

**LESANZ Submission to the ACCC concerning the draft** ***Guidelines on the repeal of sub-section 51(3) of the Competition and Consumer Act 2010 (Cth)***

***29 July 2019***

The Licensing Executives Society of Australia and New Zealand, Inc. (**LESANZ**) thanks the ACCC for the opportunity to provide comments on the draft *Guidelines on the repeal of sub-section 51(3) of the Competition and Consumer Act 2010 (Cth) (June 2019)* (**draft Guidelines**).

After reviewing the draft Guidelines and consulting with leading practitioners and various members from the research and university sectors, LESANZ is concerned that the draft Guidelines may have an unnecessary “chilling effect” on the commercialisation of science and technology in Australia, at a time when it is clearly recognised that Australia needs to significantly improve in this area.

LESANZ is committed to continuing to foster its relationship with the ACCC on behalf of its membership and hopes that our submission will be carefully considered by the ACCC. LESANZ is also keen to meet with the ACCC to discuss these comments.

# **About LESANZ**

## LESANZ is the peak body in Australia and New Zealand for innovation and commercialisation professionals. Its focus is to create an environment for effective and successful commercialisation through the open exchange of ideas, the identification of best practice and the encouragement of innovation through networking and education in all areas of intellectual property and knowledge transfer. With approximately 350 members representing all steps along the commercialisation pathway, and as a member society of Licensing Executives Society International (comprising more than 8,000 members), LESANZ is uniquely placed to provide deep insights into the commercialisation of intellectual property.

## More information about LESANZ can be found at [www.lesanz.org.au](http://www.lesanz.org.au) and about our parent international body at [www.lesi.org](http://www.lesi.org).

# **LESANZ’s overall concerns**

## LESANZ’s primary concerns with the draft Guidelines are that they do not sufficiently cover the intersection of the commercialisation of intellectual property and competition law and many of the examples and issues are not sufficiently developed to be instructive. In LESANZ’s view:

### to provide a better balance, more emphasis needs to be placed in the Guidelines on the pro-competitive aspects of the commercialisation of intellectual property;

### more guidance needs to be given on the assessment of whether certain conduct is likely to have the purpose or effect of substantially lessening competition;

### many of the examples need further development and would benefit from greater nuance and understanding of licensing practices;

### more guidance needs to be given on competitors (given the long and enduring nature of many intellectual property licences) and on output and territory restrictions under the cartel laws; and

### critically, detailed guidance is needed on the exclusive dealing exception to the cartel laws.

## The draft Guidelines were foreshadowed by the ACCC on 9 April 2019 as “guidelines on the application of Part IV of the [*Competition and Consumer Act 2010* (Cth) (**CCA**)] to intellectual property”. Presently, the draft Guidelines place too much emphasis on whether or not section 51(3) applied when that question will be irrelevant after 13 September 2019. In LESANZ’s view, there is not enough detail on the general application of Part IV of the CCA to intellectual property commercialisation.

## LESANZ considers that, without further elaboration, the draft Guidelines have the potential to adversely impact the commercialisation of new technologies in Australia. LESANZ is aware of instances already where the draft Guidelines have been cited during licence negotiations in a way that is causing confusion amongst start-ups and research, university and commercialisation bodies. Due to the speculative nature of most early stage commercialisation deals, they need to be negotiated efficiently with minimal legal fees and usually without the input of specialist competition lawyers. In that environment, the draft Guidelines will be heavily relied on and accordingly they need to provide the full context and elaboration.

# **More context about the effect on competition**

## To provide more balance, the Guidelines should place greater emphasis on the pro-competitive role of the commercialisation of intellectual property. While some general principles are included in Section 2, they are not then sufficiently connected to the explanations and examples in Section 3, particularly Sections 3.8 and 3.15 (as explained below).

## As the ACCC recognises in Section 2.2 of the draft Guidelines, intellectual property rights do not necessarily confer substantial market power on the person who owns or controls those rights. In fact, LESANZ would argue that this would seldom be the case because of the availability of substitutable or competitive products and the cross-elasticity of demand between a given product and complementary goods or services.

