

## **Guidelines on Certain Subcontracting Agreements between Non-competitors**

**(1)** Subcontracting agreements which can be concluded between undertakings of different sizes and which enable work distribution between those undertakings contribute to the development of, particularly, small and medium sized undertakings. Thanks to the work distribution achieved through such agreements, small and medium sized undertakings become capable of improving themselves as an outcome of their production using the technology and equipment provided by big companies. During their production using the aforementioned technologies, those undertakings often find the opportunity to develop these technologies. Thus, on one hand, use and creation of new technologies are encouraged thanks to the said agreements, and on the other hand, thanks to the work distribution achieved, specialization of firms is facilitated and lowering of costs becomes possible through increased efficiency.

**(2)** The Competition Board (the Board), during the period since it became operational in 1997, has taken a series of decisions setting out its approach concerning the assessment of subcontracting agreements, which are defined below, under the Act on the Protection of Competition (Act No. 4054) dated 07/12/1994 and numbered 4054. The purpose of these Guidelines is to inform those who are concerned, on the approach of the Board in relation to the application of Article 4 of the Act No. 4054 to subcontracting agreements, taking into account its past decisions and the legislation of reference. While subcontracting agreements provide opportunities for the development of, particularly, small and medium sized undertakings, it should be stated that the principles set by this Communiqué apply irrespective of the size of the undertakings which are party to the aforementioned agreements.

**(3)** For the purposes of these Guidelines, subcontracting agreements refer to agreements under which an undertaking (subcontractor) commits to produce goods, provide services or perform work on behalf of or for another undertaking (the contractor) in line with that undertaking's instructions. In this context, whether the production of goods, provision of services or performance of work under the said agreement is upon the request of a third party or not does not matter. Subcontracting agreements under these Guidelines are of vertical nature.

**(4)** Under certain subcontracting agreements, the subcontractor may have to make use of the technology or equipment to be provided by the contractor, to be able to fulfill the requirements of the agreement. Generally, under these circumstances, to protect the economic value of the said technology and equipment, the contractor imposes the condition that they may be used by the subcontractor solely for the purposes of the agreement. In such cases, the uncertainty arises as to whether the subcontracting agreements are caught by Article 4 of the Act No. 4054 or not. In order to rule out such uncertainties, it would be appropriate to take account of the explanations below which have been made also in consideration of the purposes of subcontracting agreements.

**(5)** The prohibition under Article 4 of the Act No. 4054 shall not be applicable to the provisions contained under subcontracting agreements whereby:

- the technology or equipment provided by the contractor may not be used except for the purposes of the subcontracting agreement,

- the technology or equipment provided by the contractor may not be made available to third parties,

- goods produced, services provided or work performed using such technology or equipment may be supplied only to the contractor or to a person to be indicated by the contractor, or may be carried out only on behalf of the contractor,

provided that such technology or equipment is necessary for the subcontractor to produce the goods, provide the services or perform the work in accordance with the contractor's instructions and under reasonable conditions. Prohibition under Article 4 of the Act No. 4054 shall not be applicable in so far as the said technology or equipment is necessary. Necessity of the technology or equipment provided by the contractor means that, in the absence of the subcontracting agreement, the subcontractor would be unable to produce the goods, provide the services or perform the work concerned by the contract, as an independent provider.

**(6)** The condition that the technology or equipment be necessary will be deemed satisfied, and thus the provisions contained in the previous paragraph will not be considered to fall under the prohibition under Article 4 of the Act No. 4054 where it is necessary for the subcontractor to make use of:

- industrial property rights owned by or at the disposal of the contractor in the form of patents, utility models, designs protected in a registered or an unregistered manner or other rights, or

- secret knowledge or know-how owned by or at the disposal of the contractor, or of

- studies, plans or documents accompanying the information given which have been prepared by or for the contractor, or

- dies, patterns or equipment, tools and accessory equipment that are distinctively the contractor's,

which, even though not covered by industrial property rights nor containing any element of secrecy, allow for the production of goods that differ in form, function or composition from other goods produced or supplied on the market.

Provisions included in subcontracting agreements for the subcontractor to obtain inputs such as raw material to produce goods or to purchase substances to be used in the provision of services or performance of work, in line with the instructions of the contractor, from the contractor itself or a person to be indicated by the contractor, are not restrictive of competition provided that they are necessary for the said goods, services or work to be carried out with a defined feature, standard or quality. The contractor may also demand that subcontracting agreements include provisions about objectively reasonable safeguards to ensure that the goods to be produced, services to be provided or work to be performed has a defined standard or quality.

**(7)** The restrictions under paragraph 5 shall not be justifiable where the subcontractor has at its disposal the technology and equipment needed to produce the goods, provide the services or perform the work, or where it becomes clear that it could obtain those from other resources under reasonable conditions. This is generally the case when the contractor provides no information other than the general information merely describing the work to be performed. Under such circumstances, these restrictions may restrain the subcontractor from developing its own business in areas related to the agreement.

