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# Competition Law and Intellectual Property in Australia – Traps for Unwanted Catches

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## Need to Watch out for Competition Law Traps when Licensing IP in Australia

Those licensing intellectual property ("IP") in Australia should be aware of the traps set by local competition law. There are significant differences between Australian competition law and competition laws in the U.S., the EU and other jurisdictions.

The main potential competition law traps in Australia are:

- the repeal of the former IP exemption under Section 51(3) of the Competition and Consumer Act 2010 (Cth) (the "CCA");
- the broad definition of cartel conduct under the CCA and the limited range and scope of exemptions from the cartel prohibitions under the CCA; and
- the uncertainty of the substantial lessening of competition test ("SLC" test) for CCA prohibitions against anti-competitive agreements and the lack of a rule of reason test.

## Repeal of the Section 51(3) IP Exemption

The previous Section 51(3) of the CCA set out exceptions for IP licensing conditions from certain prohibitions under the Act.[2] The Treasury Laws Amendment (2018 Measures No. 5) Act 2019 repealed Section 51(3). The repeal was enacted on February 18, 2019 and came into effect on September 13, 2019. As a result of the repeal, all conduct including conduct involving IP rights is subject to the anti-competitive conduct prohibitions in Part IV of the CCA.[3]

The scope of the Section 51(3) exemption was limited in several respects, most notably:

- the exemption applied to prohibitions against cartel conduct and anti-competitive agreements and concerted practices but not to the prohibitions against misuse of market power or resale price maintenance;
- the exemption applied only to certain kinds of IP-related conduct, e.g. the imposing of or giving effect to a condition of the license or assignment of a patent, a registered design, a copyright or of exclusive layout ("EL") rights (under the Circuit Layouts Act) – the exemption did not apply to, e.g. a refusal to license IP or a refusal to assign an IP license;
- the exemption applied only in relation to a limited range of IP (patents, registered designs, a copyright, EL rights (under the Circuit Layouts Act) and trademarks – the exemption did not apply to, e.g. unregistered trademarks, confidential information or trade secrets.

In the case of IP licensing conditions, the exemption applied "to the extent that the condition relates to" the protected subject matter (e.g. "the invention to which the patent or application for a patent relates or articles made by the use of that invention").[4] It was never clear what the words "relates to" meant in this context. On a narrow interpretation, a condition related to the protected subject matter only if it was within the scope of the IP right protecting the protected subject matter. On another interpretation, a condition did not relate to the protected subject matter if it sought to gain a "collateral advantage." On the broadest interpretation, any connection between a condition and the IP right was sufficient.

The repeal of Section 51(3) has been mooted for more than two decades, and recommended in numerous governmental inquiries. The Australian Competition and Consumer Commission ("ACCC") has tried to downplay the practical significance of the Section 51(3) exemption given its limits and uncertain application.[5] However, from the standpoint of business, the exemption has served as a useful safe harbor or at least a possible fallback defense for thousands of IP

licensing agreements. Unfortunately, the consequences of repealing Section 51(3) discussed below have been neglected by the Government.[6]

The cartel prohibitions under the CCA are broadly defined and apply to IP licensing arrangements between competitors even in situations where the restrictions are not anti-competitive. The exemptions that apply to the cartel prohibitions are limited and do not provide an adequate safeguard against overreach or *per se* cartel liability. See Part III below.

The prohibitions against anti-competitive agreements and concerted practices under the CCA are subject to the SLC test. The SLC test is uncertain in operation and its scope is not limited by a rule of reason. These limitations of the SLC test did not matter previously for IP licensing agreements where the Section 51(3) exemption applied. See Part IV below.

It would be a mistake to assume that the untoward consequences of repealing Section 51(3) will arise only in relation to IP licensing agreements made on or after September 13, 2019. *Giving effect to* a cartel provision or SLC provision in a contract, arrangement or understanding created before September 13, 2019, or even before September 13, 2013 (the start of the 6-year civil limitation period), is subject to the prohibitions against cartel conduct and anti-competitive agreements.

It would also be a mistake uncritically to accept the ACCC's "Guidelines on the repeal of subsection 51(3) of the Competition and Consumer Act 2010 (Cth)" that were published at the end of August 2019. Those Guidelines gloss over the traps arising from the repeal of Section 51(3).

