EXPLANATORY MEMORANDUM TO

THE COMPETITION ACT 1998 (SPECIALISATION AGREEMENTS BLOCK EXEMPTION) ORDER 2022

2022 No. 1272

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Business, Energy and Industrial Strategy and is laid before Parliament by Command of His Majesty.

2. Purpose of the instrument

2.1 The order is a block exemption order under section 6 of the Competition Act 1998 ('the Act'). It gives effect to the Competition and Markets Authority's (CMA's) recommendation that the Secretary of State should make a Specialisation Agreements Block Exemption Order (SABEO) that specifies certain categories of horizontal agreements to exempt them from the prohibition in Chapter I of Part 1 of the Act which prohibits agreements between firms that prevent, restrict or distort competition. The order exempts horizontal specialisation agreements[1] if they meet the conditions set out in the order and is made in parallel with an order that exempts horizontal R&D agreements (the R&D BEO)[2].

2.1 The purpose of the order is to ensure that businesses are not prevented or disincentivised from entering into agreements that the CMA considers to be overall beneficial and not anticompetitive.

2.2 The order replaces the retained Specialisation Block Exemption Regulation (EUR 2010/1218) (retained Specialisation BER) which was made under EU law and retained in UK law after the UK's withdrawal from the EU. The retained Specialisation BER expires on 31 December 2022.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Extent and Territorial Application

4.1 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is the entirety of the United Kingdom.

4.2 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the entirety of the United Kingdom.

5. European Convention on Human Rights

5.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

[1] See paragraphs 7.13-7.16 for a description of specialisation agreements.
[2] The Competition Act 1998 (Research and Development Agreements Block Exemption) Order 2022

6. Legislative Context

6.1 The Act prohibits agreements between undertakings that prevent, restrict or distort competition (known as the Chapter I prohibition). Section 9 of the Act sets out the conditions under which such an agreement is exempt from the Chapter I prohibition. This general exemption requires businesses to self-assess to consider whether they meet the statutory criteria which can lead to a reluctance to rely on the provision.

6.2 Section 6 of the Act provides that the Secretary of State, on advice of the CMA, may make a block exemption order covering agreements which fall under a particular category of agreements that are likely to be exempt under section 9 of the Act. Such an order may impose conditions or obligations subject to which the block exemption is to have effect. An agreement which falls into a category specified in a block exemption order (and that does not breach any of the conditions specified in the order) will not be prohibited under the Chapter I prohibition, providing greater certainty for a business.

6.3 By avoiding the need for businesses to self-assess whether their agreements comply with competition law, block exemptions can reduce compliance costs for businesses and increase their confidence to engage in transactions that have a benign or beneficial effect on competition. By enabling businesses to do so, block exemptions benefit consumers (for example through the developments of new products).

6.4 A similar approach exists under EU law. The European Commission can make block exemption regulations, exempting certain categories of agreement from the prohibition under Article 101(1) of the Treaty on the Functioning of the European Union (TFEU). Before the UK's withdrawal from the EU, these block exemption regulations also applied in respect of the Chapter I prohibition as 'parallel exemptions' under section 10 of the Act. Following EU Exit, the UK retained the EU block exemption regulations and so, as of January 2021, the EU Specialisation Block Exemption Regulation[3] became the retained Specialisation BER under UK law. The retained Specialisation BER expires on 31 December 2022.

6.5 The retained Specialisation BER is one of two retained horizontal block exemption orders which expire at the same time and were therefore reviewed and will be replaced in parallel. The SABEO is being made alongside the R&D BEO.

6.6 The first retained block exemption regulation to expire was replaced in May 2022 by The Competition Act 1998 (Vertical Agreements Block Exemption) Order 2022.[4] Other block exemptions to be reviewed in due course include:

- Motor vehicle vertical agreements – expires 31 May 2023
- Liner shipping consortia agreements – expires 25 April 2024
- Technology transfer agreements – expires 30 April 2026
- Rail, road and inland waterways transport – no expiry date

6.7 The order also amends another retained block exemption regulation, the retained Technology Transfer Block Exemption Regulation[5]. Article 9 of that Regulation

[3] Commission Regulation (EU) No 1218/2010 of 14 December 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of specialisation agreements (OJ L 335, 18.12.2010, p. 43).

