BRAM VAN MELLE

THE INTERFACE BETWEEN INTELLECTUAL PROPERTY LAW AND THE COMMERCE ACT 1986: EXEMPTIONS FOR STATUTORY INTELLECTUAL PROPERTY RIGHTS

LLM RESEARCH PAPER
COMPETITION LAW (LAWS 525)

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ABSTRACT

Intellectual property law permits the making of "monopoly" profits by granting exclusive rights in respect of innovations. The exclusive rights prevent appropriation of the innovation and permit innovators to recover development costs, thereby encouraging innovation. Competition law promotes competition in markets as a means to ensure economic efficiency. Although competition law and intellectual property law ultimately share the common goal of promoting economic efficiency (and hence consumer welfare), the exclusivity of intellectual property law conflicts with competition law's aim of efficient, competitive, markets. This paper suggests that competition law should not interfere with the incentive scheme of intellectual property law but that the anti-competitive effects of intellectual property law should be limited to those expressly deemed by intellectual property law to be necessary to encourage innovation. Once the existence of the intellectual "property right" itself is accepted, competition law should restrain the anti-competitive exercise of these rights in licensing agreements. In particular the paper argues that the intellectual property rights holder should be permitted to divide and assign the totality of the statutory grant of rights as the rights holder considers best achieves efficient exploitation, and that competition law should only intervene when licensing terms, or refusals to license, are aimed at procuring advantages not directly envisaged by the intellectual property right. These "collateral" advantages should be subjected to the usual competition law tests to determine their validity. The paper argues that the Commerce Act 1986 ("the Commerce Act") attempts to observe these principles, but that the Commerce Act exemption provisions, which are the mechanism for regulating the interface, contain anomalies in their operation and are uncertain in their scope. The paper also emphasises that intellectual property rights confer a monopoly only in respect of a product, and that market power is not created where adequate product substitutes exist. Therefore the failure of an intellectual property licensing term to fall within one of the Commerce Act exemptions will not automatically doom the licensing term to condemnation.

Word Length

The text of this paper (excluding contents page, footnotes, bibliography and annexures) comprises approximately 15 000 words.

I INTRODUCTION*

The Commerce Act 1986 ("the Commerce Act") promotes competition in New Zealand markets. At first glance the Commerce Act directly conflicts with intellectual property law which grants "monopoly" rights. Ultimately however both the Commerce Act and intellectual property law seek to promote economic efficiency, and hence consumer welfare. Intellectual property law achieves this by granting exclusive rights in respect of innovations. This prevents appropriation by competitors and therefore permits the making of monopoly profits. By permitting effective commercial exploitation, the socially and economically desirable of goal innovation is encouraged. Competition law achieves economic efficiency by prohibiting anti-competitive conduct in markets which may lead to excessive prices. Firms exposed to competition will be encouraged to become the most efficient, and pass efficiency gains on to the consumer.

Because the legislature deems intellectual property law to be necessary to encourage innovation, competition law cannot challenge the existence of intellectual property rights. Once the existence of the intellectual property right is accepted however, the exercise of that right should be subject to the same competition policy as the exercise of tangible property rights. Therefore this paper purports that competition law should not disrupt the incentive schemes created by intellectual property statutes, and conversely that intellectual property law should not permit anti-competitive conduct *beyond that necessary to maintain the incentive to create as envisaged by the relevant intellectual property statute.*

Intellectual property licensing contracts have the potential for the inclusion of anti-competitive terms. While some restrictive licensing terms are legitimate, licensing contracts have been used to monopolise secondary markets and to gain advantages "collateral" to the intellectual property right. Such contracts are subject to competition law

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scrutiny. In regulating the interface, one should ask whether the conduct in question a necessary incident of the intellectual property regimes. If the conduct is not, and is therefore an attempt to accrue anti-competitive advantages beyond those envisaged by the intellectual property statute, then competition law should apply. From this test two general principles emerge: First, the intellectual property rights holder ("the rights holder") should be entitled to divide and license the totality of the grant as the rights holder considers will best achieve efficient exploitation, and secondly, that the rights holder is precluded from gaining advantages "collateral" to the rights conferred by the intellectual property statute. This paper argues that the Commerce Act attempts to observes these principles.

While no cases have yet dealt with the Commerce Act interface in New Zealand, cases considering functional copyright[1] and the inbuilt limitations on intellectual property right monopolies,[2] suggest that (from the perspective of competition economics) the New Zealand courts have adopted a stance generally more disposed to protecting intellectual property rights holders than have the courts of many overseas jurisdictions.[3]

Hammond observes that "the relationship between intellectual and industrial property values and competition policy has been inadequately thought through in New Zealand and needs attention".[4] Currently the interface is regulated by two exemptions in the Commerce Act. First, section 45 provides an outright exemption from all of the restrictive trade practices provisions in Part II of the Commerce Act except for section 36 (which has its

[1]See the series of cases beginning with *P S Johnson* v *Bucko Enterprises* [1975] 1 NZLR 311 discussed in the text below at n 39.

[2]See *Bleiman* v *News Media (Auckland) Ltd* [1994] 2 NZLR 673 (CA) discussed below at n 38.

[3]Compare the United States Supreme Court's copyright judgments of the last decade, in *Feist Publications Inc* v *Rural Telephone Service Company Inc* 113 L Ed 2d 358 and *Campbell* v *Acuff-Rose Music* 127 L Ed 2d 500 in particular which firmly restrict the scope of the right. In Britain see the House of Lords' judgment in *British Leyland* v *Armstrong Patents* [1986] 1 All ER 850 discussed below at Part IV C and in Appendix B.

[4]Professor G Hammond in Law Commission *Report No 13 Intellectual Property: The Context for Reform* (Law Commission, Wellington, 1990), 29.

own exemption) and sections 37 & 38 (retail price maintenance)[5]. The section provides that a licensing provision is not subject to the Commerce Act "in so far as it contains a provision authorising any act that would otherwise be prohibited" by the statutory intellectual property right. Basically the section exempts from the application of the Commerce Act "permissive" licensing provisions that assign the whole, or portions, of the intellectual property right. Secondly, section 36(2) provides a qualified exemption.[6] A dominant position in a market is not used for a proscribed purpose under section 36(1) "by reason only that [the rights holder] seeks to enforce" a statutory intellectual property right. Several other minor statutory provisions affect the interface. Section 7 of the Commerce Act provides an exemption for the common law breach of confidence action, and section 43 of the Commerce Act provides an exemption for conduct specifically authorised by other Acts. Additionally, provisions in the Patents Act 1953 ("the Patents Act") restrict some anti-competitive practices.

It should be noted at the outset that the fact that the Commerce Act applies to specific terms in licensing agreements does not necessarily preclude the conduct in question. The competition law tests, such as "substantially lessening competition" and "market dominance", must first be satisfied before contravention of the Act is established.

II ECONOMIC RATIONALES

McCarthy notes that one's view concerning the regulation of the interface will "largely turn upon one's own personal set of priorities as to the relative importance of intellectual property and antitrust. This in turn, depends upon what one sees as the true goals of both

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[5]Resale price maintenance is never exempted, but it can be authorised. See below n 179.

[6]Section 36A(2) is the Trans-Tasman counterpart and issues particular to section 36(2) are dealt with below in Part XV.

intellectual property law and antitrust law".[7] With this caveat in mind, the purpose of these areas of the law are examined.

A *Economic Rationale for the Commerce Act 1986*

New Zealand competition law is rooted firmly in economic principle and is not complicated by the political overtones that exist in the United States, such as the "freedom to trade" and a distrust of large aggregations of wealth.[8] Instead, such debate as exists in New Zealand is about the focus of competition law is whether economic efficiency is best achieved by competition or monopoly.[9] The Commerce Act in its current form clearly prefers the former approach. The debate has resulted in a shift of focus from consumer welfare to economic efficiency however. The author assumes for the purposes of this paper that both short and long term efficiency are best achieved by a competitive business environment.[10] The Commerce Act is an Act to promote competition in New Zealand

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[7]J McCarthy "Intellectual Property and Trade Practices Policy: Coexistence or conflict? The American Experience" 1985 Australian Business Law Review 198, 199.

[8]Hence the Commerce Act does not prohibit monopolisation *per se* (other than by business acquisitions under Part III), but only restrains monopolistic or anti-competitive behaviour. United States antitrust law in contrast is underpinned by what McCarthy, above n 7, 207, describes as "Jeffersonian populism" - a preference for a business structure of small firms in competition with each other independent of any economic reasoning. This principle was articulated by Learned Hand J in *US* v *Alcoa* 148 F 2d 416 (1945). "[Congress] was not necessarily actuated by economic motives alone... Throughout the history of these [antitrust] statues it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organisation of industry in small units which can effectively compete with each other". See R Pitofsky "The Political Content of Antitrust" 127 University of Pennsylvania Law Review 1051, 1053 & 1058 for a discussion of the traditional United States antitrust concerns of large aggregations of capital as potentially disruptive political forces and the concern for the ability of the small businessman to earn a living from trade.

[9]See T Hazeldine "The Role of Efficiency in Competition Policy" Fifth Annual Workshop of the Competition Law & Policy Institute of New Zealand, Volume 1, and J Land "The Role of Efficiency in Competition Policy" Fifth Annual Workshop of the Competition Law & Policy Institute of New Zealand, Volume 1.

[10]An absence of competition can lead to efficiency gains through greater economies of scale and procurement of operating synergies. However monopolies occur at the expense of a competitive business framework which ensures long term efficiency. In the absence of competition there is no assurance that efficiencies arising from monopolisation will be passed on to the consumer. The Commerce Act achieves a competitive environment by regulating conduct rather than business structure however. Except in respect of business acquisitions, monopolies are tolerated. Monopolistic behaviour however is prohibited.

markets. "It is based on the premise that society's resources are best allocated in a competitive market where rivalry between firms ensures maximum efficiency in the use of resources".[11] Competition, rather than monopoly, will benefit consumers by ensuring that goods are available at a price *as close to the marginal cost of production as possible*. This type of economic efficiency is allocative economic efficiency and can be regarded as essentially static.

B *Economic Rationale for Intellectual Property Law*

Allocative efficiency alone is insufficient for promoting consumer welfare. Technological advancement also has a role to play, and is achieved primarily by intellectual property law.[12] This is the economic efficiency associated with innovation - "dynamic" or "innovative" economic efficiency.[13] The economic rationale for intellectual property law is one of monetary incentive. By securing exclusive exploitation rights to the inventor, innovation is encouraged.[14] The encouragement of innovation and the disclosure of that

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[11]*Tru Tone Ltd* v *Festival Records* [1988] 2 NZLR 352, 358 per Richardson J. See also K Vautier "Competition Policy and Competition Law in New Zealand" in A Bollard (ed) The Economics of the Commerce Act (NZ Institute of Economic Research, Wellington, 1989) Chapter 3, 46, who has mirrored these comments stating that the underlying presumption of competition law is that "more rather than less competition... will improve the economy's ability to increase economic and social welfare, in that it will necessarily lead to more efficient resource allocations. 'Competition policy' thus represents an explicit choice among alternative means of pursuing ultimate economic and social objectives".

[12]In some circumstances innovation may prosper in a competitive environment without intellectual property protection. Where the assumptions upon which the current intellectual property regime are based do not apply, the absence of intellectual property laws and the presence of a competitive environment may actually foster innovation. See n 17 below.

[13]This paper uses the term "innovative" economic efficiency rather than "dynamic" economic efficiency because the latter term can also be used to describe types of efficiency associated with non-innovation products. For example, allocative efficiency can be viewed in static or dynamic senses. Dynamic allocative economic efficiency may be used when discussing the incentives for a firm to develop an essential facility such as a railroad or telecommunications network.

[14]Historically there has been much debate about whether the foundation of intellectual property rights is in natural law or public policy. The school that one subscribes to will affect one's interpretation of the proper object and scope of intellectual property law. Under the natural law theory intellectual property law rewards creators by providing protection for the fruits of their labours. Under the public policy theory the social and economic utility of creativity is acknowledged and creators are rewarded with *enough* fruits of their labour to act as an incentive for further creative activity. Currently the public policy basis of intellectual property law is dominant: the monetary incentive is a means to an end. The ultimate purpose

innovation are the major objects of intellectual property law. An intellectual property right is a "monopoly" in the sense that it provides the rights holder with the "power to occupy an area of activity with a degree of exclusiveness",[15] but the monopoly is of a product and *not* a market.[16] Only if there are no substitutes for the intellectual property will monopolisation of a market be possible.

The fixed costs in developing intellectual property are great while the marginal cost of manufacturing intellectual property goods is competitively small. Once invented, intellectual property goods can be duplicated at little effective cost (relative to tangible goods), and in theory, intellectual property is easily "appropriated" by competitors.[17] If appropriation were permitted most of the benefits would be "external" to the inventor. Competitors that did not bear the costs of development will not have these fixed costs to recover[18] and could undercut the original producer by selling closer to marginal cost.

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of the laws relating to patent and copyright is to promote consumer welfare: the manufacture of affordable consumer goods and the promotion of the community's intellectual well-being. See G Hadfield "The Economics of Copyright: An Historical Perspective" 38 Copyright Law Symposium (1992) 1, 2.

[15]L Melville *Forms and Agreements in Intellectual Property and International Licensing* (Clark Boardman Company New York, Sweet & Maxwell Ltd London, 1979 rev ed 1991) 1.3.

[16]Melville, above n 15, argues that the term is also misleading because it implies control of *existing* resources rather than control over the fruits of one's own labour. The term "monopoly" has some useful purpose in intellectual property law to stress the trade regulation nature of intellectual property law as opposed to a competing natural law "property" basis to intellectual property which obscures the limited nature of the rights holder's statutory grant. See L R Patterson & S W Lindberg *The Nature of Copyright - A Law of Users' Rights* (University of Georgia Press, Athens Georgia, 1991).

