and the exploitation stage. Both stages can be organised in various ways and the parties have a lot of freedom in this regard. They can truly co-operate and work on each stage jointly by each providing experts and equipment, or one of them can take the lead with some input from the other parties. The same principle applies to the exploitation stage, which is the more risk-prone stage. If the R&D agreement includes joint exploitation, the parties can decide to commercialise products by sharing responsibilities or they can decide that only one party should be responsible for selling products and the other party receives licence payments in return. Both forms are considered joint exploitation. It is also possible to allocate fields of use, or exclusive customer groups or territories, for active sales with regard to the exploitation by each party.

Key provisions

Content	The Competition Act 1998 (Research and Development Agreements Block Exemption) Order 2022	Regulation 2023/1066/EU on the application of Article 101(3) to certain categories of research and development agreements
Definitions	Articles 2, 8(9) and 8(10)	Article 1
Conditions for block exemption	Articles 3, 4, 6 and 7	Articles 2, 3, 4 and 5
Market share threshold	Article 9(1); Article 11(2) (grace period)	Articles 7(2) and (3); Article 6(5) (grace period)
Hardcore restrictions	Article 10	Article 8
Excluded restrictions	Articles 12 and 13	Article 9
Transitional provisions	Article 17	Article 12
Withdrawal	Article 15	Articles 10 and 11

Conditions for block exemption

The UK and EU R&D legal frameworks apply both to agreements between non-competing companies and agreements between competing companies. However, agreements between non-competing companies are unlikely to restrict competition, except where they compete in relation to innovation (*see "Innovation competition" below*). This is also reflected in the exemption mechanisms of the frameworks.

Non-competitors. Under both the UK and the EU legal frameworks, R&D agreements between non-competitors are exempted without the need to assess a market share threshold. If an agreement between non-competitors also includes joint exploitation, the exploitation stage is exempted for seven years from the date on which the newly developed or improved product is first put on the market. After seven years, the exemption is only available if the 25% market share threshold is not exceeded.

Competitors. For actually or potentially competing undertakings, the R&D stage and the exploitation stage are only exempted if, at the moment of entering the R&D agreement, the respective market share thresholds are not exceeded; that is, the parties' joint market shares on the technology or product market do not exceed 25%. If the market shares are below 25%, the agreement is exempted for the duration of the R&D stage and for a seven-year exploitation stage after the products or technologies have been put on the market.

At the end of the seven-year period, the exemption continues to apply as long as the combined market share of the parties to the R&D agreement does not exceed 25% of any market to which a jointly developed product or technology belongs.

Grace period. The UK and EU frameworks grant a grace period of two years after the seven-year exploitation period, which applies to R&D agreements both between competitors and between non-competitors. If the parties' combined market share rises above the 25% threshold after the end of the seven-year period, the exemption continues to apply for two consecutive calendar years following the year in which the threshold was first exceeded (*Article 11(2), the Order and paragraphs 4.58 and 4.67, the UK guidance; Article 6(5), the Regulation and paragraph 104, the EU guidelines*).

Access to results and know how. An important condition for the block exemption is that all parties to the joint R&D get access to the final R&D results. Depending on how the agreement is structured, it may be sufficient that access to final results is granted for further research only; for example, where research services are provided by a third party, or if only one party exploits the results and the other party receives compensation in lieu (*paragraphs 4.32-4.34, the UK guidance; paragraphs 74-78, the EU guidelines*). In addition, the exemption requires that the parties have access to pre-existing know how as far as this is required to use the R&D result for further research or, if applicable, for exploitation.

Market share calculation. Market shares should be calculated either based on:

- The turnover generated in the preceding calendar year; however, if no sales have been generated other parameters may be considered, such as expenditure on R&D.
- If more meaningful, the average of the parties' market shares of the three preceding calendar years (*Article 9(1), the Order; Articles 7(2) and 7(3), the Regulation*).