[4] https://www.legislation.gov.uk/uksi/2022/516/contents/made

provides that the Regulation does not apply to licensing arrangements which fall within the scope of the retained Specialisation BER. The SABEO amends Article 9 so that it refers to this order instead of the retained Specialisation BER. This amendment is made under section 10A of the Act which is a power for the Secretary of State to vary or revoke a retained block exemption regulation (i.e., a power to amend retained direct EU legislation). Section 10A was inserted in the Act by the Competition (Amendment etc) (EU Exit) Regulations 2019 (S.I. 2019/93) which were made under the European Union (Withdrawal) Act 2018 (c. 16) ('EUWA'). Section 7 of EUWA provides that retained direct EU legislation may be amended by subordinate legislation so far as it is made under a power which permits such a modification by virtue of any provision made under EUWA. This (together with an equivalent provision in the R&D BEO) is the first use of the power in section 10A of the Act.

7. Policy background

What is being done and why?

7.1 Competition law and its enforcement contribute to ensuring that market failures are prevented or remedied by prohibiting agreements between businesses that prevent, restrict or distort competition. This can include, for example, price-fixing, limiting output or sales, and the allocation of markets and customers. In so doing, competition law protects UK businesses and UK consumers from illegal, anticompetitive behaviours across the economy.

7.2 However, certain types of agreements – which would ordinarily be captured by this prohibition – are generally considered to be beneficial and not anticompetitive. This includes horizontal cooperation agreements, understood as agreements between actual or potential competitors, that meet certain conditions. Specialisation agreements comprise the following types of horizontal production agreement: joint production agreements, unilateral specialisation agreements and reciprocal specialisation agreements which concern the manufacture of goods or the preparation of services (see further below). Specialisation agreements have the potential to improve production processes and lower costs which can lead to lower prices for consumers. For example, parties to the agreement may agree on a reciprocal basis to cease production of certain products in order to purchase those from the other parties to the agreement.

7.3 As referred to in paragraph 6.4, prior to the UK's withdrawal from the EU, block exemption regulations made by the European Commission which exempt certain categories of agreement from the Article 101(1) TFEU prohibition (which is equivalent to the Chapter I prohibition in UK law) were applied to the Chapter I prohibition as "parallel exemptions". The EU Specialisation BER was retained in UK law after EU Exit and therefore forms part of UK law. As it expires in December 2022, the CMA reviewed the retained Specialisation BER for the purpose of making a recommendation to the Secretary of State about whether to replace it and, if so, how.

7.4 The CMA recommended that the Secretary of State replace the retained Specialisation BER with a block exemption order under the Act. This recommendation was based on a review of the retained Specialisation BER and its effect on UK markets. It drew on

[5] Commission Regulation (EU) No 316/2014 of 21 March 2014 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of technology transfer agreements (EUR 2014/316). See https://www.legislation.gov.uk/eur/2014/316/contents.

relevant evidence gathered from businesses with operations in the UK relying on the retained block exemption; law firms advising businesses on the application of competition law to horizontal agreements in the UK; and relevant trade and industry associations. The CMA also drew on additional evidence from an EU evaluation of the EU Specialisation BER and related EU Horizontal Guidelines (the EU Guidelines on Horizontal Cooperation), to which the CMA and UK stakeholders contributed.

7.5 In April 2022, the CMA published a draft recommendation and consulted on it publicly for four weeks.[6] The CMA considered the views presented, resulting in the CMA's final recommendation to the Secretary of State on 24 June 2022 and published on 28 June 2022.[7]

7.6 The CMA found that the evidence it gathered during its review shows that a specialisation block exemption is a relevant and useful tool for businesses operating in the UK. The CMA also noted that it is beneficial in particular to have a 'safe harbour' for categories of specialisation agreements that are considered likely to satisfy the requirements for exemption under section 9, as such agreements will often generate benefits through promoting efficiencies, lower costs, and improving production processes.

7.7 Allowing the retained Specialisation BER to expire without replacing it could lead to significant increased uncertainty among businesses and potentially fewer benign or economically beneficial specialisation agreements being made. This order thus helps to avoid future harm to businesses and consumers alike.

7.8 A specialisation block exemption has benefits for businesses. Firstly, it provides legal certainty by assuring businesses that their specialisation agreements comply with competition law provided they meet the conditions of the exemption. Secondly, it avoids placing on businesses the burden of scrutinising many essentially benign specialisation agreements. Thirdly, it ensures consistency of approach by providing a common framework for businesses to assess their specialisation agreements against.