[17]Any economic model makes assumptions about the framework in which it operates. In the case of intellectual property these assumptions may be too broad to allow development of the law from a purely theoretical stand-point. Some of the assumptions the model makes are that there are no transfer costs in appropriating another's' creativity, that perfect competition exists, that the "first mover" into a market gains no advantage, that markets are "contestable", and that the period of protection is no more than is needed to recover the fixed costs. See R Benko *Protecting Intellectual Property Rights - Issues and Controversies* (American Enterprise Institute for Public Policy Research, Washington D.C. 1987) generally. However as I Eagles "Intellectual Property and the Commerce Act" Unpublished Paper, Department of Accountancy, Auckland University, 5, notes, the interface is not constructively regulated by simply attacking the theoretical premises of each area of the law. Therefore this paper assumes that intellectual property law is sound in principle and any anomalies in its application are ignored.

[18]Economic theory states that where perfect competition exists, price will equal the "marginal cost" of production (ie the increase in total cost resulting from a unit increase in output). This would not allow the original producer to recoup the cost of development.

Without laws conferring monopoly rights to allow recovery of the fixed costs[19] involved in creating intellectual property goods, there would be a total "market failure" in promoting innovation, and it would effectively cease.[20]

Consider the following example: A and B are equal sized companies. A has brought a book onto the market and is retailing it at $10. B begins to manufacture and sell the book at $9. B will gain a greater market share and earn more profits as, other things being equal, rational consumers will purchase the cheaper book. Are A and B competing on an even footing? Both will have had to bear the cost of 'tooling up' to print the book, and the raw materials and distribution costs will be equal. But what if A paid the author to write the book? What if A has marketed the book? B bears neither the fixed cost of development nor of advertising. B is able to sell the book closer to the marginal cost that A, though neither may be making "super-normal" net profits. A has simply incurred more costs. B is a "free rider". Such a situation is allocatively efficient as the resource is in the hands of the party best able to use it - competition brings the price closer to marginal cost. This state of affairs would not encourage the creation of further books or technology however as it would be impossible to recoup the costs of development. There would be a market failure in promoting innovation.

Therefore intellectual property law grants the innovator exclusive exploitation rights, allowing a producer to raise prices *above* marginal cost. As the market failure to promote innovation results from the inability of the original producer to recover the fixed costs,

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[19]Fixed costs are a factor in any economy of scale whether in tangible or intangible goods. An example of a fixed cost in intellectual property is type-setting for a book. The writer also uses the term to include R&D costs or authors' fees etc. In theory only some of these fixed costs must be met by competitors (eg type setting but not the authors' fees).

[20]However market failure may not occur in *all* cases where intellectual property protection does not exist. Where the innovator gains the "first mover advantage" the foothold in the market place may be strong enough to permit recovery of fixed costs. Furthermore not all intellectual property is easily appropriated. Aeroplanes and racing yachts are not easily reverse engineered. Reproduction of the subtleties of such designs would be impossible without plans. America's Cup contestants continuously attempt to copy each others designs, but to no avail even without the intervention of intellectual property laws. See Benko, above n 17, generally.

intellectual property law protection extends only long enough for the fixed costs to be recovered.[21] Hence the term of copyright and patent protection is limited. Benko sums up the position when discussing patents:[22]

> Intellectual property rights... grant the inventor a temporary monopoly over the use of his or her invention and prevent competitors from sharing the knowledge without payment. They thus compensate for market failure and thereby solve the problem of appropriability... Static economic efficiency or optimal resource allocation is violated in the short term in an effort to generate a continuing supply of inventions.

Once it is accepted that innovation is worth protection as a property right, it is unhelpful from a competition law perspective to view this as a disruption of allocative efficiency in itself. Property rights in tangible goods also "inhibit" allocative efficiency in an analogous manner, yet without a legally enforceable property right such goods would not be produced either.[23] "Competition can only evolve as a regulatory mechanism in an economically meaningful manner *once the results of productive labour are protected by property rights*".[24] The focus of competition law should not be to attack the existence of the intellectual property right, but to restrain the exercise of intellectual property rights in licensing agreements that disrupt allocative efficiency beyond the scope of the original statutory grant.

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[21]The degree of protection necessary to encourage innovation is outside the scope of this paper. It is assumed therefore that the present intellectual property law regime is adequate for its purpose.

[22]R Benko, above n 17, 17.

[23]See Organisation for Economic Cooperation and Development *Competition Policy and Intellectual Property Rights* (OECD, Paris, 1989), 11-14 generally.

[24]M Lehman "Property and Intellectual Property - Property Rights as Restrictions on Competition in Furtherance of Competition" (1989) 20 ICC 1, 12 (emphasis added), quoted in Ministry of Commerce 1990 Discussion Paper on the Commerce Act, 224.

1 *Non-innovation intellectual property*

Not all intellectual property is subject to an "incentive for innovation" analysis. An alternative rationale for the interface may be needed. The law of trade marks grants exclusive rights for product *packaging* rather than in the product itself. Thus trade marks law does not act as an incentive to innovate and is unrelated to dynamic economic efficiency.[25] By regulating product packaging to reduce "search" costs, trade marks law permits rational consumers to select superior products. This permits market forces to reward efficient producers. Hence trade marks laws are related to *allocative* economic efficiency. No control is granted over the product *per se* and therefore no question of market power arises.[26] Trade marks are most relevant to competition law in franchising cases. As trade marks are not really relevant to innovation, and as the intellectual property link to franchise agreements is at best tenuous, trade mark licensing is not specifically addressed in this paper.[27]

C *Economics of the Interface*

The disruption of allocative efficiency is disrupted to the extent necessary to encourage innovation by the creation of a property right in innovation. The intellectual property right provides the economic incentive. Once the results of "productive labour" are protected by a property right no further disruption of allocative efficiency should be countenanced. In

[25]R Posner *Economic Analysis of Law* (Little, Brown and Company, Boston and Toronto, 1986) 37. Posner views trade marks partially in terms of incentive however. If the trade mark right was not to exclusive use, then producers would have no incentive to create them, and consumers would suffer. The point is that trade marks are not desirable innovations *in themselves*. They primarily operate to identify products. Posner notes also that trade marks can bestow monopolies of markets when they become generic terms. When this occurs the trade mark will not be renewed.

[26]Unless the trademark *is* the product. This may be the case with "image" goods such as Coca Cola where more importance is attached to the logo than the quality of the product on which it appears.

[27]Franchising agreements are generally permissible under competition law. Franchising promotes business growth and foster interbrand competition. For example Kentucky Fried Chicken and McDonalds are highly competitive.

other words, the rights holder is entitled to monopoly profits on the innovation, *but nothing more*. For purposes of analysing the interface, it is assumed that the current intellectual property rights are broad enough in scope to provide an adequate incentive for innovative activity. If not, defects in the intellectual property statutes (such as the term of protection) should *not* be remedied by allowing anti-competitive practices. Revision of the statue conferring the rights would be appropriate.

III INTELLECTUAL PROPERTY

There are subtle but important differences between the various types of intellectual property rights which have ramifications upon the Commerce Act interface. The following is a brief summary of the most relevant features of the intellectual property law statutes.

A *The Patents Act 1953*

A patent is a monopoly on innovations in either products or in manufacturing processes.[28] To gain patent protection the Patents Act 1953 ("the Patents Act") requires that the interest be registered.[29] This involves drafting a "specification" of the innovation which is both difficult and expensive.[30] If the specification is incomplete the patent can be contested and struck down. If the specification is too detailed the patentee may give away more trade secrets than necessary to obtain protection. To obtain patent protection the innovation must actually be a new one.[31] This high threshold justifies the grant of a total

[28]W R Cornish *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights* (Sweet & Maxwell, London, 1981), 132, notes that the "basic distinction [in patent law] is between, on the one hand, product or substance claims and, on the other, process, method or use claims. The first of these categories comprises claims to things. Such claims are infringed primarily by making, selling or using the things claimed. The second category concerns procedures for conducting activities. Here infringement consists primarily of performing the activity". The competition law implications of this duality are in the extent that the patent monopoly extends into the market place. This is discussed below in Part IV A.

[29]Section 7 of the Patents Act 1953.

[30]See Cornish, above n 28, 111.

[31]Sections 13 & 14 of the Patents Act.

monopoly. No use of the patented innovation is permitted without license even if the innovation is independently discovered.[32] This creates enormous pressure to keep development projects secret to then be the "first to file" for protection.[33] The patent term of protection is 16 years but this will be extended to 20 years by the end of 1994 pursuant to the TRIPS agreement.[34]

B *The Copyright Act 1962*

Copyright originally developed to further the intellectual betterment of the community by assuring remuneration for authors and creators.[35] The Copyright Act 1962 ("the Copyright Act") grants a limited monopoly over the work. Copyright focuses on originality as distinct from novelty: Any original expression of an idea, however hackneyed, will receive copyright protection.[36] Copyright aims to prevent wholesale plagiarism or piracy, and

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[32]The Letters Patent provide that "the patentee shall have and enjoy the whole profit and advantage from time to time accruing by reason of the... invention during the [patent] term". No one other than the patentee shall "... during the [patent] term either directly of indirectly make use of or put into practice the [patented] invention without the consent, license, or agreement of the patentee..." See Form A from the Third Schedule to the Patents Act Regulations 1954.

[33]Cornish, above n 28, 112.

[34]Article 23 of the Agreement on Trade-Related Aspects of Intellectual Property Rights, Including Trade in Counterfeit Goods ("TRIPS").

[35]Copyright policy is illustrated in the Long Title to the first copyright act, the Statute of Anne 1709 (GB): "An Act for the *Encouragement of Learning* by vesting the "copies" of printed books in the Authors or Purchasers of such Copies during the Times herein mentioned..." (emphasis added). The Preamble continues "Whereas Printers ... have of late frequently taken the Liberty of printing, reprinting and republishing Books without the Consent of the Authors or Proprietors of such Books ... for preventing such Practice and for the Encouragement of Learned Men to compose and write useful Books, be it enacted that ..."; The utility of copyright as a device to facilitate social improvement was also recognised by the framers of the U.S. Constitution. Article 1, § 8, cl 8 states that "The Congress shall have the power ... to *Promote the Progress of Science and useful Arts*, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries" (emphasis added).

[36]"Copyright protection is given to literary, dramatic, musical and artistic works and not to ideas, and therefore it is original skill and labour in execution, and not originality of thought that is required". *Copinger and Skone James on Copyright* (11 ed, Sweet & Maxwell, London), 48, cited in *Martin* v *Polyplas Manufacturers Ltd* [1969] NZLR 1046, 1050, and *Johnson* v *Bucko Enterprises* [1975] 1 NZLR 311, 315; See *Artifakts Design Group* v *N P Rigg* [1993] 1 NZLR 196, 210 for a discussion of the authorities on this point and see s 7(1) of the Copyright Act.

therefore an *independent* creator of the same work will also have an enforceable interest.[37] This is in contrast to the total monopolies granted by other intellectual property rights such as patent law and designs law. The low threshold for copyright protection results in a further limitation on the copyright monopoly: The "idea-expression" dichotomy. Only the expression of a work, and not the idea embodied in a work, is protected. Ideas are free for all to use,[38] and if protection for ideas is desired it is properly available under patent law. Because of the limited nature of the monopoly the term of protection is long - usually the life of the author + 50 years.

In New Zealand copyright protection can extend to functional goods in addition to the traditional classes such as books, music, and films.[39] This protection arose from desires to include three dimensional art works within the copyright scheme. It was not possible to arbitrarily decide what did or did not qualify as an artistic work however, and consequently such mundane items as frisbees,[40] plastic kiwi-fruit trays,[41] and rubber lavatory pan connectors[42] have been afforded copyright protection. The common element in these cases seems to be the restraint of competitors rather than the promotion of the useful arts.[43] The limited monopoly is rather illusory in the functional copyright context as

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[37]See *University of London Press Limited* v *University Tutorial Press Limited* [1916] 2 Ch. 601, 608.

[38]See *Bleiman* v *News Media (Auckland) Ltd* Unrep CP 185/94, 30 April 1994, HC Auckland Registry, 11. *Bleiman* concerned a newspaper competition called "Fantasy Football". The defendants had copied the key elements of the format and content of the game, without copying any specific wording. In the High Court Blanchard J observed that "[i]t may be thought to be hard on an originator of an idea or system that it is incapable of copyright protection, but that is the law as I understand it. The law reflects the fundamental value that ideas should, except to the limited extent that patent and design protection law may grant a monopoly for a period, be in the public domain, *to be used and built on to the advantage of the public*" (emphasis added). Blanchard J's decision was however overturned by the Court of Appeal on the application of the doctrine to the facts. See *Bleiman* v *News Media (Auckland) Ltd* (CA), above n 2.

[39]See s7(1) of the Copyright Act and the s2 definition of "artistic work" which includes sculptures and models.

[40]*Wham-O MFG Co* v *Lincoln Industries Ltd* [1984] 1 NZLR 641.

[41]*Plix Products Ltd* v *F M Winstone* (1984) 3 IP 390.

[42]*P S Johnson*, above n 2.

infringement can be shown by proof of access to the original work, and proof of substantial similarity.[44] Unless evidence is adduced by the defendant supporting independent creation (ie a "clean room" environment), liability will follow if the goods are substantially similar as proof of access is hardly a problem with *commercially marketed* products. Copyright protection of functional goods is especially damaging as the 'idea-expression' dichotomy (a major limitation on the copyright monopoly) is easily manipulated in functional copyright cases. Not all judges share a low view of functional copyright however. In *Artifakts* Williams J noted that[45]

> Some observers seem to think that the law relating to copyright in industrial design and commercial designs has become the red light district of copyright law with pernicious bootleg relief freely being made available. If the legislature is persuaded of that viewpoint it is for the legislature to move in and close it down. Until then the Courts must continue to decide, on a case by case basis, whether, in terms of the existing statue and its judicial exegesis, copyright protection should be given.

