THE INSTITUTE OF PATENT AND TRADE MARK ATTORNEYS OF AUSTRALIA

Via Email Only:
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26 July 2019

Mr Parnos Munyard
Advocacy and Law Reform
Australian Competition & Consumer Commission
23 Marcus Clarke Street
Canberra ACT 2601

Dear Mr Munyard

RE: Draft guidelines on the repeal of Subsection 51(3) of the Competition and Consumer Act 2010 (Cth)

We refer to the draft guidelines on the repeal of subsection 51(3) of the *Competition and Consumer Act 2010* (Cth) (CCA) published by the ACCC for public consultation.

Introduction

The Institute of Patent and Trade Mark Attorneys of Australia ("IPTA") welcomes the opportunity to comment on the ACCC's draft *Guidelines on the repeal of subsection 51(3) of the Competition and Consumer Act 2019 (Cth)* (the "Act").

IPTA is the representative body for Australian patent and trade mark attorneys. IPTA has over 900 members, representing a broad cross section of Australian and international owners (licensors, assignors) and users (licensees and assignees) of intellectual property ("IP") rights, comprising patents, registered designs, plant breeder's rights and trade mark rights, including certification trade marks.

Executive Summary

IPTA understands that the Guidelines set out the Commission's current understanding and interpretation of the law, following the repeal of subsection 51(3) of the Act. The Commission intends for the Guidelines to provide general guidance on its approach to the application of the anti-competitive conduct prohibitions in Part IV of the Act to IP rights.

From a practical perspective, IPTA's members and their clients are looking to the Guidelines for:

- clear direction as to the specific types of IP transactions which will contravene the relevant sections of the Act;

- comfort that the Commission's approach won't stifle socially valuable practices (such as the licensing of IP); and

- assurance that the Guidelines won't impose an onerous compliance burden.

IPTA believes that the Guidelines as currently drafted, do not meet these expectations. They do not provide sufficient clarity or analysis for IP owners and users to respond to the potential impacts and risks of the repeal of s51(3). These concerns are compounded by the fact that compliance with the Guidelines does not equate to a safe harbour, and penalties for contravention are severe.

In the absence of sufficient clarity, the Guidelines are unlikely to mitigate compliance costs relating to the review and negotiation of IP arrangements. In fact, they are more likely to result in significant additional time and cost to parties involved in relevant IP transactions, as the parties seek complex analysis and advice on their compliance position.

IPTA has three principle areas of concern with the Guidelines:

- application of *per se* cartel provisions to IP licences;
- lack of clarity as to how the competition test will be applied to IP arrangements, and the types of behaviour in an IP context which will likely result in a "substantial lessening of competition"; and
- the Commission's narrow focus on the operation and effect of IP rights.

The proposed application of *per* se cartel provisions to IP licences is particularly concerning, and IPTA believes is likely to have a chilling effect on those transactions in Australia. In the medium-to long-term, this may result in Australia being seen as a less desirable place to seek to innovate, invest and conduct business.

IPTA does not support the application of *per se* cartel conduct provisions to IP arrangements, and submits that the Commission should issue a class exemption in that context.

IPTA would also like the Commission to provide more detailed analysis and specific examples of how the competition test is to be applied to IP arrangements.

Introductory Matters and General Principles

IPTA believes that the Commission's focus on the effect of IP rights in paragraphs 2.2 – 2.5 is somewhat narrow and fails to take into account the careful balance which needs to be struck between minimising anti-competitive behaviours, enhancing consumer welfare and promoting innovation.[1] This is particularly relevant in the context of the cartel provisions.

IPTA submits that the analysis required when assessing an IP transaction is different to that required for other transactions; for example:

- an IP licence is essentially a right to exploit the relevant IP within its scope and the licence terms, rather than a straight supply of goods or services; and

[1] As an example of comprehensive guidelines which deal with the interplay of intellectual property arrangements and competition law, IPTA refers to the July 1991 paper of the then Trade Practices Commission - "The Application of the Trade Practices Act to Intellectual Property". That publication dealt with a broad range of examples and provides more detailed analysis than the current draft Guidelines.

- an IP licence *enhances* competition, by allowing a licensee to do something it would not otherwise be permitted to do, without infringing the relevant IP right. This has implications both for the competition condition and the purpose condition which are required elements for cartel conduct in s45AD.