## Broad Definition of Cartel Conduct under CCA and Limited Range and Scope of Exemptions from Cartel Prohibitions

Cartel conduct is broadly defined under the CCA, in the context of criminal as well as civil liability.[7] Liability often depends on whether or not an exemption under the CCA applies. As explained below, current exemptions from the cartel prohibitions do not adequately carve out IP licensing restrictions that are pro-competitive or competitively benign.

The main gap is that there is no exemption from cartel liability for licensing or other supply agreements between competitors.[8] The lack of any accompanying supply/acquisition exception is inconsistent with the Competition Policy Review Final Report (March 31, 2015) (the "Harper Report").[9] The Harper Report recommended that the repeal of Section 51(3) of the CCA be subject to exempting supply/acquisition agreements between competitors (including IP licensing) from the cartel prohibitions:

An exemption should be included for trading restrictions that are imposed by one firm on another in connection with the supply or acquisition of goods or services (including intellectual property licensing), recognising that such conduct will be prohibited by Section 45 of the CCA (or Section 47 if retained) if it has the purpose, effect or likely effect of substantially lessening competition. … (Recommendation 27)

[A]s is the case with other vertical supply arrangements, IP licences should be exempt from the per se cartel provisions of the CCA insofar as they impose restrictions on goods or services produced through application of the licensed IP. Such IP licences should only contravene the competition law if they have the purpose, effect or likely effect of substantially lessening competition.[10]

Four and a half years on from the Harper Report there is still no specific exemption in the CCA for supply/acquisition agreements between competitors. In October 2016, Exposure Draft

Section 44ZZRS followed Recommendation 27 of the Harper Report. However, Section 44ZZRS did not appear in the Competition and Consumer Amendment (Competition Policy Review) Bill 2017 that was enacted and came into effect on November 6, 2017. The Explanatory Memorandum to that Bill says that "the vertical trading restriction cartel exception was removed from this Bill, to be given further consideration and progressed in a future legislative package together with amendments to section 47."[11] It remains unclear when, if ever, a further legislative package will emerge. The Government has failed to publish a plan for Harper Report implementation. Nor has any further draft competitor supply/acquisition cartel exception been published for public consultation.

The inadequacy of the range of current exemptions from cartel liability are apparent from the following example of a typical field of use restriction in an IP licensing agreement.

A invents a new resin for use in fiberglass and supplies fiberglass products using this resin in several fields, namely boats, planes, and swimming pools. It has strong distribution and marketing channels in the fields of boats and planes, but not in that of swimming pools. B is a competing supplier in all three fields but has a particularly strong position in the field of swimming pools. A decides to maximize the value of its patented formula for the new resin by licensing the patent to B in the field of swimming pools (a "Field of Use Provision").

An IP licensing condition of this kind is not unusual and will rarely be anti-competitive. The orthodox view is that:

> (a) Patent owners may grant licenses extending to all uses or limited to use in a defined field; and
>
> (b) The possibility of anti-competitive effects should be tested by assessing the competition effects, not by resorting blindly to *per se* liability.[12]

The Field of Use provision in this example contains a "cartel provision," a key element of the cartel prohibitions.[13] In the case of cartel conduct other than price fixing, "cartel provision" is defined in terms of: (a) a purpose condition; and (b) a competition condition (the parties to the contract, arrangement or understanding containing the provision must be competitors or likely competitors). The purpose of the condition under Section 45D(3(a)(iii) of the CCA is met in this example: one substantial purpose of the Field of Use Provision is to restrict or limit the supply of goods made by B with the use of A's patent in a market in Australia.[14] The competition condition under Section 45D(4) is also met: A is a competitor of B in relation to the supply of swimming pools.

The former Section 51(3) exception would apply: The Field of Use Provision "relates to" A's patent within the meaning of the subsection. The term "relates to" is subject to varying possible interpretations, as noted earlier, but a Field of Use Provision comes within the narrowest interpretation (namely that the licensing condition must be within the scope of the relevant IP right).

The cartel prohibitions under the CCA are carved out under Section 45AR where the conduct is exclusive dealing conduct as defined by Section 47. However, the exclusive dealing exception under Section 45AR will not apply to the Field of Use Provision. The condition imposed by this Provision is not exclusive dealing as defined by Section 47.[15]

The cartel prohibitions under the CCA do not apply where the joint venture exceptions under Sections 45AO and 45AP apply. Those exceptions do not apply to the example here because there is no joint venture between A and B.