The problem stems from the fact that copyright law requires only a very low threshold of originality to gain protection. This is in total contrast to patent law. The comments in *Artifakts* were made in response to Thomas J's observations in *Franklin Machinery*:[46]

> Copyright has now invaded the field of technical design in a manner which has been dramatic. The most banal of industrial or technical drawings, which involve little more originality than that which accompanies many routine domestic tasks, has come to attract an aggressive claim to copyright protection. Frequently, the monopoly protection which the statue confers is out of all proportion to the degree of originality involved in producing the copyright work.

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[43]Ironically functional copyright appears to operate to the advantage of foreigners rather than any portion of the New Zealand public. New Zealand is primarily a consumer of intellectual property goods and the degree of functional copyright protection provides overseas interests with protection not available in their home countries.

[44]*Wham-O*, above n 40.

[45]*Artifakts Design Group*, above n 36, 213.

[46]*Franklin Machinery Ltd* v *Albany Farm Centre* CP 1081/91 Auckland Registry, 8 November 1991, 17; See P Sumpter "Case and Comment - Has Copyright Law Got Out of Hand?" 1992 NZLJ 151 (May) for a discussion of this case.

Parliament did move in 1985 to limit industrial copyright protection by reducing the term of protection to 15 years and by removing some of the remedies.[47] However the scope and availability of protection, which were the fundamental problems, were not addressed. It is now likely that the period of protection will be shortened again to 3 years.[48]

The law relating to industrial copyright has two important competition ramifications. First in the area of after-markets (spare parts),[49] and secondly on parallel importation.[50]

C *The Designs Act 1953*

Registered designs provides protection for functional goods with aesthetic qualities. A total monopoly is granted for 15 years. There is a registration requirement however. Industrial copyright protection has rendered the Designs Act almost totally redundant.[51]

D *The Trade Marks Act 1953*

Unlike the previous intellectual property rights, a trade mark is not a monopoly on a product.[52] A trade mark is simply a right to *label* a product in a distinctive way. This

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[47]In particular the prior availability of conversion damages was seen as oppressive. See R J Sutton "Industrial Design: The Copyright Amendment Act 1985" (1987) 12 New Zealand Universities Law Review 343 generally for a summary of functional copyright cases and the effects of the 1985 amendments.

[48]See A Brown "Review of Copyright Laws Poses a Threat to the Designers' Friend" National Business Review, March 18, 1994, 61. This still does not address the *scope* of the protection however.

[49]See below at Part IV C and at Appendix B.

[50]See n 57 below.

[51]See Sutton, above n 47, 349. Lack of registration requirements and the illusory monopoly limitation of copyright law mean there is little practical advantage in securing Designs Act protection. Brown, above n 48, notes that only about 600 designs are registered each year.

[52]See text at Part II B 1 above.

prevents unfair competition and allows market forces to encourage efficiency by facilitating rational consumer choice. Trade mark law does not operate to encourage innovation.[53] A trade mark can be renewed indefinitely.

IV THE LIMITATIONS OF INTELLECTUAL PROPERTY RIGHT MONOPOLIES

A *Exhaustion of Rights and the "First Sale" Doctrine*

It is a fundamental principle of intellectual property law that the licensor's rights are limited to the first act of commercial exploitation.[54] The principle was first enunciated in copyright cases. Early copyright statutes granted the copyright holder the exclusive right to "print, publish, and *vend*" the copyright work.[55] The issue soon presented to the courts was whether the copyright holder could restrain a purchaser of a book from selling (ie "vending") the book second hand. The copyright holders' rights were exhausted with the "first sale", although obviously the purchaser could be restrained from *duplicating* and selling copies of the book.[56] This problem is resolved in modern copyright legislation by redrafting the copyrights holder's exclusive rights. The right to "reproduce" the copyright work indicates that copyright aims only to protect the market for the work at the point of first sale.[57] Some copyright holders still try to evade the doctrine by characterising

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[53]See Posner, above n 25.

[54]See Cornish, above n 28, 23-30 and 199-200, generally. Note that the doctrine is not as strictly observed in international trade as in domestic trade. Parallel importing restrictions remain an important exception. See n 57 below.

[55]Section 1(a) of the Copyright Act 1909 (US) (emphasis added). See Patterson & Lindberg, above n 16.

[56]The first sale doctrine was actually expressly stated in § 27 of the Copyright Act 1909 (US). "...[N]othing in this title shall be deemed to forbid, prevent, or restrict the transfer of any copy of a copyrighted work the possession of which has been lawfully obtained". The principle is also stated in §109 of the Copyright Act 1976 (US).

[57]Some exceptions to the first sale doctrine still exist in the Copyright Act 1962. For example the parallel importing provisions in s10 permit the copyright holder to restrict the importation of second hand (and "new") copies of copyright works even when legally manufactured overseas. The provisions are designed to prevent exclusive territorial licenses being circumvented by the importation of goods. As the copyright

purchasers as "licensees". This is common in the "shrink wrap" licensing contracts that accompany much computer software, which is protected as a copyright work.[58]

The first sale doctrine is also true in patent law.[59] Here the distinction between patented products and patented processes in important. The licensor of a patented product has no patent control over that product after the first sale. For example this would be true of a patented lawn mower. The licensor of a patented process, such as the chemical treatment of timber, has no control over the timber itself but only over the use of the process. Difficulties arise where a patent falls in between the two classes. Arguably where the patented goods perform innovative functions, such as a patented film projector, the purchaser is really a licensee as they are "using" the patent when they use the machine.[60] In these situations the court will have to decide the appropriate scope of the monopoly. If the licensor uses the rights within the patent scope to gain collateral advantages then arguably this conduct should be subject to competition law.

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holders rights are exhausted by the first sale, a wholesaler may be able to sell *second hand but unused* goods to an importer. The result of the section's drafting is to catch genuine second hand goods with the ludicrous result that, when combined with functional copyright, manufacturers can now restrain the import of second hand, used, motor vehicles! See C Hutching "Car Dealer Settles Out of High Court" 1994, 6 May, National Business Review. An exception is made for the importation of goods for private use in s10(2) however. A further difficulty with the first sale doctrine is the modern practice of book, music, and video rental. Currently in New Zealand copyright holders have no control over this practice which usurps their marketing rights. Section 109(b)(1)(A) of the Copyright Act 1976 (US) provides "rental rights" for copyright holders of recorded musical works and computer programs. The Copyright Bill 1994 proposes to introduce similar rental rights in New Zealand.

[58]See D W Bonser "Preemption of 'Shrink-Wrap' Legislation by the Copyright Act" 37 Copyright Law Symposium 128 (1990).

[59]In the United States the "misuse of patents" doctrine was the initial justification for preventing control beyond the first sale rather than antitrust law. Throughout the twentieth century however the principles of the doctrine, and the relevant case law, has been absorbed into antitrust jurisprudence. See the comments of Goldberg J in *US* v *Loew's Inc* 9 L Ed 2d 11, 18. Cornish, above n 28, 199, notes that the exhaustion of rights principle was rather slower to develop in Britain, and had little restrictive effect on licensor's activities until the Treaty of Rome in the 1960s. Indeed Cornish, 25, observes that until this time Britain had taken the opposite stance to most jurisdictions on the matter - ie that the patentee could control all subsequent uses and sales.

[60]See *Motion Picture Co* v *Universal Film Co* 243 US 502 (1917) below at n 101 and *Transfield Pty Ltd* v *Arlo International Ltd* (1980) ATPR ¶ 40-166 in Appendix A. In both cases patented goods were sold, but it was uncertain whether the patentee had control over the use of the goods.

B *Compulsory Licensing Provisions*

The Patents Act, Designs Act, and the Copyright Act have compulsory licensing provisions which operate to mitigate the anti-competitive effects of the exclusive rights. The relevant Patents Act provisions are the most comprehensive, and are discussed below.[61] Section 14 of the Designs Act 1953 provides for compulsory licensing orders for a registered design on the grounds that it is not being applied by any industrial process to a commercially reasonable extent.[62] The Copyright Act has no general compulsory licensing provisions, as the copyright monopoly is more limited than that of other intellectual property rights. Section 22 of the Copyright Act however provides for a compulsory license in respect of musical works. When musical recording devices were invented, legislatures feared monopolies on musical recordings.[63] The compulsory license permits the making of recordings by any party of musical works for a prescribed royalty fee, if the musical work in question has already been recorded and exploited with the musical work copyright holder's permission.

C *The "Spare Parts" Exemption*

The "spare parts exemption" originates from *British Leyland* v *Armstrong Patents*[64] which held that, although copyright subsisted in the component parts of machinery such as exhaust pipes, the copyright was not infringed by the commercial manufacture of spare parts as the seller of the intellectual property product could not derogate from the "grant"

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[61]See text below at Part IX.

[62]The rationale for these compulsory licensing provisions is more the public policy goal of promoting access to innovation rather than preventing anti-competitive practices although the provisions may also perform this latter role. See text below at Part IX.

[63]The proviso to § 1(e) of the Copyright Act 1909 (US) was the first compulsory license for musical works to be enacted. Similar licenses followed in the United Kingdom and New Zealand.

[64]*British Leyland* , above n 3.

by denying the purchaser the right to repair the product.[65] The exemption seeks to mitigate the excesses of market power that can be created by functional copyright by restricting the scope of copyright law. In contrast to an order for compulsory licensing, the spare parts exemption does not allow the copyright holder to participate in any of the gains resulting from the manufacture of the spare parts. For this reason the House of Lords' precedent has not been followed in New Zealand.[66] This paper suggests that compulsory licensing is preferable to limiting the scope of intellectual property law (as enacted by Parliament) as then the copyright holder can gain remuneration from the licensing of the intellectual property right, as envisaged by statute, but the copyright holder cannot monopolise the market of manufacture and gain monopoly profits from this secondary market.

V INTELLECTUAL PROPERTY LICENSING

Licensing agreements occur between firms in different functional markets[67] and are a practical necessity for commercial exploitation. The licensor gains access to markets otherwise out of reach and the licensee gains access to proven technology. The licensor retains ownership of the rights while allowing another to exercise them. A license will contain restrictions on the use of the intellectual property right and may therefore appear to be anti-competitive when in fact the license is permissive. The restrictions cannot fall

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[65]The spare parts exception and the relevant case law is discussed in Appendix B. The doctrine can also be applied to other areas of intellectual property such as computer software. See J Gyngell "A User's Right to Repair and Maintain Software?" (1991) 2 Intellectual Property Journal 40 and J Yates "Third Party Computer Maintenance - A Legal Perspective" (1994) 10 Computer Law & Practice 9.

[66]See *Mono Pumps (New Zealand) Ltd* v *Karinya Industries Ltd* 7 IPR 25 and *Dennison Manufacturing Co & Another* v *Alfred Holt Co Ltd & Others* Unrep. Hight Court, Auckland Registry, 5 March 1987, A 736/78, Smellie J, discussed in Appendix B.

[67]Functional markets are the different vertical levels of a market for a particular product. In an intellectual property context, different functional markets might be the markets for development of the innovation, manufacture of the innovation product, and distribution of the innovation product.

foul of competition law unless the licensing terms go beyond the scope of the original intellectual property right to accrue collateral advantages.

A *Benefits of Intellectual Property Licensing*

The primary advantage of licensing is that it permits the maximum exploitation of the innovation. The rights holder alone will not be able to obtain the gains from every avenue of exploitation. The rights holder may not be vertically integrated[68] or the rights holder may not be a participant in the relevant geographic or product markets.[69] Through licensing, a rights holder is able to identify and separate customers "according to the value they place on the innovation" and charge accordingly.[70] The licensor can create incentives for the licensees to use their best endeavours in promoting the innovation,[71] and the licensor can structure licenses to encourage the licensee to improve upon the licensed innovation.[72] Licensing also spreads the economic risk by involving additional entrepreneurs with specialised expertise in their respective fields.[73]

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[68]A vertically integrated firm is one that competes in more than one functional market. For example a firm that engages in research and development as well as the manufacture of the intellectual property goods is vertically integrated.

[69]For example, an American firm may not be able to adequately exploit the New Zealand market, especially if freight costs are high. Such a form may license a New Zealand firm to manufacture the product.

[70]In this way the licensor captures the full consumer surplus of each consumer. See OECD, above n 23, 19.

[71]The licensor can grant exclusive territorial licenses that prevent "free riding" by competing licensees thus encouraging the exclusive licensee to actively promote the product. See text at Part XII A.

[72]By granting an exclusive license for particular applications of the innovation the licensee is assured of reaping the rewards from any improvements made in that application. See OECD, above n 23, 20.

[73]OECD, above n 23, 21. Simply put, innovations, or particular applications of innovations, can be licensed to those best able to exploit them.

B *Dangers of Intellectual Property Licensing to Competition Policy*

While "[l]icensing is to intellectual property what leases are to real property",[74] intellectual property licensing nonetheless poses risks to competition policy.

1 *Collateral advantages*

Intellectual property rights can be used to gain collateral advantages by exacting monopoly profits from markets not properly the subject of the right. Even if no collateral advantages are gained in the short term by exacting additional monopoly profits, intellectual property rights can be used to leverage market power in different functional, or different product, markets.[75] Other things being equal the acquisition of market power has a detrimental effect on efficiency and consumer welfare as it permits discretionary conduct in markets. The means of gaining collateral advantages and gaining power in secondary markets are discussed below.[76]

2 *Horizontal Arrangements*

"The single greatest concern facing competition authorities when reviewing intellectual property licensing agreements is that the agreement is a vehicle for a cartel arrangement to fix prices, limit output or divide markets. Although this concern can be briefly stated, it is the most serious threat to competition found in such licensing agreements".[77] The extent to which the Commerce Act addresses these concerns is discussed in Part _.