## Further, the purpose of granting intellectual property rights is precisely and intentionally to allow and facilitate the owners of those rights to exercise a legal monopoly right and to provide a limited restriction on competition within the scope of that right, so the fact that they are used to restrict competition is not *per se* unlawful. As briefly recognised in Section 2.3 of the draft Guidelines, this is the case even if the restriction is substantial (such as where a patent is granted following the discovery of a compound that is later commercialised into a valuable pharmaceutical product). In LESANZ’s view, this needs to be better recognised throughout the explanations and examples in Section 3 and more balance shown, similar to the following statement in the US Antitrust Guidelines for the Licensing of Intellectual Property (**US Guidelines**):

## “*The Agencies will not presume that a patent, copyright, or trade secret necessarily confers market power upon its owner. Although the intellectual property right confers the power to exclude with respect to the specific product, process, or work in question, there will often be sufficient actual or potential close substitutes for such product, process, or work to prevent the exercise of market power. If an intellectual property right does confer market power, that market power does not by itself offend the antitrust laws*.”

## The draft Guidelines should recognise that in many cases it is unlikely to be anti-competitive for an intellectual property owner to allow a licensee to use intellectual property, even under tight conditions, when the intellectual property owner could otherwise lawfully prohibit any use. As an example of this point and the need for more overall context, Example 8 seems to suggest that the mere transfer of that exclusive right could be for the purpose or effect of substantially lessening competition. Instead, without more information about Firms A and B, there appears to be no impact on or lessening of competition. While the nuances of the test of substantially lessening competition may be understood by competition lawyers, LESANZ is concerned that the current framing of Example 8, and the general lack of detail about the substantial lessening of competition test as it applies to intellectual property, has the potential to inhibit the granting of exclusive licences. Such an outcome would disincentivise licensees to properly invest in the licensed intellectual property rights and reduce the likelihood of commercialisation.

## In order to achieve the ACCC’s stated goal of developing guidelines on the application of Part IV of the CCA to intellectual property, LESANZ believes that the Guidelines should include greater detail and examples of how the ACCC intends to apply the substantial lessening of competition test to intellectual property. For example:

### By definition a product or process protected by (most forms of) intellectual property rights is unique and it may be completely different to and disruptive of existing technology. In the case of cutting-edge technology, there may only be a handful of researchers in Australia working in the area. It would be helpful if the ACCC provided some guidance on how the ACCC intends to approach emerging disruptive technologies and identifying the relevant market.

### Many products and services involve use of a bundle of intellectual property rights, often owned by multiple licensors or the licensee itself. It would be helpful if the ACCC could indicate how it intends to evaluate the impact (say) of an exclusive licence of an intellectual property right where other intellectual property rights are or might also be required in order to exercise the licensed intellectual property right, or otherwise to exploit the product or service the subject of the intellectual property right.

### It would be helpful to clarify the time dimension of the test. Often patent and other intellectual property rights are licensed at a very early stage of product development, when the form of the final product may be many years away.

## More generally, the draft Guidelines appear to have been prepared with a primary focus on corporations. In LESANZ’s experience, most commercialisation agreements in Australia derive from the research sector and the research sector will be the sector which most closely relies on the Guidelines. LESANZ recommends that examples in the draft Guidelines be developed to be more relevant to the research sector with more consideration given to the different, and in some cases, non-commercial objectives of the research sector.

# **Contracts, arrangements, understandings and concerted practices**

## LESANZ is concerned that Sections 3.15 to 3.17 have the potential to hamper and confuse the negotiation of intellectual property licences.

## The draft Guidelines could be read by licensing professionals as suggesting that the relevant test for determining whether section 45 of the CCA applies is whether a purpose of the clause or restriction is ‘collateral’, as opposed to a purpose or effect of substantially lessening competition. This confusion arises because of the focus of the draft Guidelines on the removal of section 51(3), as opposed to the more general application of Part IV of the CCA and the competition test to intellectual property. LESANZ is of the view that it should be clearer, across all of Section 3.15, that any of these potential issues are still subject to a test of whether they have the purpose or effect of substantially lessening competition (for example, Example 6 makes this clearer).