The Field of Use Provision would not be covered by the Exposure Draft Section44ZZRS exception discussed in Part III above. The drafting of Exposure Draft Section 44ZZRS is

unsatisfactory partly because it does not cover a sufficiently wide range of supply/acquisition agreements between competitors where there is no adequate policy justification for imposing *per se* cartel liability. The Field of Use Provision in the example here is one example of the undue narrowness of Exposure Draft Section 44ZZRS. A well-defined competitor supply/acquisition cartel exception should and would do so.

A field of use provision like that in the example above might conceivably be exempted from the cartel prohibitions by a class exemption under Section 95AA (see further the discussion of class exemptions in Part IV below). However, there is no relevant class exemption under Section 95AA of the CCA.

Authorization by the ACCC is a possible escape route.[16] Authorization is available generally under the CCA as a means of avoiding liability for conduct that might otherwise be anti-competitive. However, authorization is costly and bureaucratic. Moreover, in the context of cartel conduct, authorization can be granted only if there is sufficient public benefit to outweigh any anti-competitive detriment. By contrast, the authorization test that applies to anti-competitive agreements under Section 45 is either overriding public benefit *or* absence of a SLC effect or likely effect).[17]

### Uncertainty of SLC Test under CCA and Lack of Rule of Reason Test

For many IP licensing conditions, the former Section 51(3) exemption spared businesses and their advisers from the application of the SLC test under Sections 45 and 47 of the CCA. The repeal of Section 51(3) means that the SLC test now applies to those licensing conditions. Unfortunately, the SLC test in Australia is both vague and unqualified by a rule of reason. These two flaws are discussed in turn below.

The meaning of "substantial" in the SLC test is obscure.[18] The case law offers limited guidance beyond telling us that "substantial" does not mean "large" or "big."[19] The opportunity to clarify the law was not taken by the High Court of Australia in *Rural Press Ltd v. ACCC* (2003) where it was stated unhelpfully that "substantial" means "meaningful or relevant to the competitive process."[20]

As a result, the assessment of evidence on the issue of substantiality depends much on impression and unstated assumptions. ACCC guidelines do not assist much on this key issue.[21]

Various potentially significant questions are raised by the SLC test but have rarely been discussed.[22] These are some of the questions:

- What is the necessary duration of competition effects required under the SLC test?[23]
- Is the SLC test to be applied by reference not only to the competitive process but also to outcomes such as price effects?[24]
- If measured by price effects, what is the threshold? 5 percent?[25]
- Does the standard of substantiality vary in accordance with the probability of the competition lessening effects?

Market share thresholds can be expedient. They are used to provide safe harbors[26] under several EU block exemptions, including those relating to technology transfer agreements, vertical restraints and horizontal cooperation agreements. For example, under the technology transfer block exemption, a market share threshold of 20 percent applies in the case of

agreements between competitors and a market share threshold of 30 percent in the case of agreements between non-competitors.[27] Case by case rule of reason assessment is required outside the safe harbors. The fact that market shares exceed a threshold does not give rise to any presumption of liability.[28]

The CCA includes the power for the ACCC under Section 95AA to create class exemptions that exempt specified types of conduct from prohibitions under the Act. This mechanism could be used to provide safe harbors based on market shares in the context of IP licensing and elsewhere.[29] No class exemption for IP licensing has emerged.

The SLC test in Australia is unqualified by a rule of reason.[30] The SLC test is a competition test, not one that is geared to assessment of offsetting welfare-enhancing efficiencies.[31] By contrast, a rule of reason applies in the U.S. under Section1 of the Sherman Act[32] and, in practical effect, under the exemption in Article 101(3) of the Treaty on the Functioning of the European Union.[33] Thus, under Section 4.2 of the U.S. DOJ and FTC *Antitrust Guidelines for the Licensing of Intellectual Property* (2017), efficiencies are highly relevant to the analysis of the anti-competitive effects of IP licenses:

If the Agencies conclude, upon an evaluation of the market factors described in section 4.1, that a restraint in a licensing arrangement is unlikely to have an anticompetitive effect, they will not challenge the restraint. If the Agencies conclude that the restraint has, or is likely to have, an anticompetitive effect, they will consider whether the restraint is reasonably necessary to achieve procompetitive efficiencies. If the restraint is reasonably necessary, the Agencies will balance the procompetitive efficiencies and the anticompetitive effects to determine the probable net effect on competition in each relevant market.