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[74]Eagles, above n 17, 10.

[75]OECD, above n 23, 17 and 25. See text below at Parts XII B and XIII D 2.

[76]See text at Part XII B.

[77]OECD, above n 23, 23.

C *Typical Licensing Provisions in Vertical Arrangements*

The following are some of the most common licensing terms in vertical arrangements.[78] Further licensing terms, including horizontal arrangements, are discussed in the specific context of the statutory exemptions later in the paper.[79]

1 *Exclusive licensing*

Intellectual property rights are inherently exclusive. This exclusivity can be passed on in whole or in part to licensees. Many licenses are of limited value unless they are granted exclusively. Substantial sunk costs in promoting intellectual property goods and the potential for free-riding by competitors may deter potential licensees if exclusivity is not granted.[80] A film promoter will expect an exclusive license for the film before making any investment. The licensee has a vested interest in licensing to an efficient manufacturer. If manufacturing costs are kept down, then greater quantities of the goods will be sold, increasing the licensor's royalties. Exclusivity is not necessary for all intellectual property however. The patent holder for a new means of house construction may seek to license as many parties as possible. The fundamental point is that exclusivity is part of the intellectual property right grant and the licensor should be free to pass it on if this is the most effective means of exploitation.

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[78]See Table 4-4 from F J Contractor *International Technology Licensing: Compensation, Costs and Negotiation* (1981) in OECD *Competition Policy and Intellectual Property Rights* (OECD, 1987) 13, reproduced in Appendix C. Some of the licensing provisions discussed in this paper in Parts _ , notably tying and price control, do not appear with high frequency in this table of United States Licensing provisions. This may be due to inaccurate survey results, or more probably, that effective competition law has discouraged these practices. This is supported by the fact that the least frequent licensing provisions seem to have been the most litigated! Also see OECD *International Technology Licensing: Survey Results* (OECD, 1987) Table 40 which confirms the findings of Contractor.

[79]See text below at Part VII.

[80]This is the *ex ante* affect of exclusivity which is frequently ignored in both intellectual property licensing and in non-intellectual property supply. While *ex post* it may appear that the lack of competition is allocatively inefficient, this must be balanced against the fact that without the exclusivity the market *may not exist at all*. See below at Part XII A.

2 *Divisions of the totality of rights*

Licensors will usually impose restrictions on the *scope* of the licensee's activities. "Field of use" restrictions are common licensing terms.[81] An intellectual property right may have more than one application. A patented chemical could have medicinal and industrial uses, and a film can be used in the cinema or on television. A licensee operating in only one of these fields has no desire for rights to operate in the other field. The licensee pays only for as much of the "field" as is necessary and the licensor can maximise exploitation opportunities. Some manipulation of field of use restrictions is possible however to gain collateral advantages and should be subject to competition law.[82]

Division of the totality of an intellectual property right is clearly evident in territorial exclusivity provisions. A licensee will be granted exclusivity for a particular jurisdiction, or sometimes, for territories of smaller area. This is for practical reasons of exploitation. Few will be able to exploit an intellectual property right world-wide and many products do not lend themselves to this sort of exploitation. It may be easier to manufacture products in the destination country rather than ship them.

Temporal restrictions are also typical. The period of protection afforded by intellectual property varies according to the right. Patent protection for pharmaceuticals is 16 years, of which only the latter few are practically available for exploitation.[83] Thus a license for drug manufacture will typically be for the full duration of patent protection.[84] Copyright

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[81]In copyright field of use restrictions are the rule rather than the exception. This is partly due to the fact that the exclusive rights of a copyright holder are defined in terms of various uses. Section 7(3) of the Copyright Act 1962 grants the copyright holder in a literary, dramatic or musical work the rights to publish, reproduce, perform, broadcast, transmit on a diffusion service, and make adaptations of the work.

[82]A field of use provision can facilitate collateral advantages by defining the field of use so that in practice it amounts to a product tie or restriction on composite products. See text below at Part VII C 2.

[83]See D Tuffery "Longer Drugs Patents an Urgent Priority" National Business Review, March 18, 1994.

[84]Clause 4 of the GATT (Uruguay Round) Bill 1994 will amend s30(3) of the Patents Act by lengthening the period of patent protection to 20 years.

works receive much longer protection, usually the lifetime of the author plus 50 years. Copyright licenses will therefore commonly be restricted in time.

Field of use, territorial, and temporal restrictions are not restrictive in themselves. The licensee is permitted to do something that would otherwise have been prohibited without a license. The licensor is merely dividing and assigning the totality of the intellectual property right. No restriction of competition is created beyond that initially granted by the intellectual property statute. Each field license or territory license will be an exclusive license for that application, but likewise the exclusivity goes no further than the exclusivity created by the intellectual property right itself.

3 *Tying*

The term "tying" is used to describe the situation where the licensor of an intellectual property product (the "principal" product)[85] requires the licensee to pay for additional products. The additional products are referred to as the "tied" products. Although a tying arrangement can *force* the purchaser to buy unwanted additional products, the term "tying" is usually applied where the licensee already requires additional products and the licensee is merely instructed to purchase them from a nominated supplier. The economic effect of tying agreements is to inhibit competition in the market for the tied product.[86] Where the licensee accepts the tie voluntarily, and declines to deal with competing suppliers of the tied product, then it may be assumed that the tied product is being supplied on competitive terms. More often however the licensee uses market power in the market for the principal product as leverage to impose product ties upon the licensor.

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[85]These products are sometimes referred to as the "tying" products.

[86]See the discussion of *Jefferson Parish Hospital District (No 2)* v *Hyde* 104 S Ct 1551, 80 L Ed 2d 2, 466 US 2 (1984) below at n 105.

Although ties may only be imposed when the supplier has sufficient market power in the market for the principal products, such market power may often be present with intellectual property.[87] A typical tying arrangement might be where the licensor of a patented process for making bricks ties into the license the raw materials for brick manufacture. For a copyright example, the licensor of cinema films might tie pop-corn supplies to the licensee.

(a) *Full-line forcing and third-line forcing*

Full-line forcing is where the licensor forces additional products of its own upon licensees. The licensee may have to purchase the licensor's entire "product range". Third-line forcing is where the licensor imposes tied products from a third party supplier. The third party supplier can then compensate the licensor.[88]

(b) *Intellectual property ties and non-intellectual property ties*

Tied products tend to be non-intellectual property goods such as raw materials. This can occur where the licensor has diverse business interests, is itself vertically integrated, or where the licensor third-line forces as mentioned above. Alternatively the tied product can also be an *intellectual property right.* This latter situation is described as "package licensing". A copyright holder for a film may tie other films to the license,[89] or a patent holder may tie other patent processes to the license. The United States courts do not discriminate between non-intellectual property and intellectual property goods. In New

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[87]See text below at Part XIII A.

[88]See R I McEwin "Third-Line Forcing in Australia" (1994) 22 Australian Business Law Review 114, 117.

[89]As in *US* v *Loew's*, above n 59, discussed below at Part VII D 3.

Zealand however the distinction may be material owing to the particular phrasing of section 45 of the Commerce Act. This is discussed below.

4 *Exclusive dealing*

Exclusive dealing arrangements are where a licensee is prohibited from purchasing products from suppliers other than the licensor. Thus it is the reciprocal of an exclusive license which fetters the *licensor's* freedom to trade.[90] Exclusive dealing arrangements are different from tying as the former arrangements cannot *force* the licensee to acquire additional products. In practice the distinction may be slight, as where the licensee already requires additional products, an exclusive dealing agreement may amount to a "constructive" product tie. The effects of an exclusive dealing agreement go beyond tying effects however. The licensee is also precluded from purchasing the *same* products from another supplier.[91] In an exclusive dealing arrangement the licensee of cinema films could not obtain films from other suppliers. In a tying arrangement the licensee must take additional films or other products from the licensor, but is still able to obtain films from other sources. Hence an exclusive dealing arrangement will protect the licensor's market for the principal goods while a tying arrangement will protect the licensor's market for the tied goods.

Exclusive dealing arrangements often occur as reciprocal arrangements for licensee exclusivity. If an exclusive licensee were permitted to deal in competing products then there may be little incentive for the licensee to promote the licensor's goods, and the licensor may be deprived of royalties. Aggressive licensees may use their product exclusivity as a means of removing competition from a market. In *Transfield* v *Arlo*

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[90]This is an over-simplification. See H P Marvel "Exclusive Dealing" 25 Journal of Law & Economics 1 (1982), 4, who notes that exclusive licenses are often used by manufacturers in the absence of exclusive dealing arrangements.

[91]Although if the licensor's entire range is full-line forced it may be commercially impractical to deal with other licensors.

Transfield was the exclusive licensee of the patented "Arlo pole" used in the construction of power transmission lines.[92] Transfield developed a competing design and ceased to market the Arlo pole in substantial quantities. As Transfield had an exclusive license, *Arlo could not license another party to use the pole*. Transfield had no incentive to use the Arlo pole as its own pole was royalty free and it could block competition from the Arlo pole. Exclusive dealing arrangements are frequently aimed at preventing this type of situation and therefore are usually limited to products that *compete* with the licensed product rather than all products the licensee may potentially desire to acquire.[93]

5 *Refusals to license*

Normally the licensor will grant exclusive licenses and hence not grant licenses to other parties. In some circumstances refusals to license may go beyond the rights conferred by the intellectual property law and potentially infringe competition law. Where the intellectual property right is freely licensed to all applicants, a refusal to license to one particular applicant may be an abuse of market power, especially when no substitutes are available.[94] Furthermore, when an exclusive intellectual property license has been granted, the arrangement may also be intended to procure collateral advantages. A licensor with market dominance may refuse to license to a third party in order to protect an inefficient subsidiary manufacturer. The lack of product substitutes on the market may mean that inefficient production does not materially affect product demand. Refusals to license are discussed in detail below.

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[92]*Transfield*, above n 60.

[93]This can be achieved by "best endeavour" clauses. The licensee must use its best endeavours to promote the licensed product, but the licensee's other business activities remain unaffected.

[94]This might be the case with copyright collection agencies. See the discussion at Part XIII D 3 of the text.

VI REGULATION OF THE INTERFACE

A *New Zealand*

The Commerce Act regulates the interface by a series of exemptions designed to prevent the gaining of collateral advantages. Collateral advantages may be obtained in two ways. First, onerous licensing terms may be imposed on a licensee. Second, the licensor may refuse to license. These issues are dealt with by sections 45 and 36(2) respectively. If a licensing provision falls outside of the exemptions, it will not be void *ipso facto*. The elements of the appropriate restrictive trade practices sections in the Commerce Act must first be satisfied: An intellectual property right may not confer enough *market* power for section 36 to be applicable, a collateral advantage may not substantially lessen competition in a market under section 27, or the licensor may not be vertically integrated as is necessary to fall within section 29.[95]

The Commerce Act exemptions apply only to *statutory* intellectual property rights. These include copyright, patent, registered designs, trade marks, and registered plant varieties.[96] Not included in the exemption are the "common law" intellectual property rights created by actions such as breach of confidence and passing off.[97]

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[95]Section 29 requires that an arrangement must be entered into between two or more competitors for the purpose of restricting the access to goods or services to or from a third party that is in competition with one of the parties to the exclusionary contract. Where the exclusionary contract is between two firms in different functional markets prima facie the section cannot apply. If however one of the parties to the contract is *vertically integrated*, so that it is in competition with the subject of the restriction, then the elements of section 29 can be satisfied. (See *Tui Foods Ltd* v *New Zealand Milk Corporation Ltd* (1992) 4 NZBLC 103,335). In an intellectual property context section 29 would require that either the licensee was competing in the market for innovation or that the licensor was competing in the market for manufacture for the section to be breached.

[96]The Plant Variety Rights Act 1987 is not dealt with in this paper as it is a somewhat less common intellectual property right than copyright and patent.

[97]See D Calhoun & B Brown *The Interface Between Amended Section 36 of the Commerce Act 1986 and Intellectual Property Law* (Competition Law and Policy Institute of New Zealand (Inc), August 1990 Workshop), 17-22, and Eagles, above n 17, 39-43.

B *Australia*

The Australian Trade Practices Act 1974 ("the Trade Practices Act") also regulates the interface with intellectual property exemptions which are found in section 51(3). There are three material differences between the Australian and New Zealand exemptions. First, the Australian exemption uses a "relates to" test. Licensing conditions that would otherwise have contravened the Trade Practices Act shall not contravene the Act "to the extent that the condition relates to" the protected innovation.[98] In theory this test applies the collateral advantage principle, although it creates some leeway for courts determining what "collateral advantages" actually are.[99] This test was abandoned from section 45 of the New Zealand Commerce Act in 1990. Secondly, section 51(3) does not apply to sections 46 and 46A that deal with the use of market power - the equivalent of sections 36 and 36A in the Commerce Act. Unlike New Zealand no additional exemption is made for section 46 and 46A. Thirdly, section 51(1)(a) of the Trade Practices Act, which is the general exemption for acts specifically authorised by other statutes, expressly *excludes* intellectual property rights from its ambit. Section 43 of the Commerce Act contains no such exclusion. The significance of these differences is discussed below.

C *The United States*

United States litigation of the intellectual property interface with antitrust law has centred around tying agreements,[100] exclusive dealing agreements,[101] and exclusive territory

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[98]Section 51(3)(a) of the Trade Practices Act 1974 (Cth).

[99]See below n 134..

[100]*US* v *Loew's Inc*, above n 59, where the licensing of films was conditional on the licensing of further, less desirable, films. The Supreme Court held that the contract violated § 1 of the Sherman Act.