7.9 In addition, the block exemption ensures that the CMA does not need to scrutinise essentially benign or beneficial agreements and allows the UK's competition authority to effectively use its resources to enforce competition law across the UK by targeting more detrimental forms of anti-competitive agreements and practices.

7.10 The order gives effect to the CMA recommendation to replace the retained Specialisation BER broadly in line with the status quo. It does, however, introduce some important amendments tailored to the needs of UK consumers and businesses to improve the block exemption provisions and the current legal framework.

Explanations

What did any law do before the changes to be made by this instrument?

7.11 The retained Specialisation BER exempts from the Chapter I prohibition categories of specialisation agreements which are assumed to confer sufficient benefits to outweigh any potentially anti-competitive effects. By virtue of satisfying the conditions of the

[6] https://www.gov.uk/government/consultations/retained-horizontal-block-exemption-regulations-rd-and-specialisation-agreements-consultation#:~:text=Consultation%20description,responses%20by%206%20May%202022.
[7] https://www.gov.uk/government/consultations/retained-horizontal-block-exemption-regulations-rd-and-specialisation-agreements

retained Specialisation BER, such specialisation agreements are automatically exempt from the Chapter I prohibition.

7.12 The exemption in Article 2 of the retained Specialisation BER applies to specialisation agreements (see 7.13-7.16) and is subject to conditions, including conditions regarding market share (see 7.17-7.19) and hardcore restrictions (see 7.20-7.21). The CMA is also entitled to withdraw the benefit of the retained Specialisation BER in respect of individual agreements under section 10(5)(d) of the Act.

Scope of the block exemption

7.13 The retained Specialisation BER covers unilateral specialisation agreements, reciprocal specialisation agreements and joint production agreements.

7.14 Unilateral specialisation agreements are agreements between 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). Only unilateral specialisation agreements between no more than two parties are included within the scope of the retained Specialisation BER.

7.15 Reciprocal specialisation agreements 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).

7.16 Joint production agreements are agreements between two or more parties that agree to produce certain products jointly.

Market share threshold and its application

7.17 The combined market share of the parties to the specialisation agreement must not exceed 20% (Article 3 of the retained Specialisation BER). Article 5 of the retained Specialisation BER sets out the rules applying to the application of market share threshold in Article 3.

7.18 According to Article 5(b) of the retained Specialisation BER, the market share threshold is calculated on the basis of the preceding calendar year. Article 5(d) and (e) provides for grace periods when the combined market share of parties exceeds 20%.

7.19 When the combined market share is initially below 20% and rises to 25% without exceeding it, a grace period of two consecutive calendar years applies to the agreement. However, if the combined market share rises above 25%, then a one calendar year grace period applies.

Hardcore restrictions

7.20 The specialisation agreement must not contain any hardcore restrictions (Article 4 of the retained Specialisation BER). Hardcore restrictions are provisions in agreements that are in general considered to be serious restrictions of competition. If a specialisation agreement contains a hardcore restriction, the entire agreement falls outside of the retained Specialisation BER and does not benefit from the block exemption. The agreement would not automatically be considered to be in breach of the Chapter I prohibition and could still satisfy the conditions for individual exemption in section 9 of the Act. Given the seriousness of hardcore restrictions, however, an agreement containing these restrictions would be highly likely to fall

within the Chapter I prohibition and unlikely to meet the conditions for individual exemption. Parties are, though, entitled to rebut this presumption by submitting efficiency claims to demonstrate pro-competitive efficiencies that outweigh the likely harm.

7.21 Hardcore restrictions under the retained Specialisation BER include fixing prices when selling to third parties other than immediate customers in the context of joint distribution; limiting output or sales, apart from provisions on the agreed amount of products in the context of unilateral or reciprocal specialisation agreements or the setting of the capacity and production volume in the context of a joint production agreement and the setting of sales targets in the context of joint distribution; and allocation of markets or customers.

Why is it being changed?

7.22 The retained Specialisation BER expires on 31 December 2022. The CMA has concluded, and the Secretary of State has agreed, that further provision should be made for a block exemption in respect of specialisation agreements, in the form of a block exemption order made under section 6 of the Act. While the CMA has recommended that the new provision should in large part preserve the existing exemption for specialisation agreements, it has also identified some important amendments to improve on the current legal framework and ensure that the exemption is most effective and appropriate for the UK market.