**(8)** It has been seen that under subcontracting agreements, the subcontracting firm is imposed certain restrictions in relation to the technology provided by the contractor. In considering whether these restrictions are caught by Article 4 of the Act No. 4054, it would be appropriate to take account of the explanations below:

- imposing an obligation on either one of the parties, not to disclose knowledge of secret nature provided by the other party during the negotiation process of the agreement or performance of the agreement, unless they become public knowledge, is a legitimate provision for protecting the value of the said information and shall not bring the relevant subcontracting agreement under Article 4 of the Act No. 4054. Among such knowledge of secret nature are production processes first and foremost, as well as other elements which may be characterized as know-how, whereas it is not possible to give a restrictive list. What is important is that the knowledge transferred be confidential – in other words, not known or easily accessible by everyone. For instance, where the knowledge transferred under the subcontracting agreement is covered by the definition of know-how contained in the Block Exemption Communiqué on Vertical Agreements No. 2002/2, adopted by the Competition Board and published on the Official Gazette dated 14/07/2007 and numbered 24815, imposing a non-disclosure obligation on the party to whom the know-how is transferred shall be deemed justifiable.

- imposing an obligation on the subcontractor not to make use of the manufacturing processes of secret nature, or of other elements which may be characterized as know-how, transferred to itself during the currency of the agreement, even after the expiry of the agreement, unless they have become public

knowledge is aimed at protecting that knowledge and preventing unjust utilization of that knowledge, therefore such a restriction will not be considered in violation of Article 4 of the Act No. 4054.

- the subcontractor may be imposed an obligation to pass on to the contractor the technical improvements it has made during the currency of the agreements on a non-exclusive basis. Without such an obligation, the contractor may refuse to make the subcontracting agreement whereby it is to pass on its technology. Owing to the obligation to pass on the technical improvements on a non-exclusive basis, the contractor will be more willing to make a subcontracting agreement since it will be able to obtain the improvements relating to its technology, and the subcontractor, provided that it does not disclose it, will not only be able to make use of the knowledge of secret nature passed on to itself, it will also be able to make it available to somebody else other than the contractor. Furthermore, having these possibilities will be reflected positively on the subcontractor's incentive to make improvements on the technology passed on to it.

Similarly, where the subcontractor makes a patentable invention during the currency of the agreement, while using the contractor's technology, imposing an obligation to grant non-exclusive licenses to the contractor in respect of that invention for the term of the patent held by the contractor, shall not fall under the prohibition of Article 4 of the Act No. 4054. While the invention of the subcontractor may concern the improvements on the contractor's invention, it may also concern the new applications of the contractor's invention.

However, where it is not possible for the improvements and inventions made by the subcontractor during the currency of the agreement to be used independently from the know-how or patents passed on by the contractor, the obligation imposed on the subcontractor to pass on the improvements or to grant licenses in respect of the invention may be in the form of exclusive licenses.

However, an obligation relating to the results which the subcontractor have attained through its own research and development activities and which may be used

independently, may render the said subcontracting agreement restrictive of competition under Article 4 of the Act No. 4054.

**(9)** Where the subcontractor is authorized by the subcontracting agreement to use a specific trademark, trade name or get up, outlook, or package, the contractor may restrict the use of these elements solely to goods, services or works which are covered by the agreement.

**(10)** Where a vertically characterized subcontracting agreement falls under Article 4 of the Act No. 4054, it shall be able to qualify for exemption provided that it fulfills the requirements under Article 5 of the said Act. As for whether these agreements fall under the Communiqué No. 2002/2, it would be appropriate to refer to the explanations under the said Communiqué, especially Article 2 titled "Scope", paragraph two, and under the Guidelines on the Explanation of Block Exemption Communiqué No. 2002/2 regarding Vertical Agreements, section titled "1.2. Vertical Agreements Involving the Use of Intellectual Rights." To summarize the said explanations very briefly, it is stated that where the vertical agreements involving the transfer of intellectual property rights to the buyer, or the use of them by the buyer fulfill the other specified conditions, they may benefit from the Communiqué No. 2002/2; however, under subcontracting agreements, the know-how required for production is generally transferred by the contractor, who is in the position of buyer, to the subcontractor, who carries out the production and is in the position of provider, therefore such agreements cannot qualify for the block exemption conferred by the said Communiqué. However, despite not explicitly provided for under the Communiqué No. 2002/2 and the Guidelines published in relation to that Communiqué, the subcontracting agreement concerned may be able to qualify for the block exemption provided by the said Communiqué where the contractor, who is in the position of buyer, passes on to the subcontractor, who is in the position of provider, the detailed specifications whereby the products or the service to be provided is described.