HERBERT SMITH FREEHILLS

COMPETITION CONSIDERATIONS IN “OPEN INNOVATION”

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Legal Briefings – By **Joel Rheuben**

The ways in which businesses innovate are becoming increasingly complex and diverse. Technology is connecting individuals and businesses across sectors, and it is easier than ever before for anyone, anywhere to innovate.

One of these trends is towards “open innovation”, by which businesses are looking beyond traditional research and development functions, and instead leveraging new technologies to gather ideas from a range of sources both inside and outside their organisations. This might involve incentivising employees across all departments to contribute ideas, or opening public contests or “hackathons”.

There is also a trend towards industry-wide participation in the creation of common platforms: for example, the energy sector is exploring the use of “blockchain” technology for contributions to national grids.

Such arrangements give rise to a host of legal issues, most notably in relation to ownership of IP rights, handling sensitive data, and managing risk. While efforts to improve innovation are generally viewed favourably by competition authorities, businesses that collaborate with their competitors should also ensure that such collaboration remains compliant with applicable competition laws.

- General principles
- Data sharing agreements
- Exemptions from competition law

GENERAL PRINCIPLES

Competition authorities recognise innovation as a parameter of competition just as much as traditional parameters of competition such as price and product quality. Accordingly, as a basic principle, companies are encouraged to innovate in competition with other players in the market. This has become particularly relevant for innovation-driven industries, such as the pharmaceutical and digital sectors, where research and development (R&D) activities are an important driver of competition.

The European Commission in particular has focused heavily on innovation in merger review in recent years, including requiring the divestment of R&D assets in several transactions in the chemicals sector, and looking further back into the product pipelines of merging pharma companies. Innovation was also a key theme of the Commission's recent report on "Competition policy for the digital era".

"Open innovation" is likely to be viewed positively by competition authorities, as it may ultimately result in market efficiencies and benefit consumers. However, it can also conflict with the principle that companies should compete to innovate, in particular, when that collaboration involves competitors. Businesses involved in innovative collaboration with a competitor should be mindful of the prohibition on anti-competitive agreements or concerted practices.

This means, for example, that the collaboration should not lead to a loss of competition on prices, output, product quality, or product variety, nor should it give rise to any unlawful sharing of commercially sensitive information between competitors. Participants in the collaboration should also remain free to continue to innovate more generally on their own or in parallel partnerships.

To mitigate the risks of infringing competition law, before engaging in any collaboration with an actual or potential competitor, some safeguards should be implemented. Depending on the specific circumstances, these could include, for example: identifying delineated teams involved in the project; limiting any information exchange on a need-to-know basis; ensuring that the scope of the co-operation arrangement does not go beyond what is necessary for the innovative purpose; and providing guidance and training to the teams involved to assist in achieving these aims.

In addition, since not every project is ultimately taken forward, it is important to agree the parties' rights and obligations in the event that the project is abandoned, for example, destroying confidential information received from the other party, and considering the parties' rights to develop projects on their own. As regards the latter point, any exclusivity or non-compete obligations should be kept to the minimum necessary for the success of the collaboration, and should be reviewed closely.

DATA SHARING AGREEMENTS

Data sharing agreements in particular should be monitored from a competition law perspective. For example, in some circumstances, exclusive licensing arrangements can raise competition concerns where they limit third-party access to a specific product or service, and give parties with access to that product or service a competitive advantage.

In the context of any proposed collaboration, it is also important for companies to monitor their market power in respect of the data that they have access to, or what value they can extract from those data. For example, a company could be viewed as having a dominant position on a relevant market where it has specific systems capable of extracting additional value from the data, even if those data are shared.

Competition regulators are increasingly looking at competitive dynamics in the digital sector and are scrutinising the close link between market power, data collection and characteristics of data being collected.

EXEMPTIONS FROM COMPETITION LAW

Where open innovation could lead to a restriction of competition law, some general exemptions may allow, in certain circumstances, innovation-related agreements not to be found in breach. For example, in the case of the EU, there are "block exemption" regulations that automatically exempt specific categories of agreements from infringing competition law where certain criteria are met. R&D agreements may fall within the so-called "research and development block exemption", and specialisation agreements may fall within the "specialisation block exemption". This is on the basis that these agreements are more likely to promote technical and economic progress if the parties contribute complementary skills, assets or activities.

Competition authorities may also recognise, on a case-by-case basis, the benefits arising from certain co-operation on the basis that certain restrictions of competition can give rise to efficiencies and consumer benefits which could not be achieved without that restriction.

At each stage of a collaborative initiative, it is important to determine a legal framework which takes potential competition law challenges into account. This should allow stakeholders to define the red lines, and to structure their projects to ensure more legal certainty and greater protection.

This article has been adapted from a longer HSF article that originally appeared in PLC Magazine (available here). For more details on the legal issues surrounding open innovation, including IP and data-related aspects, please see the HSF website.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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