## In its current form, Section 3.15 is likely to be used by licensees as support for not agreeing to provisions which would have no purpose related to or have any effect on competition, but which encompass provisions which are commonly included in intellectual property licences. For example:

### **Time restrictions** – a term which goes beyond the term of a licensed patent may be justified. The term may relate to associated knowhow which remains confidential, genuine quality provisions which are intended to protect the reputation of the licensor or deferred consideration designed to allow a lower royalty at the beginning of the licence while the technology is being established in the market. The commentary in the draft Guidelines and the associated Example 4 should recognise that such provisions are only an issue if they are for the purpose or have the likely effect of substantially lessening competition.

### **No challenge provisions** – in LESANZ’s experience, no challenge provisions are not requested by a licensor for the purpose of substantially lessening competition nor are they likely to have that effect.  The primary purpose of a no challenge clause[[1]](#footnote-1) is to support the bargain that is formed by the licence agreement, with the licensee having the ability to do due diligence on the intellectual property prior to entering into the licence agreement.  Once the bargain is struck, a no challenge clause is intended to support that bargain. Further, it would be inimical to a licence agreement for a licensor to be bound to a licence agreement in circumstances where the licensee does not accept that the licensed intellectual property is valid. LESANZ suggests that this commentary should be removed.

## ***Grant back provisions (Example 5)***

## The ACCC’s default position, as it appears in the draft Guidelines, seems to be that the grant back of improvements is inherently problematic under competition laws, in contrast with the US Guidelines which outline that each grant back should be evaluated in light of the circumstances. The US Guidelines state that they evaluate “*its likely effects in light of the overall structure of the licensing arrangement and conditions in the relevant markets*.” The US Guidelines outline that an important factor in any analysis of a grant back will be whether the intellectual property licensor has market power in relation to a relevant technology or research and development market.

## Furthermore, the US Guidelines also reflect how certain grant back provisions have offsetting procompetitive effects, for example,“*promoting dissemination of licensees’ improvements to the licensed technology… increasing the licensors’ incentives to disseminate the licensed technology, or… otherwise increasing competition and output in a relevant technology or research and development market*.”

## LESANZ is aware of instances where the draft Guidelines have been used by licensees to resist grant back improvements clauses. This demonstrates the inherent risks of the draft Guidelines being used as leverage in negotiations where the factual circumstances are far removed from the example outlined in the draft Guidelines.

## The applicable example, Example 5, ignores the complex nature of grant back clauses and the nuances and crucial significance of assessing whether the relevant conduct has the purpose or effect of substantially lessening competition, and consequently has the potential to impede the commercialisation of new technologies. Broadly speaking, Example 5 rolls up too many issues into a brief set of unrealistic facts. Improvements clauses are usually only agreed in exclusive licences which cover all of the patented rights or within a field. It would be unlikely for them to be agreed in non-exclusive licences and then have the improvements shared between licensees which appear to be competitive. However, this unusual example has the potential to “tar” all improvements and grant back clauses with “the same brush”.

## Ideally Example 5 should:

### clarify whether Firms B and C are competitive[[2]](#footnote-2);

### provide more details on the scope of the improvements which are assigned back[[3]](#footnote-3);

### remove the focus on the collateral purpose and focus on the purpose of the clause more generally;

### give additional insight on the substantial lessening of competition assessment such as the nature of the technology and the existence of other technology in the market (for example, is this dominant technology or is the technology just one of hundreds of different touchscreen technologies?); and

### be contrasted with more realistic examples of grant back clauses as described below.

## The assignment back of improvements is standard practice in licences from the research sector. The associated provisions are complex and are structured in many different ways. A more typical grant back clause involves:

### the licensor and licensee agreeing royalties based on the sales of licensed products that incorporate the “Licensed IP”;

### the Licensed IP including the original intellectual property and defined improvements; and

### the defined improvements being assigned back to the licensor to form part of the Licensed IP (with the licensor gaining no additional exploitation rights).

## The primary purpose of such a structure is to protect the future royalties which are payable in relation to licensed products and to recognise the likelihood that the originally licensed intellectual property will be a springboard for the licensee to further develop the intellectual property that will be commercially applied. In the absence of that structure, the licensor may not be fully rewarded for their original innovation and the licence which permitted the licensee to achieve its success. The inclusion of improvements in the Licensed IP and then subsequently licensed products, provides the licensor which a more secure claim to those royalties than if it was just a contractual right to royalties.