That is not the legally relevant analysis in Australia under the SLC test.

Where doubt arises as to whether or not an IP licensing provision breaches the SLC test, or where efficiencies need to be taken into account, what can be done to help ensure compliance with Section 45 (anti-competitive agreements and concerted practices) and Section 47 (exclusive dealing)? The answer under Section 45 is to apply for an authorization by the ACCC. The answer under Section 47 is to apply for authorization or use the statutory notification procedure. Authorization and notification are costly and bureaucratic approaches that contrast markedly with the process of self-assessment that applies in the U.S. and other more mature competition law regimes.

## Conclusion

Those licensing IP in Australia should be aware of the competition law traps that arise from the repeal of the IP exemption under the former Section 51(3) of the CCA.

In summary:

- The former IP exemption under Section 51(3) served as a useful safe harbor or fallback line of defense against competition law challenge in many IP licensing settings. The repeal of the exemption means that IP licensing agreements, including those entered into before the commencement of the repeal of Section 51(3) (September 13, 2019) have become subject to the CCA prohibitions against cartel conduct and anti-competitive agreements. Compliance precautions need to be realigned and taken accordingly. See Part II above.
- Current exemptions from the cartel prohibitions do not adequately carve out IP licensing restrictions that are pro-competitive or competitively benign. The main gap is

that there is no exemption from cartel liability for licensing or other supply agreements between competitors. The only possible escape route open may be authorization by the ACCC.[34] Authorization is costly, bureaucratic and, for cartel conduct, limited to a public benefit test. See Part III above.

The prohibitions against anti-competitive agreements are subject to a SLC test. However, the SLC test in Australia is vague: no one knows what a "substantial" lessening of competition really means. The Australian SLC test is unqualified by a rule of reason: unlike the position under U.S. antitrust law in IP licensing, anti-competitive effects cannot be trumped by efficiencies. Where doubt arises as to whether or not an IP licensing provision breaches the SLC test, or where efficiencies need to be taken into account, it may be necessary to try to sanitize the provision by immersing it in bureaucratic regulatory process: in the case of Section 45 (anti-competitive agreements), authorization by the ACCC; in the case of Section 47 (exclusive dealing), authorization by or notification to the ACCC. See Part IV above.

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[2] See further A. Duke, *Corones' Competition Law in Australia* (7th ed, 2018) ch. 11.

[3] See further ACCC, *Guidelines on the repeal of subsection 51(3) of the Competition and Consumer Act 2010 (Cth)* (2019).

[4] See F. Hanks, "Intellectual property rights and competition in Australia," in SD Ackerman (ed), *The Interface Between Intellectual Property Rights and Competition Policy* (2007) 315, at 322-324.

[5] See ACCC, *Guidelines on the repeal of subsection 51(3) of the Competition and Consumer Act 2010 (Cth)* (2019).

[6] See B. Fisse, "Harper Report Implementation Breakdown: Repeal of Section 51(3) of the Competition and Consumer Act 2010 (Cth) and lack of Proposed Supply/Acquisition Agreement Cartel Exception," (2019) 47 ABLR 127; Address by Justice Michael O'Bryan, Federal Court of Australia, "The repeal of s 51(3) of the Competition and Consumer Act 2010 (Cth)," at: https://www.fedcourt.gov.au/digital-law-library/judges-speeches/justice- obryan/obryan-i-20190410.

[7] See further B. Fisse, "Harper Report Implementation Breakdown: Repeal of Section 51(3) of the Competition and Consumer Act 2010 (Cth) and lack of Proposed Supply/Acquisition Agreement Cartel Exception," (2019) 47 ABLR 127.

[8] See C. Beaton-Wells & B Fisse, *Australian Cartel Regulation* (2011) chs. 4-5.

[9] Available at http://competitionpolicyreview.gov.au/.

[10] *Competition Policy Review: Final Report* (2015), 110.

[11] Para 15.57.

[12] American Bar Association, *Intellectual Property and Antitrust Handbook* (2nd ed, 2015) 85-89.