[101]*Motion Picture Co*, above n 60, where the license of patented film projecting machinery containing a prohibition on using the machinery for projecting films from suppliers other than the licensor was held to be a misuse of the patent grant (Holmes J dissenting); *IBM Corp* v *US* 298 US 131 (1936) where the contract use of patented machinery requiring the purchase of stationary from the licensor was held illegal; *International Salt Co* v *US* 322 US 392 (1947) where the license of patented salt processing machinery

agreements.[102] Although the United States regulation of the interface involves no statutory exemptions, and the cases have been decided by much the same criteria as non-intellectual property anti-trust cases, the courts have observed the collateral advantage principle. In *Motion Picture Co* v *Universal Film Co* the patent holder for film projecting machinery sought to restrain "licensees" from using films other than those of the licensor.[103] The court considered the scope of intellectual property right monopolies:[104]

> The scope of every patent is limited to the invention described in the claims in it, read in light of the specification. These so mark where the progress claimed by the patent begins and where it ends... The restrictions of the [patent] law relate to the useful and novel features of the machine which are described in the claims of the patent, [and] they have nothing to do with the materials used in the operation of the machine... Whatever right the owner may have to control by restriction the materials to be used in operating the machine must be derived through the general law from the ownership of the property in the machine and it cannot be derived from or protected by the patent law, which allows a grant only of the right to an exclusive use of the new and useful discovery which has been made - this and nothing more.

Until the late 1970s many licensing practices such as tying were regarded as *per se* illegal - anti-competitive effect will be presumed without inquiry into market damage. Under the influence of the Chicago school of economics the courts have relaxed this approach. *Jefferson Parish Hospital* v *Hyde*, although not directly concerning intellectual property, is illustrative.[105] Jefferson Parish Hospital had a 30% share of the relevant geographic

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containing a prohibition on purchasing salt from suppliers other than the licensor was held illegal per se under § 1 of the Sherman Act; *Siegal* v *Chicken Delight Inc* 448 F 2d 43 (1971) where a contract requiring franchisees to purchase raw materials and equipment from the franchisor was held to be subject to a per se standard under the Sherman Act; *Kypta* v *McDonald's Corp* 671 F 2d 1282 (1982) where the license of the franchisor's name was "tied" to the lease of the franchisor's properties but held not illegal because the plaintiff suffered no economic damage.

[102]*Continental TV Inc* v *GTE Sylvania* 433 US 36 (1977) where a contract restricting a franchisee to selling from a particular location was held to be subject to the rule of reason standard.

[103]*Motion Picture Co*, above n 60.

[104]*Motion Picture Co*, above n 60, 510-513.

[105]*Jefferson Parish Hospital*, above n 86.

market. The hospital had engaged the services of Roux, a firm of anesthesiologists, for all the hospital's operations. The Roux anesthesiologists in return would work for no other hospitals. The effect of this agreement was that patients of the hospital could only use the anaesthesia services of Roux.[106] The Supreme Court was unanimous in deciding that this arrangement did not breach section 1 of the Sherman Act,[107] but the Court was divided 5 to 4 on the reasoning. The majority of the Supreme Court took a traditional approach concluding that tying breached the Sherman Act *per se* if the defendant had "monopoly" power in the principal product market and used this to force the tied product upon the consumer.[108] Citing *International Salt Co* v *US*[109] Stevens J noted:[110]

> It is far too late in the history of our antitrust jurisprudence to question the proposition that certain tying arrangements pose an unacceptable risk of stifling competition and therefore are unreasonable "per se".

The *per se* approach was justified by the reasoning that if the tied product could stand in the market on its own merits then there would be no reason for the firm with market power in the principal product market to use this power to force the tied product upon the consumer.[111] In this case however Jefferson Parish Hospital did not have sufficient market power to justify the *per se* condemnation of the tie.[112]

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[106]This agreement was referred to in the case as a tying arrangement. Note however that the tied product was not forced upon the patients who did not need it. It may have been more appropriate to describe the contract as an exclusive dealing arrangement. The Court did not make this distinction. See *Jefferson Parish Hospital*, above n 86, 1558.

[107]Section 1 of the Sherman Act is roughly the equivalent of s27 of the Commerce Act. Section 1 of the Sherman Act states that "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal...".

[108]Implicit in the majority judgment are concerns about the "freedom to trade" and presence of monopoly power. See R Pitofsky, below n 8, for a discussion of these considerations in United States antitrust law.

[109]*International Salt Co* v *US* 332 US 392, 396.

[110]*Jefferson Parish Hospital*, above n 86, 1556.

[111]*Jefferson Parish Hospital*, above n 86, 1558, per Stevens J citing T*imes-Picayune Publishing Co* v *US* 345 US 594, 605.

The minority held that ties should be subjected to a "rule of reason" test permitting evaluation of the tie's effects on competition in the relevant markets. Citing *Continental TV Inc* v *GTE Sylvania Inc*[113] O'Conner J noted that the rationale for *per se* offences:[114]

> In deciding whether an economic restraint should be declared illegal per se, "[the] probability that anticompetitive consequences will result from a practice and the severity of those consequences [is] balanced against its procompetitive consequences. Cases that do not fit the generalization may arise, but a per se rule reflects the judgment that such cases are not sufficiently common or important to justify the time an expense necessary to identify them"...

O'Conner J observed that "in practice, a tie has been illegal only if the seller is shown to have 'sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product'"[115] and then continued:[116]

> The "per se" doctrine in tying cases has thus always required an elaborate inquiry into the economic effects of the tying arrangement. As a result, tying incurs the costs of a rule-of-reason approach without achieving its benefits: the doctrine calls for the extensive and time consuming economic analysis characteristic of the rule of reason, but then may be interpreted to prohibit arrangements that economic analysis would show to be beneficial.

O'Conner J suggested that tying should be "brought into accord with the law applicable to all other allegedly anticompetitive economic arrangements, except those few horizontal or quasi horizontal restraints that can be said to have no economic justification whatsoever".[117] The rule of reason approach was justified because a firm with enough

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[112]*Jefferson Parish Hospital*, above n 86, 1565.

[113]*Continental TV Inc*, above n 102, 50 n 16 (1977).

[114]*Jefferson Parish Hospital*, above n 86, 1568.

[115]*Jefferson Parish Hospital*, above n 86, 1569, citing *Northern Pacific Railroad Co* v *US* 356 US 1, 6 (1957).

[116]*Jefferson Parish Hospital*, above n 86, 1569-1570.

[117]*Jefferson Parish Hospital*, above n 86, 1570.

market power in the principal product market to impose a tying arrangement has no rational anti-competitive motive for doing so unless it can inhibit competition in the tied product market and thus increase its power in that market also. Without a lessening of competition in the tied product market, the firm would gain no anti-competitive advantage from the tie as the firm's market power in the *principal* product market would be sufficient to gain monopoly profits.[118]

This is the approach that would be taken by New Zealand courts, as the majority approach in *Jefferson* of making tying illegal *per se* where the supplying firm has market power in the principal product market cannot fit within the Commerce Act framework. For section 27 to be breached a substantial lessening of competition in the tied product market is necessary, and for section 36 to be breached a dominant position in the principal product market would have to be used to hinder, or eliminate, effective competition in the tied product market. The only *per se* offence in the Commerce Act that may be applicable is section 29 which would require that the supplying firm, or another party to the arrangement, be a *competitor* of the supplied firm.[119] This generally requires vertical integration in the supplying firm which may not be present.

While most vertical restraints in the United States can now be said to be subject to a rule of reason analysis,[120] *this position is still far removed from granting absolute intellectual*

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[118]Therefore O'Conner J proposed 3 threshold prerequisites for illegal ties. First the seller must have power in the principal product market. Secondly, there must "a substantial threat that the [supplier] will acquire market power in the tied-product market". Thirdly, there must be "a coherent economic basis for treating the [principal] and ties products as distinct". This last element can only be satisfied when the tied product is one that consumers might wish to purchase separately without also purchasing the principal product because "[w]hen the tied product has no use other than in conjunction with the [principal] product, a seller of the [principal] product can acquire no additional market power by selling two products together". When these elements are satisfied then a rule of reason analysis must be conducted to determine the tie's effects on competition. See *Jefferson Parish Hospital*, above n 86, 1571-1573.

[119]See above n 95 and text at Part VII.

[120]See *Jefferson Parish Hospital*, above n 86, 1570, and V S Khanna "Vertical Restraints: - The Pandora's Box of Competition Law" LLB(Hons) Research Paper, Competition Law, Victoria University of Wellington, 1992, 22 for a discussion of *Continental TV* v *GTE Sylvania*, above n 102.

property exemptions from antitrust law as the Commerce Act does. The minorities' position in *Jefferson Parish Hospital* is basically the same as the Commerce Act *without* the exemption sections.[121]

VII SECTION 45 OF THE COMMERCE ACT 1986

Section 45 is intended to regulate vertical restraints found in licensing agreements.[122] Section 45 provides that nothing in Part II of the Act, except the sections relating to use of a dominant position and retail price maintenance, applies:[123]

> (a) To the entering into of a contract or arrangement or arriving at an understanding in so far as it contains a provision authorising any act that would otherwise be prohibited by reason of the existence of a statutory intellectual property right; or
>
> (b) To any act done to give effect to a provision of a contract, arrangement or understanding referred to in paragraph (a) of this subsection.

The key issue under section 45 as it stands is whether a licensing provision goes beyond merely authorising what would otherwise be prohibited by virtue of the intellectual property right. This is a "but for" test,[124] and suggests that the licensor may divide the totality of the rights in any way desired, but may go no further. The licensing provision should be interpreted in light of the original intellectual property right, and any provisions seeking to gain advantages collateral to that right will not fall within the exemption.

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[121] See text above at Part VI A.

[122] Section 36(2) regulates licensing agreement that potentially breach section 36. However claims against anti-competitive licensing terms are likely to be first brought under section 27 or section 29 as these sections have lower thresholds than the market dominance required by section 36. Section 36 is useful when section 45 provides an exemption. Refusals to license, and refusals to license to more than one licensee, are examples of practices that could only be challenged under section 36.

[123] Section 45(2) defines "statutory intellectual property right" as any rights conferred by the Patents Act 1953, the Designs Act 1953, The Trade Marks Act 1953, the Copyright Act 1962, or the Plant Variety Rights Act 1987.

[124] The test asks "but for the license provision would the actions permitted under the license violate an intellectual property right?" If so, then the provision is valid.

Another way the drafters could have framed section 45 would be to ask whether the statute authorises the conduct in question. However most intellectual property rights are defined in negative terms (ie what the holder can prevent others from doing) and hence the "negative" wording of the section.[125] In substance however section 45 is consistent with the Act's general approach of subjecting all conduct to scrutiny that is not specifically authorised by another act, although in fact this "form" is not used.[126]

Licensing terms that do not fall within section 45 will be subject to sections 27 and 29 of the Commerce Act.[127] Section 27 can apply to vertical or horizontal practices and provides that contracts, arrangements, or understandings that have the purpose or effect "of substantially lessening competition in a market" are prohibited. Hence an inquiry into market damage is necessary before the section can be breached. Many intellectual property licensing terms that do not fall within the section 45 exemption may nonetheless be exempt because competition in the relevant market is not substantially lessened. Note that "substantially lessening competition" test considers effects only on allocative efficiency and not innovative efficiency. Section 29 is intended to apply to horizontal arrangements and is breached by contracts, arrangements, or understandings in which two or more competitors prevent or restrict the supply of goods and services to, or the acquisition of goods or services from, any person that is in competition with one of the parties to the contract, arrangement or understanding. Section 29 is a *per se* offence in so far as no inquiry into the effects on competition is required if the conduct in question satisfies the elements of the section.[128] While section 29 is intended to apply only to horizontal practices, it can also apply to vertical practices if an element of vertical integration is present. Vertical

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[125]Ministry of Commerce, above n 24, 225.

[126]Section 43 is the clearest statement of this objective in the Commerce Act. See Ministry of Commerce, above n 24, 226.

[127]Section 45 also provides an exemption for s28 that concerns covenants that substantially lessen competition, but as this section is rarely used the discussion is confined to s27 and s29.

[128]Prior authorisation may be obtained however. See below n 179.

integration occurs where a firm competes in more than one functional market. In an intellectual property context this may be where a firm both develops intellectual property and manufactures the intellectual property. Where either the licensor or the licensee is vertically integrated these parties are technically in competition with each other, and hence section 29 can apply. An example would be where a licensor also manufactures the intellectual property product. The licensee could be in competition with the licensor in the market for manufacture.[129] It should be noted also that prior authorisation is possible for practices that might otherwise breach sections 27 and 29

A *Legislative History*

Section 45 was amended to its current form in 1990. Eagles has described the original draft of section 45 as a clause of "breathtaking scope",[130] and even in its original enacted form it was still an "unforgivably defective instrument to place in the hands of the Courts and the Commerce Commission as they seek to evolve a set of principles which will preserve the social utility of intellectual property... while immunising consumers and traders against their anti-competitive effects".[131]

Before its amendment in 1990, section 45(1) provided an exemption for contractual provisions "relating to the use, licence, or assignment of rights under or existing by virtue of" a statutory intellectual property right. Section 45(2) deemed that provisions for the purpose of controlling the nature, extent, territory, or period of the licence related to the "use or licence" of an intellectual property right. Also exempted by virtue of the deeming section were licensing provisions that protected the licensor's interests in a "technically

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[129]Assuming that the manufactured products are competing in the same geographical and product market etc.

[130]Eagles, above n 17, 2.