While the Commission notes that the '[*l*]*icensing or assignment of intellectual property rights usually encourages competition*' (paragraph 2.4), its subsequent assessment of IP arrangements in the context of territorial restraints and output restrictions seem inconsistent with that position.

IPTA believes that the Guidelines would benefit from the Commission's analysis of specific intellectual property transactions and examples, so IP owners and users can better understand the implications and risks of proposed IP arrangements in the context of Part IV of the Act.

Cartel Conduct

Consistent with the findings of key Government enquiries over a number of years[2], IPTA does not support the application of *per se* cartel conduct provisions to IP arrangements, and submits that the Commission should issue a class exemption in that context.

Whether provisions in arrangements constitute **cartel conduct** and are therefore absolutely prohibited (subject to any applicable exemption) is a critical issue for IP owners and users.

The Guidelines provide very little assistance as to the analysis to be undertaken under s45AD. For instance, there is little or no direction given in the Guidelines as to the assessment required to determine:

a. who are the relevant **competitors** for the purposes of the section;

b. **when** that determination should be made; and

c. how "**purpose**" is to be determined.

IPTA is concerned that in the absence of clear guidance on these issues, the removal of s51(3) is likely to have a chilling effect on intellectual property transactions in Australia which in the medium-to long-term, may result in Australia being seen as a less desirable place to deal with (particularly licence) IP.

a. <u>Who are the relevant competitors for the purposes of s45AD?</u>

The Act essentially requires that at least two of the parties to an arrangement are, or would be likely to be, **in competition with each other in relation to certain goods or services**.

The relevant goods or services are "those" which are the subject of the purpose/effect condition, or the purpose condition[3].

[2]Including the Productivity Commission, *Inquiry into Australia's IP Arrangements* (Final Report, 23 September 2016); the Harper Competition Policy Review (Final Report, 31 March 2015); and the Ergas Intellectual Property and Competition Review (Final Report, September 2000).
[3] ss 45AD(4)(c)-(k) of the Act.

In the case of the **purpose/effect condition** relevant to a pricing restriction, "those" goods or services are those which are or are likely to be supplied, acquired or resupplied by parties to the arrangement or their customers and in respect of which a provision of the arrangement provides for the controlling of the price (or any element of price).

In the case of the **purpose condition**, the relevant goods or services for the purposes of section:

- 45AD(3)(a) are "those" goods or services which are, or are likely to be produced, supplied or acquired by one or more parties to the arrangement and in respect of which there is a provision preventing, restricting or limiting that activity; and

- 45AD(3)(b) are "those" goods or services supplied or acquired by one or more parties and in respect of which an allocation of a supplier, customer or territory has occurred.

In each case, the result of ss 45AD(4)(c)-(k) is that the parties are required to be **competitors**, or **likely competitors** in relation to what might be loosely termed the "licensed" goods or services.

In 2017 Justice Beach considered the meaning of "in competition with each other" in a non-IP context[4], and noted that:

> "In respect of…s44ZZRD(4)[5], it is not necessary to identify a precise market in respect of which the parties to the relevant arrangement or understanding were in competition or competitive or that such competition was in respect of all customers or sales. What is required is that any two or more of the parties compete to supply the goods or services the subject of the restraint…" (paragraph 488).

His Honour went on to discuss what was required to show that parties were competitors in relation to the acquisition or supply of goods or services, and concluded on the facts that the parties were actual or likely competitors in relation to the supply of electrical cable. His Honour's analysis is clearly correct in the case of goods where there are no relevant IP rights which serve to differentiate the particular goods referred to in (for present purposes) section 45AD(3).

The *Olex* case was concerned with an alleged limitation in respect of electrical cable supplied by all of the companies alleged to be engaging in cartel conduct. No intellectual property rights were involved.

IPTA submits that the analysis required in a situation where an IP right subsists in respect of the goods and services to which the purpose condition applies, is distinguishable from the analysis required where no IP right subsists.

In the IP scenario, the parties by definition would not be "in competition with each other in relation to" the licensed goods or services. The licensor is granting the licensee a right to engage in activities which would otherwise constitute an infringement of the licensor's IP. It follows that those parties are not, are not likely to be, and but for the licence would not be, in competition with each other in relation to the licensed goods or services prior to the licence being granted. In this scenario, the competition condition in section 45AD(4)

[4] *Australian Competition and Consumer Commission v Olex Pty Ltd [2017] FCA 222.* The matter concerned the supply and resupply of electrical cable which was not the subject of any intellectual property rights.