Hardcore restrictions

If the R&D agreement includes one or more of the listed hardcore restrictions, which are identical in the UK and EU legal frameworks, it can no longer benefit from the safe harbour of the block exemption (*Article 10, the Order; Article 8, the Regulation*). In these circumstances, the entire agreement will need to be assessed under the individual exemption rules. Typically, it is nearly impossible to demonstrate sufficient efficiencies that balance out the restrictive effects of a hardcore restriction.

One of the main hardcore restrictions that puts R&D agreements at risk of being anti-competitive is any limitation on the parties conducting R&D and creating innovations; for example, a restriction on using the R&D results for further R&D after completion of an R&D agreement, or a prohibition on conducting any research with regard to unrelated areas that are not connected to the R&D agreement.

In addition, there are a number of more typical hardcore restrictions; that is, those that also apply under other block exemption regulations. These hardcore restrictions are:

- The limitation of sales and output, unless necessary for a joint exploitation arrangement.
- Price fixing, unless necessary for a joint exploitation arrangement.
- Passive sales bans to certain territories or customer groups.
- Active sales bans without having exclusively allocated territories or customer groups.
- Obligations to refuse to meet the demand of a customer that is located in an exclusive territory but intends to sell into a different territory.
- Obligations to make it difficult for users or resellers to obtain a contract product from other resellers in the UK or the EU, as relevant.

Excluded restrictions

Both the UK and the EU frameworks set out a list of so-called excluded restrictions for which the block exemption is not available (*Article 12, the Order; Article 9, the Regulation*). An individual assessment is required for each of these restrictions. If an excluded restriction can be severed from the remaining part of the R&D agreement, the benefits of a block exemption are cancelled only with regard to the excluded restriction (*Article 13, the Order; Article 9(3), the Regulation*). These restrictions include:

- The obligation not to challenge the intellectual property rights (IPR) that are relevant to the R&D agreement.
- The obligation not to grant a licence to third parties for the production of the contract product or apply a contract technology unless this is justified as part of the exploitation arrangements.

INNOVATION COMPETITION

Both the Order and the Regulation include new language to protect innovation competition, that is, competition in relation to new products or technologies that do not currently exist, such as a new vaccine against a certain illness where no vaccine exists. The Order adds a number of new definitions to provide companies with more legal certainty when assessing innovative co-operation. Under the Regulation, the assessment of co-operation in relation to not yet existing products or technologies has not changed in principle, although a few clarifications have been added.

The Regulation

Recital 21 to the Regulation includes a revised paragraph on the assessment of R&D projects regarding new products and technologies as well as early R&D efforts; that is, innovation competition. However, the mechanism of assessment stays the same. Parties that co-operate in relation to innovation competition are not considered competitors as the market does not yet exist on which they could compete and therefore there is no need for a market share assessment.

Therefore, R&D efforts in relation to new products that do not yet exist are generally exempted under the Regulation, unless they include hardcore restrictions. In the event that any such R&D co-operation does restrict competition, the Commission has the power to withdraw the benefits of the Regulation. A new Article 10 of the Regulation sets out the withdrawal mechanism and Article 10(2)(e) provides that the benefit of the exemption may be withdrawn where the existence of the R&D agreement would substantially restrict innovation competition in a particular field. Further details on the assessment of the restrictive effects of a co-operation regarding new products and technologies that could justify a withdrawal are included in paragraphs 150 to 151 and 166 to 168 of the EU guidelines. For example, the number of parties having competing R&D projects, as well as the stage of the R&D efforts, are relevant elements of the assessment.