7.23 In addition, the original EU Specialisation BER was adopted with a view to market conditions across the EU and did not reflect specific characteristics of the UK market. Following EU Exit, the Secretary of State and the CMA are now able to take account of specific UK market conditions and the interests of UK customers and UK businesses.

What will it now do?

7.24 The order makes provision for a block exemption for specialisation agreements which meet the specified conditions. The conditions largely follow the existing approach in the retained Specialisation BER, with the following modifications.

Scope

7.25 As referred to in paragraph 7.14, the retained Specialisation BER covers unilateral specialisation agreements concluded between no more than two parties. The order expands the scope of the block exemption to include unilateral specialisation agreements between more than two parties. Unilateral specialisation agreements entered into by more than two parties are likely to be beneficial as they can be efficiency-enhancing and should therefore fall within the scope of the block exemption.

7.26 The proposed expansion in the scope of the block exemption in Article 3 of the SABEO should allow for more agreements to benefit. These agreements may result in products being produced more efficiently and cheaply, thus benefitting businesses and consumers.

7.27 The provisions of Article 3 of the new order also set out more clearly which agreements are in scope which will assist businesses in their application of the block exemption.

Definitions

7.28 The SABEO includes a number of key changes to the definitions in the retained Specialisation BER. For example, the concept of 'potential competitor' in Article 1 of the retained Specialisation BER has been removed as a defined term in the SABEO but instead directly integrated into the definition of a 'competing undertaking' to ensure that the block exemption becomes easier to apply. It has also been further clarified through the removal of 'a small but permanent increase in relative prices' which should simplify the assessment by companies of what may constitute a competing undertaking.

7.29 The concept 'joint' in relation to distribution is clarified to mean activities where the work involved is caried out by the parties to the specialisation agreement through a joint team, organisation or undertaking or is undertaken by a third-party distributor which is jointly appointed by parties to a specialisation agreement exclusively or non-exclusively, on the condition that the third-party distributor is not a competing undertaking, as addressed in Article 2 of the new order.

Application of the market share

7.30 The current market share threshold of 20% is retained in Article 5 of the SABEO.

7.31 The order simplifies the rules for applying thresholds through the introduction of a single grace period of two calendar years after the 20% market share threshold has been exceeded, as stipulated in Article 5(3) of the SABEO.

7.32 The SABEO also simplifies the calculation of the market share threshold. According to Article 6 of the order, the market share is to be calculated as an average of the party's market shares of the three preceding calendar years if the preceding year is not representative of the party's position on the relevant market.

Other provisions

7.33 Article 9 (as provided for by section 6(6)(c) of the Act) gives the CMA the power to cancel the block exemption in respect of a particular specialisation agreement if it determines that it is not one which is exempt from the Chapter I prohibition as a result of section 9 of the Act.

7.34 Articles 8 and 10 include further provisions introducing an obligation to provide information to the CMA in connection with the relevant specialisation agreements as well as specifying how the CMA is to give notice in writing of information requests, decisions or proposals made under the SABEO. These powers are necessary to allow the CMA to examine specialisation agreements that meet the conditions of the block exemption but that the CMA believes may or may not meet the criteria for exemption under section 9 of the Act.

7.35 Article 12 makes a consequential amendment to the retained Technology Transfer Block Exemption Regulation to replace a reference to the retained Specialisation BER with a reference to the SABEO.

Transitional provision

7.36 The SABEO will provide for a transitional period to allow businesses that wish to take advantage of the 'safe harbour' to review and (if necessary) revise their existing agreements. Existing agreements that meet the conditions of the retained Specialisation BER will be treated as an agreement that benefits from the SABEO

until the end of 31 December 2024. Agreements entered into after the retained Specialisation BER's expiry will need to meet the conditions of the new block exemption (the SABEO) in order to benefit from the exemption.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

9. Consolidation

9.1 This is the first order made under the powers in section 6 to the Act that deals with specialisation agreements. It replaces a piece of retained EU law that expires on 31 December 2022. As a result, the need for consolidation does not arise.