[5] s44ZZRD(4) of the Act being the equivalent of what is now s45AD(4) of the Act.

would not be satisfied. This would be the case in respect of all IP licences, including those containing territorial or output restraints.

IPTA submits that the appropriate analysis - in a situation where an IP right subsists in respect of the goods or services to which the purpose condition must apply – is that the parties <u>would not be</u> "in competition with each other in relation to" those licensed goods or services.

b. <u>When should competition be determined?</u>

IPTA submits that a once and for all determination of whether a cartel provision exists should be made **at the time the parties enter into the arrangement** containing it. This results in a **once and for all determination of who are competitors being made at the same time**.

The reasons for this position are:

- Section 45AD defines what a cartel provision is, and section 45AG makes it an offence to give effect to a cartel provision in a contract, arrangement or understanding irrespective of whether or not that contract, arrangement or understanding was arrived at before or after the commencement of the section. Section 45AG(4) would not have been necessary if the legislature intended that an assessment of whether a provision constituted a cartel provision was to be made from time to time. The presence of section 45AG(4) alone makes it clear that the determination of a cartel provision is to be made **at the time the contract, arrangement or understanding was entered into**.

- Section 45AG requires there to be a contract, arrangement or understanding containing a cartel provision - suggesting a **static arrangement**.

- The Act defines a cartel provision as one having a purpose/effect (in the case of pricing restraints) or a specific purpose (in respect of other restraints). In the context of s4D of the *Trade Practices Act 1974* (Cth) - and, by extension, section 45AD of the Act - the Courts have made it clear that the term "purpose" is to be determined subjectively. However, as Gleeson CJ said in *News Limited v South Sydney District Rugby League Football Club Ltd* [2003] HCA 45:

  > "…The purpose of conduct is the end sought to be accomplished by the conduct. … In the context of Competition Law, it is necessary to identify purpose by describing what is sought to be achieved by reference to the bodies relevant in market terms. …The manifest effect of the provision in an Agreement, in a given case, may be the clearest intention of its purpose. In other cases, it may be difficult, or even impossible, to determine the purpose (of a kind relevant to the operation of Act) of a provision in a written contract merely by reading the document." (paragraph 18)

  That being the case, the purpose does not change over time and therefore **fixes** that determination at the time the arrangement is entered into.

- The section involves **criminal liability** and therefore is to be construed strictly.

- From a **commercial perspective** it would be impractical for businesses to be placed in the position of continually having to assess whether and how circumstances may have changed, and whether what was not subject to a cartel yesterday has potentially become subject to a cartel provision today.

- In the case of the **common law doctrine of restraint of trade**, the time for assessing the reasonableness of the restraint is the date the restraint was imposed.[6]

c. *Purpose*

In the draft Guidelines, the Commission concludes that territorial restraints and output restrictions are likely to be prohibited cartel conduct, but does so without any meaningful analysis of those provisions in an intellectual property context.

IPTA submits that if parties to an intellectual property arrangement are:

- **not in competition with each other**, in respect of the licensed goods and services before an arrangement is entered into; and

- it is **not relevant that they might become competitors**, in relation to those goods and services because they entered into a licence,

then the Commission's conclusion regarding territorial restraints, price restrictions and output restrictions in an intellectual property context are not well founded.

As a corollary to this, IPTA submits that a **licence** granted under an intellectual property right - where the licence is limited in scope - is in fact ***pro-competitive*** because it allows for conduct which, absent the licence, could not otherwise be engaged in. It follows that for the purposes of s45AD(3)(a), such arrangements by themselves cannot prevent, restrict or limit conduct which is otherwise permitted and therefore cannot have the purpose of doing so.

The analysis for an IP arrangement is therefore different to that for a non-IP arrangement, which is not well reflected in the Guidelines.

Exemption of IP licensing provisions from cartel conduct

IPTA is strongly of the view (as detailed in the Harper Competition Policy Review and the Productivity Commission's Inquiry into Australia's IP Arrangements) that **IP licensing provisions should be exempt from the cartel conduct prohibition**, and should only be prohibited if they have the purpose or likely effect of substantially lessening competition.