The Order

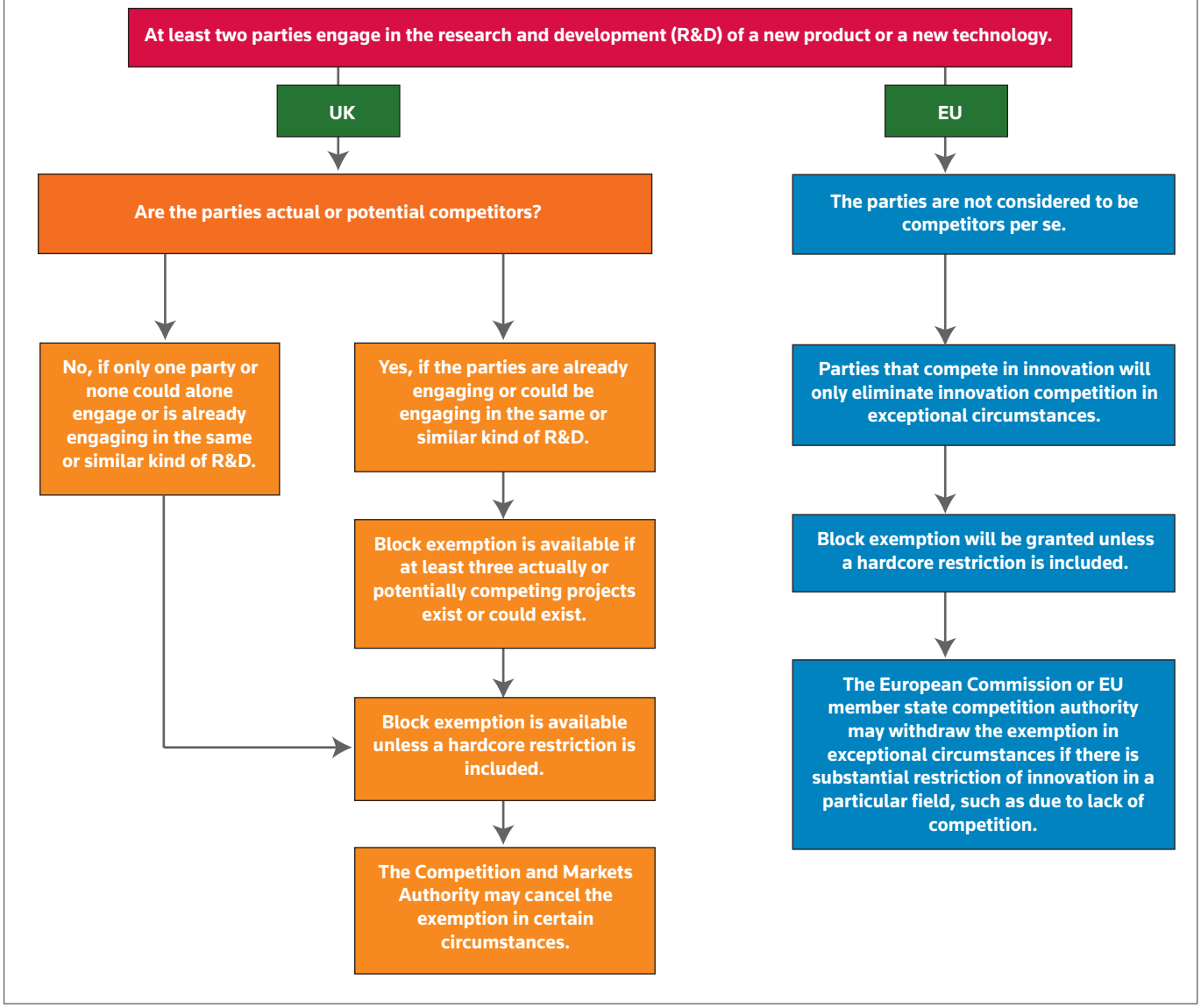
The Order includes several new definitions to cover co-operation in relation to developing new products or technologies:

- A "new product" is a product, technology or process that does not exist at the time when the 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 (*Article 2(2)(b)*).
- An "R&D cluster" means R&D efforts that are directed primarily towards a specific aim or objective that cannot yet be defined as a product or a technology, or involve a substantially broader target than a specific product or technology on a specific market (*Article 2(1)*).
- A "competing R&D effort" means R&D of a new product, technology or cluster that is the same as, or likely to be substitutable for, the R&D project under assessment (*Article 8(10)*).
- A "not competing undertaking" is an undertaking where the parties do not meet the definition for competing undertakings (*Article 8(9)*).
- An "undertaking competing in innovation" is an undertaking that is engaging in R&D, or would be able and likely to engage in R&D, of a new product, technology or cluster that could compete with the R&D project under assessment (*Article 8(10)*).

While Article 2 of the Order sets out the general definitions used, some of the above definitions are included in Article 8 as they are intended to clarify the test to assess whether two or more parties to an R&D agreement are undertakings competing in innovation and can therefore benefit from the safe harbour.

The first step of this assessment involves considering whether the parties to the R&D agreement are competitors with regard to the R&D project. This is the case if the parties are either both currently working on an R&D project in view of developing the same or a substitutable product or where they have the ability to engage in the R&D of the same or substitutable product (*paragraphs 4.49-4.54, the UK guidance*). If the parties to an R&D agreement that relates to developing a new product or technology are not competitors, the parties can benefit from the safe harbour without being subject to a market share or other threshold.

Assessing innovative co-operation



If the parties are actual or potential competitors, in order to benefit from the safe harbour they must demonstrate that there are at least three actually or potentially competing R&D projects that are directed at the same or a substitutable product (*Article 8(5), the Order*). This test offers two alternative routes to assess the market power of an R&D project in view of a new product, technology or cluster, looking at either actual or potential innovation competition. The interesting question is how to assess whether a project exists actually or potentially, given that R&D projects are usually confidential and not in the public domain. It seems likely that, due to the lack of public data, in most cases the assessment of potential rather than actual projects will be the default test.

Article 9(3)(a) of the Order sets out the following parameters for the assessment of actual innovation competition:

- The size, stage and timing of the R&D efforts.
- The availability of financial and human resources, their IPR, know how or other relevant assets, and their previous R&D efforts.
- The ability to exploit in the UK any possible results of the R&D efforts.

It seems burdensome and time-consuming to verify whether other R&D efforts are sufficiently similar to the R&D project under assessment based on the above parameters. If the listed information is publicly known and easily accessible, the benefit of the test is that there is a high degree of legal safety for the R&D project under assessment. However, it seems unlikely that companies will have access to this kind of information and therefore they are unlikely to be able to assess competition in sufficient detail to grant the desired legal certainty.

If there is no actual knowledge of an existing competing R&D project, the Order offers an alternative test with regard to potential competition. The assessment follows the same parameters set out above for actual competition without the first parameter regarding the size, stage and timing of any existing R&D efforts (*Article 9(3)b), the Order*). Again, it seems that, in practice, only a superficial assessment of potential competing R&D efforts will be conducted. However, companies will at least be able to get an overall indication of whether they are the only ones that could take on the specific R&D project.

The CMA added this additional test, instead of keeping the assessment as it was and

as it remains in the Regulation, because it took the view that dynamic competition was not sufficiently protected under the previous regime. Dynamic competition refers to companies that are making efforts or investments, such as through R&D, that may eventually lead to new business opportunities. While the CMA seems to recognise that dynamic competition is important because it drives innovation by increasing the likelihood of new and improved products, it is questionable whether this additional layer of assessment will, in practice, make it easier for companies to engage in innovation.

Assessment in practice

Compared to the UK regime, the EU test under which R&D projects in relation to new products are generally exempted unless the block exemption is withdrawn is much easier to be applied and allows innovative efforts to take place in a less restrictive legal environment (*see box "Assessing innovative co-operation"*).