## In addition, an improvements grant back structure is intended to keep the intellectual property together as a whole and prevent fragmentation. This ensures that in the event that the licence is terminated for breach or poor performance, the licensor is able to license the intellectual property to another licensee with less risk that the terminated licensee will challenge the new licensee based on incremental improvements. This approach provides the greatest chance that the intellectual property will ultimately be commercialised.

## Lastly, the Guidelines should recognise that “improvements” is not a set statutory term. The meaning of “improvements” and the scope of the grant back is often heavily negotiated. The licensee typically wants the improvements definition to have a narrow meaning restricted to improvements which would infringe the original intellectual property, while the licensor may seek a broader definition to protect its claim for royalties in the future. The definition may be relevant to any potential impact on competition.

## ***Quality provisions***

## The imposition of quality requirements by licensors is essential in trade mark licences[[4]](#footnote-4), and highly desirable in other licences, in order to protect the validity of the intellectual property being licensed, limit the licensor’s potential exposure for product liability claims and to protect the licensor’s reputation.

## While Examples 4 and 6 involve highly specific circumstances, the ACCC’s use of the imposition of quality standards as anti-competitive conduct in those examples may be used in negotiations to resist reasonable quality requirements in licence negotiations. The Guidelines should provide some additional balance to the legitimate role of quality requirements.

# **Cartel conduct**

## Given the significant consequences for breach of the cartel provisions and their *per se* nature, LESANZ submits that there are many matters which require further clarification and coverage as described below.

## In LESANZ’s view, the draft Guidelines should give more guidance as to the identification of competitors in the context of intellectual property. For example, as recently identified in a speech by The Honourable Justice Michael O'Bryan of the Federal Court of Australia[[5]](#footnote-5):

*“Difficult questions will arise where the owner of intellectual property exploits the rights to supply goods or services in Australian trade or commerce but, at the time the licence is entered into, the licensee is not a competitor in respect of the supply of those goods or services and is not likely to be a competitor. It is yet to be determined how the cartel prohibitions will apply to licence arrangements between persons who are not competitors at the time the licence is entered into, but have the potential to be competitors by reason of the licence.”*

## It is important that the draft Guidelines provide guidance on the question raised by Justice O’Bryan and more generally on the identification of competitors in the context of intellectual property.

## With most cartels, the alternative to competing with each other is said to be working together. However, where an intellectual property right is involved, an unlicensed non-owning entity does not have the ability to compete with the owner of the right within the scope of protection provided by that right. That entity is of course at liberty to compete in the relevant market outside the scope of the intellectual property rights. When intellectual property rights are then licenced, the licensor is enabling that entity to engage in particular activity within that broader market which that entity would not otherwise be able to do. Thus, it is not a case of parties agreeing to restrain their competitive activity in an area in which each can compete (a cartel) but a case of one entity allowing another entity to compete in a particular way which would be otherwise prohibited. Consequently, any limitation in a licence is more accurately analysed as a limitation on the scope of the licence. The limitation merely defines the scope of the permission given; it does not constrain the licensee from doing something it could otherwise do nor would it be for the purpose of “preventing, restricting and limiting” condition in section 45AD(3) of the CCA.

## The context set out in the previous paragraph should be considered by the ACCC in the Guidelines and its reference to purpose in each of the examples given in Section 3.8 (more later).

## In LESANZ’s view, it is critical that the draft Guidelines should give guidance on the operation of the exemptions relating to exclusive dealing and joint ventures, which will have a greater role to play following the repeal of section 51(3).

## The Australian research sector has been increasingly encouraged by all Governments to collaborate between themselves and with industry for many years. In that context, it would be helpful if the Guidelines provided insight on the application of the joint venture exemption to research and intellectual property commercialisation collaborations.

## Most licences from the research sector involve a form of exclusivity. There have been serious questions raised as to how the exclusive dealing exemption would apply in the research sector given the non-implementation of the recommendation of the Harper report that the exemption be widened to better fit with intellectual property licences. For example, Justice O'Bryan recently stated[[6]](#footnote-6):

“*the restriction relates to the goods or services that are the subject of the primary supply. In the case of intellectual property licences, the primary supply is a licence of the intellectual property rights and typically the restriction relates to goods or services that are produced through the exploitation of those rights. Generally, section 47 has no application to those circumstances. For that reason, the exception to the cartel prohibitions, found in s 45AR, is unlikely to apply to intellectual property licences*.”