> *"That treatment of intellectual property licences is consistent with competition laws throughout the world. It reflects an economic view that intellectual property licences, even granted on a restricted basis, are generally supply enhancing and therefore pro-competitive."*[7]

As an indication of the seriousness of the problems caused by the removal of subsection 51(3) without the inclusion of an IP exemption (or a vertical restraints exemption), IPTA refers to the commercial practise of **franchising**.

Almost all franchise arrangements involve the licensing of one or more registered trade marks and the vast majority include geographic and other limitations. If the view taken by IPTA is not correct, and by virtue of

[6] See Gummow J in *Adamson v New South Wales Rugby League Ltd* (1991) 31 FCR 242.
[7] Justice O'Brien, "*The repeal of s51(3) of the Competition and Consumer Act 2010 (Cth)*" 4, at https://www.fedcourt.gov.au/digital-law-library/judges-speeches/justice-obryan/obryan-j-20190410.

sections 45AD(4)(a) and (b) and 45AB[8], franchisors which have company owned outlets are deemed to be competitors with their franchisees, the commercial consequences would be significant.

In a survey conducted by Griffith University[9], 63% of franchisor respondents indicated that they had company owned franchises in operation. The survey estimates there are 1,160 franchises operating in Australia through 79,000 operating franchise units, turning over a total amount of $146 billion. In that context, the potential impact on the franchising sector of compliance with, and potential breach of, the cartel provisions is likely to be severe.

Class Exemptions

IPTA submits that the Commission should introduce a class exemption under Division 3 of Part VII of the Act in respect of IP licences and assignments as a matter of urgency.

Introduction of such an exemption is consistent with recommendations by the Ergas Committee, the Harper Review and the Productivity Commission. Indeed, when the legislation to repeal section 51(3) was first introduced it included a vertical restraints exemption. The failure to ultimately include such an exemption in the amending legislation has left IP arrangements (and therefore IP owners and users) with a high degree of uncertainty - this is likely to have a chilling effect on IP transactions in Australia.

IPTA accepts that the class exemption should only apply to cartel conduct and that intellectual property arrangements should otherwise be subject to the competition test.

Commission Example - Market Sharing

The scenario posited in this example is of interest to IP owners, who are particularly keen not to prolong "*lengthy and expensive litigation*"[10]. IPTA notes however the Commission's observation that the scenario would *not* have fallen within s51(3) prior to its repeal, which makes it a difficult example for comparative purposes.

IPTA also notes that a more likely commercial scenario would be a cross licence between the parties, and is interested to understand how that scenario would be considered.

Application of the competition test

IP owners and users would particularly benefit from greater clarity and specificity in the Guidelines as to the circumstances in which an IP licence may be regarded as having the purpose, effect or likely effect of substantially lessening competition.

In particular, IPTA would appreciate the Commission's guidance on application of the competition test to IP licences, which as discussed above, are more likely to have a pro-competitive impact than an anti-competitive one.

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[8] Definition of "party".
[9] Griffith University, "*Franchising Australia 2016*" at https://s3-ap-southeast-2.amazonaws.com/wh1.thewebconsole.com/wh/1401/images/Franchising-report-2016.pdf.

[10] ACCC, *Guidelines on the repeal of subsection 51(3) of the Competition and Consumer Act 2010* (Cth), Example 1.

Taking **output restrictions** contained in an IP licence as an example - without the licence grant, a licensee would not have any production or capacity to supply. In that situation, it is difficult to argue that the purpose of the provision is to prevent, restrict or limit the production of goods or the capacity to supply services. The dominant purpose of the provision is to permit the production of goods or the supply of services, albeit, to a limited degree.

Even where there is an output restriction in an IP licence, there is more (rather than less) production or capacity possible than would be the case without the licence.

Commission Example – Grant-back

IPTA would appreciate greater clarity from the Commission on how this example would **substantially lessen competition**. In particular, would the outcome be different if Firm A agrees to licence back the improvements to Firms B and C *and any other party*?

From a commercial perspective, 'splintering' an innovation (e.g. where part ownership of an innovation resides in different entities), or dampening incentives to continuously improve an innovation (for example software) is likely to hamper socially valuable innovation.

IPTA would be happy to answer any questions you may have in relation to our submission.

Yours sincerely,

Michael J Caine
President
Institute of Patent and Trade Mark Attorneys of Australia