[13] The term is defined in CCA Section 45AD.

[14] Where there are several purposes, any "substantial" purpose is sufficient: CCA Section 4(1)(a)(ii).

[15] For instance, the condition does not fall within Section 47(2) or (4).

[16] The authorisation process does not exist in the U.S., the EU, the UK or Canada; see C Beaton-Wells and B Fisse, *Australian Cartel Regulation* (2011) 8.13.3.

[17] CCA Section 90(8)(a). See further *Competition Policy Review: Final Report*, 398-399.

[18] See generally P. Armitage, "The evolution of the 'substantial lessening of competition' test – a review of case law," (2016) 44 ABLR 74.

[19] *Re Queensland Independent Wholesalers Ltd* [1995] ATPR 41-438 at 40,926. See also *Global Radio Holdings Limited v. Competition Commission* [2013] CAT 26.

[20] (2003) 216 CLR 53 at 71 per Gummow, Hayne and Heydon JJ. Nor is the meaning of "substantial" taken far in later cases; see e.g. *Seven Network v. News Limited* (2009) 182 FCR 160. [581]–[585] (Dowsett & Lander JJ); *Application by Chime Communications Pty Ltd (No 2)* [2009] ACompT *Application by Chime Communications Pty Ltd (No 3)* [2009] ACompT 4.

[21] See ACCC, *Guidelines on the repeal of subsection 51(3)* (2019); ACCC, *Merger Guidelines* (2008) (updated in 2017).

[22] See further T. Leuner, "Time and the dimensions of substantiality," (2008) 36 ABLR 327, 348-359.

[23] See further D. Robertson, "Time and Risk: The Temporal Dimension of Competition Analysis and the Role of Long-Term Contracts," (1998) 26 ABLR 273.

[24] For the argument that the SLC test under Section 27 of the *Commerce Act 1986* (NZ) is concerned with the process of competition and not the effects of competition see J. Land, J. Owens & L. Cejnar, "The Meaning of "Competition'," (2010) 24 NZULR 98, 106-109 (an increase in prices may be an indication that competition has been lessened in a market but it is not itself an aspect of lessening of competition; a lessening of competition is determined by whether there is a lessening of the level of constraints on market power).

[25] In *Commerce Commission v. Woolworths Ltd & Ors* (2008) 12 TCLR 194 (CA) at [191] the NZ Court of Appeal said that there is no precise metric.

[26] Bright-line rules may be appropriate when used as safe harbours rather than as prohibitions: see D. Crane, "Rules Versus Standards in Antitrust Adjudication," (2007) 64 Washington & Lee LR 49, 84

[27] European Commission, Commission Regulation (EC) No 772/2004 on the application of Article 101(3) of the Treaty to categories of technology transfer agreements, OJ 2004 L123/11 (TTBER); see further J. Faull & A. Nikpay, *The EU Law of Competition* (3rd ed, 2014) ch. 10C. Market share thresholds are also used in European Commission, Commission Regulation 230/2010 on the Application of Article 101(3) of the Treaty on the Functioning of the European Union to Categories of Vertical Agreements and Concerted Practices [2010] OJ L102/1 (VBER); see further J. Faull & A. Nikpay, *The EU Law of Competition* (3rd ed, 2014) ch. 9B.

[28] See further J. Faull & A. Nikpay, *The EU Law of Competition* (3rd ed, 2014) [10.119]-[10.122].

[29] As in the EU for technology transfer agreements; see J. Faull & A. Nikpay, *The EU Law of Competition* (3rd ed, 2014) [10.119]-[10.123].

[30] *Universal Music Australia Pty Ltd v. ACCC* [2003] FCAFC 193, [270]-[273].

[31] Although efficiencies may sometimes be relevant to counterfactual analysis of SLC effects and to the purpose limb of the SLC test; see A. Duke, *Corones' Competition Law in Australia* (7th ed, 2018) [1.310], [1.320].

[32] See ABA, *Antitrust Law Developments (Seventh)* (2012) Vol I, ch. 1 B3b.

[33] See J Faull and A Nikpay, *The EU Law of Competition* (3rd ed, 2014) ch. 3F.

[34] The authorisation process does not exist in the U.S., the EU, the UK, or Canada; see C. Beaton-Wells & B. Fisse, *Australian Cartel Regulation* (2011) 8.13.3.