## Justice O'Bryan’s concerns do not appear to consider the expansive definition of re-supply of services in section 4C(f) of the CCA nor that the licensee’s goods and services will often involve the resupply of the services[[7]](#footnote-7). Given the significant consequences for breach of the cartel provisions, LESANZ respectively submits that the Guidelines should provide guidance on this question and more generally explain the application of the exclusive dealing exemption to intellectual property licences.

## Example 1 states that the settlement agreement does not license intellectual property rights. However, it is commonly accepted in at least US patent cases that an express licence is the same as a promise by the licensor not to sue the licensee for using the licensor’s intellectual property rights. In any event, it would be unlikely that a settlement agreement in these circumstances would not contain express cross licences. As these licenses are likely to be exclusive, the example should not include the immutable conclusion that the conduct in likely to contravene the cartel provisions without at least referring to the potential application of the exclusive dealing exemption.

## Further to paragraphs 5.4 and 5.5 above, additional guidance needs to be provided in relation to output restrictions and where they would satisfy the purpose of “preventing, restricting and limiting” condition in section 45AD(3) of the CCA, as opposed to being permissions to use intellectual property rights within certain boundaries that the licensee was otherwise not entitled to use. Section 3.8 on output restrictions and Example 3 provide little assistance to the research sector which regularly includes field of use restrictions and quality restrictions in licence agreements.

## Similarly, further guidelines need to be provided in relation to territorial restrictions referred to in Section 3.8 and where they would satisfy the purpose of “preventing, restricting and limiting” condition in section 45AD(3) of the CCA, as opposed to being permissions to use intellectual property rights in a territory that the licensee was otherwise not entitled to use. The draft Guidelines’ Section 3.8 on territorial restraints does not expressly consider the common practice of licensing intellectual property on a country by country or region by region basis.  As most forms of intellectual property arise on a national basis and are often licenced per country or region, LESANZ queries whether the ACCC should provide an example of a territorial licensing arrangement which would cause concern. Ideally this would be contrasted with examples of territorial licensing restraints which are unlikely to cause concern.

## More generally, as noted above, each of the issues in Section 3.8 needs to refer to the possible application of possible exemptions, including at least the exclusive dealing exemption and the joint venture exemption.

# **Conclusion**

## LESANZ is committed to continuing to foster its relationship with the ACCC on behalf of its membership and hopes that our submission and our offer to provide further assistance will be carefully considered by the ACCC.

Please do not hesitate to contact me if you have any questions or queries.

Duncan Ferguson

**President**

Licensing Executives Society of Australia and New Zealand Inc.

1. No challenge clauses may comprise either a prohibition on challenges or the conferral of a termination right in the event of a challenge. [↑](#footnote-ref-1)
2. The example explains that Firm A licences touchscreen technology but each of Firms B and C may be licenced the technology in separate fields which are clearly not competitive. For example, Firm B may be licensed in the field of gaming applications only and Firm C could be licensed in the field of physical security applications. [↑](#footnote-ref-2)
3. Do the improvements relate to better versions of the touchscreen technology or do they go more broadly to cover all applications which deploy that technology or a related manufacturing process? [↑](#footnote-ref-3)
4. For example, see section 8 of the *Trade Mark Act 1995* (Cth), which mandates control by a licensor over the use by licensee. [↑](#footnote-ref-4)
5. See the linked speech by The Honourable Justice Michael O'Bryan of the Federal Court of Australia, available at <https://www.fedcourt.gov.au/digital-law-library/judges-speeches/justice-obryan/obryan-j-20190410>. [↑](#footnote-ref-5)
6. Ibid [↑](#footnote-ref-6)
7. For example, the supply of a patented good by a licensee involves exploitation of the patent rights, which would be a resupply of services under a patent licence. In addition, the High Court found in *E&J Gallo Winery v Lion Nathan Australia Pty Ltd* [2010] HCA 15 that each transfer of a trademarked good is a use of the trade mark, and would be a resupply of services under a trade mark licence. [↑](#footnote-ref-7)