[131]Eagles, above n 17, 3.

satisfactory exploitation" of the right, and provisions requiring innovation and "know-how" grant backs.[132]

The use of a "relating to" test was necessarily rather imprecise, and offered little guidance about what is a legitimate licensing restraint.[133] The Australian intellectual property exemption in section 51(3) of the Trade Practices Act 1974 also uses a "relating to" test. In *Transfield* v *Arlo*, the only Australian case to have considered the section, judges reached opposite conclusions about whether an exclusive dealing clause would be a collateral advantage and therefore not "relate" to the license of an intellectual property right.[134] Furthermore, as Eagles has observed, it was unclear whether the restrictions in section 45(2) were exhaustive or illustrative.[135]

The Department of Trade and Industry's 1988 discussion paper on the Commerce Act review stated the concern that the original section 45 went further than providing an exemption for the "matters authorised under the various specific statutes relating to intellectual property".[136] The Department's major criticism was that section 45 protected horizontal arrangements between competitors.[137] The Department did not address the anti-competitive effects of some vertical licensing agreements that go beyond the scope of the

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[132]Grant backs are where a licensee making improvements on the licensed technology is required to license these improvements back to licensor. Grant backs are discussed below at Part VII C 3.

[133]See Department of Trade and Industry *A Discussion Paper - Review of the Commerce Act 1986* (Department of Trade and Industry, Wellington, 1988), 40-42.

[134]Mason J held that an exclusive dealing arrangement is simply to ensure adequate exploitation of the licensed product and could not therefore be a collateral advantage. See *Transfield*, above n 60, 42,310. Murphy J held that an exclusive dealing arrangement was not exempted under the Patents Act 1952 (Cth) and that is was a collateral advantage. See *Transfield*, above n 60, 42,310. See Appendix A for a full discussion of the case.

[135]Three interpretations of section 45(2) were possible. First the sub-section may *deem* certain provisions to relate to the use of an intellectual property right. Secondly, the examples may only be illustrative of provisions relating to the use of an intellectual property right. Thirdly, the examples may be an exhaustive list of provisions relating to the use of an intellectual property right. See Eagles, above n 17, 26.

[136]Department of Trade and Industry, above n 133, 40.

[137]Department of Trade and Industry, above n 133, 40.

original intellectual property right but which seem to fall within the original section 45 exemption.

B *Licensing Provisions Exempted by Section 45*

The following is a list of common restrictions that divide the totality of the right and are therefore most likely exempt from the Commerce Act under section 45:

1 *Exclusive licenses*

Exclusive licenses fall squarely within the exemption, as the licensee merely passes on the exclusivity inherent in the intellectual property right. Without an exemption many such licenses could be *per se* illegal under section 29.[138] In situations where the exclusivity serves to gain collateral advantages, section 36 would still be applicable.[139]

2 *Divisions of the totality of rights*

Territorial restrictions, temporal restrictions, and field of use restrictions are mere subdivisions of the rights holder's exclusive rights and gain no collateral advantages. Although the licensees may be "restricted", they are permitted to engage in activities that the intellectual property right would otherwise have prohibited.

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[138]See text above at Part VII.

[139]The gaining of collateral advantages is only likely to be possible by this means when there are no substitutes for the licensed product. In this situation the licensor will have market dominance and section 36 could apply. See text below at Part XI.

3 *Production quotas*

Restrictions in production are also likely to fall within the exemption, as technically the licensee is permitted to do something that would otherwise have been prohibited.

C *Licensing Provisions Not Exempted by Section 45*

1 *Tying of non-statutory intellectual property products*

Tying is the classic example of a collateral advantage and does not fall within the exemption. Tying may not be prohibited by section 27 however where competition for the supply of the tied product is not significantly affected by the tie.[140] Consider the example of the patent holder for the brick manufacturing process that ties the licensee to the purchase of raw materials. The raw materials used in brick making may have many other applications. Suppliers of the raw materials will not be significantly affected by the foreclosure of this market opportunity, but the licensee is forced to purchase from an inefficient producer. Such a situation could be dealt with by section 36, as the focus of inquiry is really the licensor's market dominance in the principal product market, but section 36 still requires the purpose of eliminating or restricting competition. If section 27 would not invalidate the tie, it is unlikely that section 36 would.

2 *Restrictions on composite products*

In *Windsurfing International* v *European Commission*[141] the licensor restricted the license of a patented windsurfer sailing rig to the manufacture of the complete product (ie a whole windsurfer). This sort of provision may be justifiable as a general field of use restriction if

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[140]There are also other justifications for tying. See T Frank "The Economic Interest Test and Collective Action Problems in Antitrust Tie-in Cases" 61 University of Chicago Law Review 639 (1994).

[141]*Windsurfing International* v *European Commission* [1986] 3 CMLR 489.

another party is licensed to manufacture for a different field (eg manufacture of rigs for DIY consumers) but it was doubtful whether the market here could be divided in such a way. The license also provided that the manufacturer only attach the rigs to hulls approved by the licensor. Both these provisions were struck down by the Court. The provisions were seen as attempts to control an un-patented product (the hulls). The manufacturer could designate from whom the licensee was to purchase hulls. Thus the markets for hulls and for separate rigs were foreclosed. The court rejected arguments that such provisions were necessary for quality control.

3 *Grant back provisions*

Grant back provisions occur because in the course of use licensees often make improvements upon the patent. The licensor will wish to remain competitive in the patented field and may wish to license these improvements to other licensees also. Grant back clauses have a number of forms with varying degrees of competition law significance.[142] The clause may simply deem improvements to be the property of the licensor. This is least favourable to the licensee and is the most likely to offend competition law as it simply attaches a collateral condition to the license which forecloses the market for the improvement.. More innocuous is a clause giving the licensor the option to acquire any improvements at a pre-ordained or determinable value (eg market price). Alternatively if the licensor only wishes to remain competitive in a market, the grant back clause may entitle the licensor only to a "royalty free" non-exclusive license from the licensee.[143] A grant back provision will be most acceptable to licensees with exclusive rights, as that licensee will not then face the prospect of competition from other licensees. A licensee may also demand additional competitive advantages in return for the grant back

[142]Melville, above n 15, 1.40.

[143]See OECD, above n 23, 86 quoting United States Department of Justice Guidelines which suggest that non-exclusive grant backs are actually pro-competitive.

obligation. In the United States the validity of grant back clauses is determined under the "rule of reason" standard.[144]

4 *Resale price maintenance*

Section 45 does not apply to resale price maintenance. This is assumed always to be anti-competitive. Note however that section 43 could provide an exemption to this practice.[145]

5 *Price fixing*

This is not a licensing issue as such as the arrangement is horizontal (between competitors). The arrangement between licensees would not exist by reason of authorising something otherwise prohibited by an intellectual property right and section 45 would not therefore apply - Price fixing is a collateral advantage. Section 30 would deem such conduct to substantially lessen competition under section 27. Intellectual property price fixing arrangements are unlikely to contain more that 50 parties so the section 32 exemption is not applicable. The only New Zealand case to have dealt with intellectual property price fixing is *HMV* v *Simmons* which concerned the price fixing and resale price maintenance of retail record prices.[146] The case was decided under the Trade Practices Act

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[144] *Transparent-Wrap Machine Corp* v *Stokes and Smith Co* 329 US 637 (1946). Transparent-Wrap had exclusively licensed Stokes to manufacture and sell patented packaging machines on the condition that Stoke assign all improvements back to Transparent-Wrap. The Supreme Court held that such contracts were subject to a rule of reason analysis, but the Court noted some of the traditional concerns about innovation grant backs. "We are quite aware of the possibilities of abuse in the practice of licensing a patent on condition that the licensee assign all improvement patents to the licensor. Conceivably the device could be employed with the purpose or effect of violating the antitrust laws. He who acquires two patents acquires a double monopoly. As patents are added to patents a whole industry may be regimented. The owner of a basis patent might thus perpetuate his control over an industry long after the basis patent expired. Competitors might be eliminated and an industrial monopoly perfected and maintained. Through the use of patents pools or multiple licensing agreements the fruits of invention of an entire industry might be systematically funnelled into the hands of the original patentee" (Transparent-Wrap, 646). See OECD, above n 23, 85 and Melville, above n 15, 1.42.

[145] Such as for the fact situation in *HMV* v *Simmons* [1960] NZLR 25. See text at Part X B.

[146] *HMV* , above n 145.

1958 which had no equivalent to the current section 45. The Court therefore applied the test in the section for general "statutory authorisations" and found that the exemption did not apply.[147]

The United States case of *US* v *Paramount Pictures Inc* dealt with the practices of the major (vertically integrated) film producers which included price discrimination, overly restrictive licensing terms,[148] block booking,[149] resource pooling, franchising, resale price maintenance, and price fixing.[150] As far as price fixing was concerned, the film licensors had set minimum admission prices to be charged by the licensees (the theatres), and the "competing" licensors had agreed on these prices between themselves. Thus the price fixing was horizontal and vertical (ie resale price maintenance).[151] The Supreme Court held that price fixing amongst competitors was *per se* illegal under the Sherman Act.[152] Applying the reasoning used in patent price fixing cases the Court quoted *US* v *Gypsum Co*:[153]

> The rewards which flow to the patentee and his licensees from the suppression of competition through the regulation of an entire industry are not reasonably and normally adapted to secure pecuniary reward for the patentee's monopoly.

The Court therefore applied a collateral advantages test. The industry regulation was not envisaged by the statutory intellectual property right, and here the licensor's actions had

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[147]See text at Part X B.

[148]In particular conditions relating to when theatres may screen films, and periods that must elapse before re-screening. See *US* v *Paramount Pictures Inc* 334 US 131 (1947), 144.

[149]Block booking is discussed below at Part VII D 3.

[150]*Paramount*, above n 148.

[151]*Paramount*, above n 148, 142.

[152]*Paramount*, above n 148, 143.

[153]*US* v *Gypsum Co* 333 US 364, 401 quoted in *Paramount*, above n 148, 144.

gone beyond merely securing the monopoly profits available from the intellectual property right.

6 *Exclusive dealing*

Exclusive dealing contracts are similar to tying. Instead of mandating the purchase of goods from a designated supplier, the licensor forbids the purchase of goods from suppliers other than the licensor. The effect will be the same where the licensee needs the goods in question.[154] Exclusive dealing contracts are the reciprocal obligation of exclusive licenses.[155] The licensor may be concerned that once having granted an exclusive license, the licensee will then market a competing product, thus depriving the licensor of royalties. The licensee will then have removed, at no cost, competing goods from the market. These contracts are sometimes framed as "best endeavours" clauses. The licensee must use their best endeavours to promote the product (ie not sell competing products). Another means of effecting an exclusive dealing contract would to require a large "up front" license fee deductible from later royalties. In *Transfield* a best endeavour clause was not held to require exclusive dealing. Opinion was divided as to whether an exclusive dealing contract would be a collateral advantage.[156] Exclusive dealing arrangements are not exempted by section 45 because they do not permit something that an intellectual property right would otherwise have prohibited.

Under the Commerce Act exclusive dealing arrangements are subject to the "substantially lessening of competition" test in section 27. *Fisher & Paykel* v *Commerce Commission* demonstrates that such contracts may not always breach the Act.[157] Exclusive dealing

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[154]A tying arrangement can force licensees to purchase goods that they do not need.

[155]See above n 90.

[156]See above n 134.

[157]*Fisher & Paykel Ltd* v *Commerce Commission* [1990] 2 NZLR 731.

arrangements may sometimes *foster* interbrand competition by preventing dealer "free-riding" on the manufacturer's promotional and servicing efforts. This same rationale could be applied to exclusive dealing contracts in intellectual property licenses, providing that sufficient interbrand competition exists.

Where vertically integrated firms are involved, an exclusive dealing arrangement may also satisfy the elements of section 29. For example, the licensee or licensor may be active in two functional markets. The licensor and licensee would then be competitors. If the licensee was prevented by the exclusive dealing arrangement from dealing with further third party licensors, the contract would breach section 29 because the contract prevents the acquisition of goods or services from the third party licensor, and that third party licensor would be a competitor of the licensor party to the licensing contract.

D *Anomalies of Section 45*

1 *Patent pooling*

Patent pooling is a horizontal arrangement where some competitors grant licenses to each other. Patent pools can also be used as a launch pad for joint research and development. To some extent these arrangements are be pro-competitive as each competitor in the pool then has access to a greater amount of intellectual property. Problems occur however when not all competitors are involved in the pool, and the licenses are granted exclusively to the competitors within the pool. Passing on exclusivity already inherent in the intellectual property right seeks no advantage collateral to an intellectual property right and therefore falls within the section 45 exemption. Although one could argue that the agreement to exclude a third party by patent pooling is a collateral advantage and does not fairly fall within section 45, *section 45 could still apply even if only one exclusive license was granted horizontally.* Ironically a prime motivation for revising the original section 45 was that it permitted horizontal arrangements between competitors - a deficiency that has not been remedied.[158] Because an exclusive horizontal license seeks no advantage collateral to the right being licensed, section 45 will exempt the practice.[159]

Where a pool is comprised of exclusive licenses patent pools may operate as exclusionary contracts of the type section 29 addresses.[160] As section 29 is currently a *per se* provision (although subject to authorisation)[161] excluding pools from section 45 would effectively prohibit the practice outright.[162] Furthermore the Commerce Act has no exception for joint ventures as such.[163] It is difficult to justify the discriminatory treatment of tangible and intellectual property goods from the operation of section 29 however. The benefits of patent pools can be attained without excluding other competitors from the technology.

As the exemption stands, pools may be challengeable if the pool was likely to have the effect of fixing, controlling, or maintaining prices for goods or services.[164]

2 *Cross licensing*

Cross licensing is the same as patent pooling but between only two competitors. The same rules apply.

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[158]Department of Trade and Industry, above n 133, 41.

[159]Furthermore as Eagles, above n 17, 61, notes, "[n]or is section 36 easily invoked against a patent pool given its emphasis on unilateral rather than collective action.