In practical terms, whether an assessment is carried out under the Order or the Regulation, companies should undertake a desktop assessment in order to verify which other actual or potential R&D projects are, or could be, competing with the R&D project under assessment. Companies should prepare a brief written analysis that refers to financial statements or press releases of the relevant competing R&D projects. This analysis should be kept on record in case any of the authorities query the market position.

In the UK, even if the desktop analysis results in identifying fewer than three competitors, this does not mean that the R&D project is unlawful or cannot take place. The co-operation can still benefit from an individual exemption if it leads to efficiencies that are to the benefit of consumers. If a co-operation includes the joint commercialisation of the R&D products, the exemption applies for seven years from the time when the product has been put on the market for the first time. After seven years has passed, the exemption is only available if the relevant market share thresholds are not exceeded. Shortly before the end of the seven-year period, the parties have to assess the relevant market share thresholds and continue to do so on a bi-annual basis for as long as the co-operation exists.

Cancellation or withdrawal

Both the UK and EU frameworks include a provision referring to the relevant competition authorities' rights to cancel or withdraw the benefit of the exemption in particular cases (*Article 15, the Order; Articles 10 and 11, the Regulation*). The Regulation provides a non-exhaustive list of cases where withdrawal may apply, such as if the R&D agreement substantially precludes third parties from either carrying out R&D in fields related to the contract product or technology, or accessing the contract product or technology.

The Order provides a general reason for cancellation. It states that the CMA can cancel the block exemption if it considers that a particular R&D agreement is not exempt from the Chapter I prohibition as a result of section 9 of the 1998 Act. Another reason for cancellation is if parties fail to comply with the obligations imposed under Article 14 of the Order, which grants the CMA the right to ask parties for information on specific agreements.

While the power to withdraw the benefit of the block exemption existed before the recent changes to the Regulation, it was mentioned only in the recitals. The power is based on rights granted to the Commission by the Modernisation Regulation (*1/2003/EC*). The Order and the Regulation state this power in Article 15, and Articles 10 and 11, respectively.

Transitional period

The new block exemptions will not apply for two years for agreements that were already in force on 1 January 2023 for the UK and 30 June 2023 for the EU, provided that they satisfied the previous block exemption (*paragraph 4.120, the UK guidance; paragraph 126, the EU guidelines*). For the UK, the new test for undertakings competing in innovation

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applies only in relation to R&D agreements entered into on or after 1 January 2024; before this time, the provisions relating to non-competing undertakings apply (*paragraph 4.121, UK guidance*).

NEXT STEPS FOR COMPANIES

The assessment of R&D agreements under the block exemption has never been straightforward. The rules remain highly complex, so it is questionable whether the aim to make rules easier and more accessible in order to abolish any hurdles for SMEs to grow innovation has been achieved. Given the innovation competition requirements, as well as the fact that multinational companies will have to apply the UK and EU regimes in parallel, the rules have become rather more complicated. At the same time, the assessment of potential restrictions of competition is based on similar parameters in both regimes, such as the number of companies conducting comparable R&D projects.

The good news is that, so far, fines have rarely been imposed for genuine R&D co-operation that may not have fallen within the scope of the safe harbour, unless such co-operation was a disguise for illegitimate conduct (*Car Emissions, Commission decision of 8 July 2021, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021AT40178(02)*).

For companies that wish to engage in R&D efforts with their competitors, the best way forward is to put the self-assessment in writing and keep it on file. The assessment should be revisited from time to time, as market dynamics may change. If a competition authority takes an interest in an R&D co-operation, the companies will be able to provide the assessment based on the knowledge they had at the time they entered into the R&D project. If the co-operation does not include any hardcore restrictions and does not infringe other applicable laws, the risk of a fine should be limited. It remains to be seen whether, and how, the competition authorities will make use of their enhanced withdrawal or cancellation powers, and how the courts of the EU member states and the UK will assess these decisions.

Sarwenaz Kiani is a partner at Vorys, Sater, Seymour and Pease LLP.