10. Consultation outcome

10.1 The CMA consulted on its proposed recommendation to the Secretary of State regarding the retained Specialisation BER along with the retained R&D BER in 2022 which ran until 6 May 2022. In addition to engaging with stakeholders proactively, the CMA received 3 written submissions primarily from the legal sector who agreed that the CMA should recommend to the Secretary of State that he should make a block exemption order to replace the retained Specialisation BER, adding to the broad range of evidence outlined in paragraph 7.4.

10.2 The CMA subsequently published the outcome of the consultation, its final recommendation to the Secretary of State and the consultation responses in full which can be viewed at: https://www.gov.uk/government/consultations/retained-horizontal-block-exemption-regulations-rd-and-specialisation-agreements-consultation.

10.3 The Department for Business, Energy and Industrial Strategy subsequently consulted on a draft version of the order from 20 September to 7 October 2022 to make sure it delivers the policy correctly and effectively. One written response was received from a competition lawyer, in addition to further engagement with stakeholders and the CMA. Stakeholders welcomed the introduction of the SABEO and were content that the order achieved the intended outcome but proposed small improvements to the drafting. The SABEO was accordingly refined and improved. More information about the consultation, including the Government's response, can be found at: https://www.gov.uk/government/consultations/draft-specialisation-and-research-and-development-agreements-block-exemption-orders-2022.

11. Guidance

11.1 The CMA will publish detailed guidance on the application of the order, the CMA Horizontal Agreements Guidance. The guidance will be available at http://www.gov.uk/cma or by writing to the CMA, The Cabot, 25 Cabot Square, London E14 4QZ.

12. Impact

12.1 The impact on business, charities or voluntary bodies of the order is limited relative to the baseline option of renewing the block exemption unchanged and preserving the status quo. The changes outlined above would introduce some limited benefits to business and no, or no significant, costs to business.

12.2 The main benefit will result from the change to expand the scope of the block exemption to include unilateral specialisation agreements concluded between more than two parties, enabling more parties who enter these agreements to benefit from the block exemption, allowing parties to potentially operate more efficiently. They would also benefit from additional legal certainty and an administrative saving from no longer having to self-assess such agreements to ensure that they are overall beneficial and that they meet the criteria for an individual exemption. The order could also enable more agreements to benefit from the block exemption by simplifying the application of the market share threshold and simplifying the definition of certain terms used in the block exemption to make it easier for users to apply.

12.3 These additional changes will lead to a small indirect net benefit to business by simplifying access for a greater number of firms. A de minimis assessment has been produced but the small net benefit to business has not been quantified. We consider the impact to consumers to be insignificant, but positive.

12.4 There is no, or no significant, impact on the public sector.

12.5 A full Impact Assessment has not been prepared for this instrument. Considering the conclusions above, the total direct business impact is less than the ±£5 million Equivalent Annual Net Direct Cost to Business threshold. Therefore, a full Impact Assessment is not required under the Better Regulation Framework's guidance. Instead, a De Minimis Self-Certification assessment has been prepared.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 No specific action is proposed to minimise regulatory burdens on small businesses.

13.3 The basis for the final decision on what action to take to assist small businesses is that small businesses will benefit from its provisions where they engage in specialisation agreements where such agreements satisfy the criteria set out in the block exemption. Where the SABEO makes changes compared to the retained Specialisation BER, the impacts are expected to be positive and the order is likely to introduce no, or no significant, new business costs. Therefore, no new burdens on small businesses are expected. In light of this, we do not consider that further specific action is required to minimise regulatory burdens on small businesses.

14. Monitoring & review

14.1 The approach to monitoring of this legislation is for the CMA to oversee its implementation. It will keep under review its application and effectiveness in achieving its policy and operational objectives.

14.2 The SABEO will expire on 31 December 2035. This provides an opportunity for the CMA to conduct a review of the regime, taking account of market developments and any representations about it which are made to the CMA. The CMA is then expected to make a recommendation to the Secretary of State about whether and how to replace the block exemption order when it expires.

14.3 A statutory review clause is included in the instrument. A review every five years is required and will provide opportunities to consider earlier changes.

15. Contact

15.1 Felix Lee at the Department for Business, Energy and Industrial Strategy Telephone: 0207 215 2139 or email: felix.lee2@beis.gov.uk can be contacted with any queries regarding the instrument.

15.2 Alesha De-Freitas, Deputy Director for Competition Policy, at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.

15.3 Parliamentary Under Secretary of State Kevin Hollinrake at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.