[160]Providing that the pool is an arrangement between competitors. Section 29 requires that the parties to the exclusionary contract be competitors and that the excluded party be a competitor of one of the parties to the contract. As pools are a purely horizontal agreement the section squarely applies. No vertical integration in necessary for the section to apply, unlike for vertical exclusive dealing arrangements. See text above at Part VII.

[161]See below n 179.

[162]Section 29 bans exclusionary contacts outright even if no lessening of competition actually occurs.

[163]Section 44(1)(a) of the Commerce Act makes an exemption from Part II of the Act for partnerships, but it most unlikely that parties to a research and development joint venture would want their relationship categorised as a partnership because of the joint and several liability that this entails.

[164]See Parts VII C 4 & 5.

3 *Package licensing*

Package licensing (or "block booking" for copyright works) is a vertical practice where a licensee must accept, and pay for, additional licenses to the one desired. In an intellectual property context this practice is distinguishable from normal tying as a distinction must be made between tying ordinary goods to the intellectual property right and imposing additional products *also subject to an intellectual property right.* Strictly speaking, in terms of section 45 there is no "collateral" advantage being sought independent of any statutory intellectual property right. The licensor is authorising something that would otherwise be prohibited by reason of an intellectual property right. It is ironic that this practice seems to fall within section 45 as exclusive dealing arrangements and tying of non-intellectual property goods are less anti-competitive but fall outside the exemption. A possible means of excluding package licensing from the operation of section 45 is discussed below however.

Package licensing can be a particular problem when dealing with copyright collection agencies or large entertainment corporations which often have a considerable degree of market power.[165] *US* v *Loew's Inc* dealt with such a situation.[166] Six major film distributors licensed films to television stations on the condition that entire blocks of films were licensed. The distributors had not acted in concert so the complaint was limited to the manner in which each distributor had licensed the films. TV station WTOP had licensed films from Associated Artists Productions Inc. WTOP had to take 99 films divided into three groups based on quality. To obtain such classics as "Casablanca" and "The Man Who Came to Dinner" WTOP also had to purchase rights to somewhat less popular films such as "Tugboat Annie Sails Again", "Gorilla Man", and "Tear Gas Squad".

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[165]The Australasian Mechanical Copyright Owners Society ("AMCOS") and Copyright Licensing Limited ("CLL") are two such collection agencies in New Zealand. Copyright owners assign their copyrights to the agency who then license them for use to the general public. This effectively bars dealing directly with the creator of a work for a license.

[166]*US* v *Loew's*, above n 59.

The Supreme Court held that the films were not substitutes for each other,[167] and thus the reasoning appropriate to tying non-intellectual property goods to patent licenses was applicable[168] - namely that the statutory monopoly cannot be extended to other products.[169] The defendants had sufficient economic power with respect to each "unique" product[170] and hence section 1 of the Sherman Act was breached *per se*.[171]

It may be possible for the courts to characterise package licensing as obtaining a collateral advantage by holding that the words of section 45 are intended only to apply to the terms of single pieces of intellectual property. Thus to fall within the exemption the license provision must relate to the specific intellectual property right in respect of which it is attached. Where a license for intellectual property right A contains a term mandating the license of intellectual property right B, the term in the A license would not permit something otherwise prohibited by *intellectual property right* **A** - the intellectual property right to which the term is attached. The intellectual property right tie could then be viewed as a collateral advantage and outside the scope of section 45. This paper suggests that this approach is preferable, as it is consistent with the policy goals of both areas of the law, and also as the United States cases have treated ties of intellectual property goods and non-intellectual property goods in an equal manner. In any case, package licensing agreements are most likely to involve a large degree of market power and can therefore also be considered under section 36.[172]

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[167]*US* v *Loew's*, above n 59, 20. If the films were "fungible" goods then no "tying" could exist as the films are all the same product. Contrast this with O'Conner J's statements in *Jefferson Parish Hospital*, above n 86, 1571 n 7.

[168]*US* v *Loew's*, above n 59, 20.

[169]*US* v *Loew's*, above n 59, 19.

[170]*US* v *Loew's*, above n 59, 20.

[171]Although the Court did note that there may be "rare circumstances in which the doctrine we have enunciated under § 1 of the Sherman Act prohibiting tying arrangements involving patented or copyrighted tying products is inapplicable". (See *Loew's*, above n 59, 21). The Court did not comment what these circumstances might be.

E *Non-Statutory Intellectual Property Rights*

Under section 45(2) no provision is made for the exemption of non-statutory intellectual property rights. Reasons for the lack of such an exemption are purportedly that Parliament has not expressly recognised these common law rights (such as breach of confidence and passing off) by codifying them, and that the scope of these rights is less rigidly defined than the scope of statutory intellectual property rights.[173] Nonetheless section 7 of the Commerce Act provides a limited exemption for breaches of confidence.

1 *Sections 7(2) & 7(3) of the Commerce Act 1986*

Section 7(2) of the Commerce Act provides that nothing in the Act "limits or affects any rule of law relating to breaches of confidence". Section 7(3) of the Commerce Act provides that "[n]o rule of law referred to in... subsection (2) of this section affects the interpretation of any of the provisions of this Act". It seems clear therefore that the breach of confidence action can be used within its bounds to protect intellectual property, but that any licensing terms that go beyond the exclusivity expressly afforded by the action will be subject to competition law in much the same way as statutory intellectual property rights.[174] Hence the "collateral advantages" principle applies to the breach of confidence action.

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[172]Note however that the United States tying and package licensing cases have been brought under § 1 of the Sherman Act - the equivalent of s27 of the Commerce Act. See Jefferson Parish Hospital, above n 86, 1551.

[173]Ministry of Commerce, above n 24, 225-226.

[174]Eagles, above n 17, 42.

2 *"Piggy-back" and "know-how" licensing*

Know-how licensing is now a common form of technology transfer using the breach of confidence action.[175] The breach of confidence action can protect non-innovation intellectual property such as data, or innovation intellectual property that has not become the subject of a statutory intellectual property right.[176] An example of the latter is the know-how relating to the use of a patent.[177] Such information will not be revealed in the patent specification if possible,[178] thereby extending the patentee's control over the innovation - breach of confidence protection does not require disclosure as patent law does and there is no limit to the period of protection. Because know-how licenses are often included in patent licenses, the term "piggy-back" licensing is sometimes used.

VIII IS THE INTERFACE BEST REGULATED WITH EXEMPTIONS?

The section 45 exemption is a rather crude means of regulating the interface. First as mentioned, several anomalies exist such as the potential for the exemption of horizontal practices and the tying of additional intellectual property licenses. Secondly, the "but for" test of section 45 may be too arbitrary for assessing the legitimacy of certain types of vertical restraints in *particular* licensing agreements. This paper purports that interface

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[175] "Know-how" licensing is now a common form of technology transfer which is not dependant on a statutory intellectual property right but on the breach of confidence action. See Calhoun, 17-22, Eagles, above n 17, 39-43, and D R Phillips "The [R]evolutionary Treatment of Know-How Licensing Under EEC Competition Law" (1988) 20 Law & Policy in International Business 205.

[176] See W R Cornish "Confidence in Ideas" (1990) 1 Intellectual Property Journal 3. Breach of confidence can be used to protect "ideas" that are unprotectable under copyright law. Although see *Wilson* v *BCNZ* [1990] 2 NZLR 565 where the defendant copied the format of a TV program from the defendant's feasibility study. This was held to be a breach of confidence *and* a copyright infringement even though witnesses described the feasibility study as "ideas" or "concepts". Also see M Gronow "Damages for Breach of Confidence" (1994) 5 Australian Intellectual Property Journal 94, and B Markel "Business Issues: Breach of Confidence" 53 Saskatchewan Law Review 229 (1989) generally.

[177] W Pengilley "Antitrust Law Versus Intellectual Property Law: Where is the Interface?" (1989) 4 Canterbury Law Review 103, 136, states that about 50% of patents must be supplemented with additional know-how before they are viable.

[178] Eagles, above n 17, 41.

should be regulated by a more flexible statutory test that clearly states the underlying economic reasons for providing an exemption.

Types of licensing provisions must, by their nature, either fall inside or outside the exemption. If the provision falls outside the exemption then it will be subjected to the rigours of competition law policy without consideration of its merits for encouraging innovation.[179] The relevant section of the Commerce Act may be a *per se* offence or, if a competition test applies, analysis will only extend to the effects on *allocative* economic efficiency and not innovative economic efficiency. Innovative efficiency concerns will remain unaddressed. On the other hand if a particular type of licensing provision falls within the exemption then the danger is that it can be used for anti-competitive purposes.

Some types of provision, such as temporal restraints, are clearly envisaged by intellectual property law. Others, such as tying, are not. In between the two extremes there is a raft of provisions which may or may not create an anti-competitive effects beyond the extent necessary to maintain the incentives to create. Consider field of use restrictions. The benefits of field of use restrictions in copyright licensing are obvious. A film may be licensed separately for cinema and television use. This aids exploitation considerably, thereby maintaining the incentive to create. A field of use restriction may be framed so that it amounts to a fetter on competition however. The ability to discriminate between cinema and television means that licensors can restrain television use until the film market is properly exploited. This supports an ailing cinema industry at the consumer's expense.[180]

[179]The Commerce Commission does have the power however to grant authorisations from the Commerce Act's application. Under s58 of the Commerce Act authorisations may be granted for conduct that would breach s27, s29, and s37 of the Act. A major limitation on this power is that section 59 permits authorisations to be granted only in respect of conduct that *not already occurred.* Section 61 states the criteria for determining whether authorisation should be granted. For a section 27 authorisation the conduct must "... in all the circumstances result, or be likely to result, in a benefit to the public which would outweigh the lessening in competition that would result, or would be likely to result or is deemed to result therefrom". For s29 and s 37 authorisations a public benefit test is also applied. In determining "public benefit" s3A of the Act instructs the Commerce Commission to "have regard to any efficiencies that the Commission considers will result, or will be likely to result from that conduct". Section 3A may therefore permit *dynamic* efficiency factors to have a bearing upon authorisation issues.

In *Windsurfing* the licensee was restricted to using windsurfer rigs on a particular type of windsurfer board. The licensor was (effectively) the only manufacturer of this board. The field of use restriction amounted to little more than an exclusive dealing contract or product tie.

"Quality" restrictions, which probably fall within section 45, are another case in point. The licensor will want to ensure that licensees meet certain quality standards to protect the image of the product, but quality restriction may also serve to place competitors at a disadvantage and allow the vertically integrated licensor to free-ride upon the licensee's efforts.

Given that licensing restrictions may only sometimes disrupt competition for the legitimate interests of rights holder, should these restrictions fall within the exemption? If so, the conduct in *Windsurfer* will go unrestrained, but if not, then the utility to both licensor and licensee of field of use restrictions will be lost. While competition law does not deem all anti-competitive practices to be illegal *per se*, the "substantially lessening competition" test does not extend to an analysis of dynamic economic efficiency criteria. It looks only to the effects of a provision on allocative efficiency and, in particular, allocative efficiency achieved by competition. Thus licensing provisions that do not contribute to innovative economic efficiency may nonetheless not infringe section 27 because sufficient competition exists in the market. If "but for" exemption provisions are to be the mechanism for regulating the interface, then the best solution seems to be to assess the net economic effect of the type restriction. If on the whole it is good then it should be exempted. Section 45 has largely achieved this, but the anomalies of patent pooling and package licensing (if

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[180]Film-makers will argue that this form of exploitation is necessary to make film production viable, but this would indicate that the either the intellectual property protection for films is inadequate or that the product does not match the consumer demand. The reality may be that the television industry could not provide sufficient remuneration to encourage production. Home-taping copyright violation may mean exploitation solely through television is impractical. The industry would argue that effective cinema exploitation is also required to maintain the mystique of the "silver screen" which supports the industry. Films may not have the same *initial* impact on the smaller TV screen. Also see Cornish, above n 28, 309, who gives similar examples such as publishing hard back books before paper backs.

package licensing falls within the exemption) demonstrate the difficulty of drafting a precise section that will exempt only the correct classes of licensing provisions.

A further consideration is that "vertical" licensing provisions may have substantially different effects when licensed horizontally. The anomaly created by exempting exclusive licenses, and therefore permitting exclusionary patent pooling, has already been mentioned.[181] Ideally therefore it would be preferable to assess individual licensing provisions on their merits and in the commercial context in which they occur. The test to be applied is whether competition is disrupted only to the extent necessary to maintain the incentive to create as envisaged by the original monopoly grant. This more flexible approach removes the arbitrary effects (both in favour of and against competition) of regulating the interface with a brightline exemption rule such as the "but for" test in section 45. Flexibility is one advantage that a "relates to" test has over a "but for" test, as the former test is better able to consider the merits of licensing provisions in their particular contexts rather than considering types of licensing provisions as a class. However the "relates to" test gives no criteria for determining what provisions should and should not be exempted. For the present, some of the arbitrary effects of section 45 may be mitigated by re-characterising the licensing provision as another type of provision: The *Winsurfing* field of use restriction can be called a tie.

IX THE COMPETITION PROVISIONS OF THE PATENTS ACT 1953

A *Section 66 of the Patents Act 1953*

Copyright by its nature does provide a total "monopoly" on the product. Independent creation of the same work is permitted, as are different "expressions" of the same general

[181] See text above at Part VII D 1. OECD, above n 23, 15, has commented that "... competition policy in the past has often been guided solely by the type of clause used rather than on a total analysis of its economic effect in a given context... [T]hat economic effect will often hinge on whether the restrictive clause is used in a horizontal or vertical arrangement".

idea. There are always likely to be adequate substitutes for copyright works. Patent however confers a total monopoly, and innovations by their nature are less likely to have substitutes. The Patents Act therefore contains some provisions restraining anti-competitive practices.

Section 66 is not an exemption as such (although see section 66(5) below) but operates to automatically make void anti-competitive patent licensing provisions. Section 66(1) provides that:

> (1) Subject to the provisions of this section, any condition of a contract for the sale or lease of a patented article or of an article made by a patented process or for licence to use or work a patented article or process, or relating to any such sale, lease, or licence, shall be void in so far as it purports-
>
> (a) To require the purchaser, lessee, or licensee to *acquire* from the vendor, lessor, or licensor, or his nominees, or prohibit him from acquiring from any specified person, or from acquiring except from the vendor, lessor, or licensor, or his nominees, any articles other than the patented article or an article made by the patented process:
>
> (b) To prohibit the purchaser, lessee, or licensee from *using* articles (whether patented or not) which are not supplied by, or any patented process which does not belong to, the vendor, lessor, or licensor, or his nominees, or to restrict the right of the purchaser, lessee, or licensee to use any such articles or process.

Section 66(1)(a) forbids the gaining of collateral advantages in licensing provisions that require the licensee to purchase additional types of products from the licensor ("full line forcing") or from a third party ("third line forcing") or the gaining of collateral advantages by preventing the licensee from purchasing other articles from alternative sources ("constructive" full and third line forcing). Section 66(1)(b) prevents the gaining of collateral advantages by forbidding licensing provisions that prohibit or restrict the licensee's use of patented or non-patented articles or processes not belonging to the licensor.

The advantage of the provisions in the Patents Act over the Commerce Act is that they operate *per se*. In other words no inquiry into anti-competitive effects is necessary. However section 66 simply provides that offending provisions are void: No damages or other remedies may be obtained.

Section 66(5) provides an exception from the operation of section 66(1).[182] The section provides that a licensing condition is not void by reason only that it prohibits any person from selling goods other than those supplied by a specified person or, in the case of a license to use a patented article, that it reserves to the licensee the right to supply new parts necessary to keep the patented article in repair. The first limb of section 66(5) applies only to *selling goods*. A licensee could still use other goods when manufacturing, use other processes, acquire other goods, or acquire other processes. The exemption will permit a franchise type arrangement where the (exclusive) licensee sells only the licensor's goods to the consumer. Unlike section 66(1)(b), section 66(5) makes no distinction between patented and non-patented articles. It would be open to a court to read down section 66(5) however and hold that "goods" relates only to *patented* goods of similar type to those regulated in the license. Such an interpretation would restrict the scope of section 66(5) to protecting the legitimate interests of a licensor in exploiting the patented invention without permitting collateral advantages to be gained.[183]

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[182]Section 66(3) also provides an exception to the operation of section 66(1). A condition may not be void if at the time of making the contract the vendor or licensee was willing to sell the articles, or grant a license for the use of the article or process, on reasonable terms without the restrictive condition; *and* that the purchaser or licensee is entitled under the contract to relief from the restrictive condition upon giving 3 months notice to the other party, and is entitled to any compensation if necessary. Section 66(4) places the burden of proof upon the vendor or licensor.

[183]This would minimise anti-competitive effect without compromising the objects of exclusive dealing agreements such as that in *Transfield*, above n 60. The *Transfield* exclusive dealing arrangement was aimed to ensure that the licensee used its best endeavours to promote the licensed product and that the licensee did not cut the licensor's product out of the market by promoting competing goods. There was some argument in *Transfield* as to whether the licensee was "using" or "selling" the licensed goods however. See Appendix A for the conflicting judgments of Stephen J and Murphy J and also above n 134.

B *Section 47 of the Patents Act 1953*

Sections 47 also bears upon patent licensing agreements. The Commissioner of Patents may amend, grant or revoke licenses on the grounds that "the manufacture, use, or sale of materials not protected by the patent is unfairly prejudiced by reason of conditions imposed by the patentee upon the grant of licenses under the patent, or upon the purchase, hire, or use of the patented article or process...".[184] Clause 8 of the GATT (Uruguay Round) Bill 1994 ("the GATT Bill") proposes to repeal section 47 presumably because the Commerce Act now governs such conduct rendering the section superfluous.[185] Licensing conditions affecting non-patented materials are likely to be outside of the section 45 exemption and subject to the restrictive trade practices sections in the Commerce Act. Section 47 would only have been of significance if "unfairly prejudiced" is an easier test to satisfy than "substantially lessening competition", although in practice this is probably a moot point.

C *Section 46 of the Patents Act 1953*

The current section 46 permits compulsory licensing where a patented invention is not being "worked to the fullest extent that is reasonably practicable",[186] or where the "demand for the patented article in New Zealand is not being met on reasonable terms".[187] This will be amended by the GATT Bill to allow compulsory licensing only where "a market for the patented invention is not being supplied, or is not being supplied on

[184]Sections 47(1) and 46(2)(e) of the Patents Act.

[185]Article 31(k) of TRIPS dispenses with requirement for compulsory licensing provisions in patent legislation if such licensing "is permitted to remedy a practice determined after judicial or administrative process to be anti-competitive".

[186]Section 46(2)(a) of the Patents Act.

[187]Section 46(2)(b) of the Patents Act.

reasonable terms, in New Zealand".[188] The change in wording does not reflect the drafting of the TRIPS agreement,[189] but does not materially seem to affect the scope of the section.

Section 46 may be particularly valuable for avoiding the difficulties of section 36 of the Commerce Act where a firm refuses to license. Unlike section 36 of the Commerce Act, section 46 has no "dominance" or "use" elements to be satisfied. Section 46 is unlikely to be of additional help where an invention is not being supplied, as this occurrence is rare and a patent holder has no rational reason for refusing to license in these circumstances. Where the patented invention is being supplied on unreasonable terms, such as at an excessive price because the manufacturer is inefficient or is gaining further monopoly profits, then section 46 may be invaluable. The operation of section 46 is dependant on the Commissioner of Patents' discretion however, and it may be that in practice the Commissioner will be reluctant to judge whether the invention is being supplied at an unreasonable price.

X SECTION 43 OF THE COMMERCE ACT 1986

Section 43(1) provides that nothing in the restrictive trade practices part of the Commerce Act "applies in respect of any act, matter, or thing that is, or is of a kind, specifically authorised by any enactment or Order in Council mad under any Act". The test is narrow however as indicated in *Apple Fields* v *NZ Apple and Pear Marketing Board*.[190] The

[188]Section 46(2) of the Patents Act as will be amended by clause 7 of the GATT Bill.

[189]TRIPS gives no guidelines for the *circumstances* in which compulsory patent licenses may be granted but only makes provisions for when this eventuality occurs. See Article 31 of TRIPS.

[190]*Apple Fields* v *NZ Apple and Pear Marketing Board* [1991] 1 NZLR 257. The case concerned the legality of a discriminatory levy imposed on growers that had the effect of discouraging increases in production. The levy was imposed under section 31 of the Apple and Pear Marketing Act 1971 that permitted the Board to levy all growers, or any class of growers, as the Board thinks fit. The levy allegedly breached section 27 of the Commerce Act. The Privy Council could "find nothing which should predispose the interpreting court to approach the issue which arises here on the footing that, if the imposition of a levy under section 31 of the Act of 1971 prima facie contravenes s 27 of the Act of 1986, one should look benevolently expecting to find a provision elsewhere in the Act of 1986 which excuses that contravention" (see *Apple Fields*, 262). The Privy Council then held that "nothing less will do than

authorisation must be of the specific act in question,[191] and authorisation in "general" terms is insufficiently specific to warrant exemption.[192] As mentioned, the Australian "statutory authorisation" exemption expressly excludes statutory intellectual property rights from its scope. The New Zealand Act does not, creating the potential for "overkill". The utility of section 43 in this respect may be limited as most intellectual property statutes state the rights holder's "exclusive" rights in negative terms not susceptible to a "specifically authorises" analysis. However the section may have application where section 45 does not exempt particular arrangements. First, section 45 is framed in negative terms. "Positive" licensing obligations may not be exempt. Section 43 would permit a more comprehensive assessment of the intended scope monopoly grant by looking to the nature of the statutory scheme, but the "specifically authorises" may still be difficult to satisfy. Secondly, resale price maintenance is not exempted under section 45, but could be under section 43. Thirdly, section 45 provides no exemption from section 36, and if section 36(2) is limited to the *judicial* enforcement of intellectual property rights, section 43 may apply.

A *Section 66(5) of the Patents Act 1953*

As mentioned section 66(5) of the Patents Act provides that licensing provisions requiring a licensee to sell only the goods of the licensor will not be struck down by the provisions of the Patents Act. Such an exclusive dealing licensing provision would not fall within the section 45 exemption because it does not authorise something prohibited by an intellectual property right. However section 43 may provide an exemption for this practice if it is "specifically authorised" by the Patents Act. In 1953 this "restrictive practice" was considered acceptable. The Patents Act pre-dates any competition law in New Zealand by

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either a statutory authorisation of the very act in question or, if it is one of a class or kind of authorised acts, that the whole authorised class would, if not so authorised, fall foul of the prohibitions in Part II of the [Commerce Act]" (see *Apple Fields*, 265). Clearly this is a test of the highest threshold.

[191]*Apple Fields*, above n 190, 265.

[192]Section 43(2) of the Commerce Act.

5 years, and thus a licensee at the time had no recourse to contest such a licensing provision. It could be argued however that section 66(5) does not offer positive authorisation for this act. It states *only that section 66(1) of the Patents Act shall not strike it down*. No mention is made of the effect of other Acts on such a clause.

It is worth noting the attitude of the Australian High Court in discussing the equivalent Australian provisions in *Transfield* v *Arlo*.[193] In *Transfield* the validity of a "best endeavours" clause was contested.[194] The clause purportedly required the licensee to use its best endeavours in promoting the licensed product and prevented the licensee from dealing in competing products. While the judgments variously considered the Patents Act 1952 (Cth) and the Trade Practices Act 1974 (Cth), unfortunately none of the judges who went on to examine the Trade Practices Act exemption had held that the "best endeavours" clause amounted to an exclusive dealing arrangement that precluded the licensee from selling competitor's products. Therefore as the clause (in the relevant judgments) did not fall within the Patents Act exemption, the consideration of the Trade Practices Act in the case cannot on its own be support for the proposition that section 66(5) is subject to competition law. However Murphy J, who did not specifically address the Trade Practices Act, observed that the Australian equivalent of section 66(5) was inconsistent with modern legislative practice. While *Transfield*, with the exception of Murphy J's judgment, is inconclusive, the restrictive provisions "exempted" in sections 66(5) are probably subject to Commerce Act scrutiny because of the high threshold for "specifically authorise".

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[193]*Transfield*, above n 60.

[194]See the casenote in Appendix A for a full discussion of the case.

B *HMV* v *Simmons*

HMV v *Simmons* is the only New Zealand case to have dealt with an exemption for an intellectual property practice.[195] The New Zealand Federation of the Phonographic Industry sought to set minimum wholesale and retail prices and maximum retail margins for records. They argued that the compulsory license provisions of the Copyright Act 1913 "expressly authorised" the arrangement in terms of section 19(4) of the Trade Practices Act 1958.[196] This was because royalties were to be calculated as a percentage of the retail price. To ascertain the royalties owing, it was necessary to establish standard prices. The Court rejected this argument on three grounds: The Federation had attempted to do more than was necessary to facilitate use of the compulsory license, it was not necessary in any case to fix prices in to compute royalties,[197] and nowhere did the Copyright Act state specifically, or by implication, that such price fixing was permissible.[198]

C *Refusals to License*

It could be argued that intellectual property law statutes specifically authorise rights holders *not* to license their innovations. The advantage of using section 43 in this situation is that a potential exemption to section 36 is obtained. The right to maintain exclusivity by refusing to license is implicit in the exclusive rights provisions of the statutes, but may not pass the high threshold of "specifically authorise". Furthermore the Copyright Act contains some exceptions to the right not to license as does the Patents Act.[199]

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[195]*HMV*, above n 145.

[196]Section 19(4) stated that "Nothing in this section shall be deemed to authorise the making of an order in respect of a trade practice *expressly authorised by any enactment*" (emphasis added). This is equivalent to section 43 of the Commerce Act 1986.

[197]*HMV*, above n 145, 30.

[198]*HMV*, above n 145, 29.

XI SUMMARY OF THE LAW RELATING TO LICENSING TERMS

Intellectual property law disrupts competition by providing exclusive rights for innovators to prevent competitors from appropriating the innovation, thereby facilitating the recovery of the fixed costs of development and encouraging innovation. Competition law does not therefore attack the existence of intellectual property rights but only the manner in which those rights are used. Licensing terms that gain advantages collateral to the intellectual property right will be subject to Commerce Act scrutiny.

A licensor is free to divide and assign the totality of the rights granted by intellectual property law. Licensing terms such as restricted territories, temporal limitations, field of use restrictions, and exclusive licenses are all "permissive" licensing terms that fall within the section 45 exemption. These terms merely permit something that would otherwise be prohibited because of the intellectual property right and therefore no collateral advantages are gained. Licensing provisions such as product ties, grant backs, and exclusive dealing arrangements are not permissive and instead go beyond the scope of intellectual property rights by obtaining collateral advantages and are therefore subject to competition law. Section 45 cannot exempt these practices as they do not permit something that would otherwise be prohibited by an intellectual property right. The drafting of section 45 produces two anomalous results for the regulation of the interface by economic principle. First, package licensing appears to fall within the exemption as the licensing terms only permit something that intellectual property rights would otherwise prohibit. A court would probably not exempt package licensing, however, as the licensing term tying another intellectual property product does not relate to the *specific* intellectual property to which that term is attached. Secondly, patent pooling and cross-licensing fall within the section 45 exemption. This results from the drafting of section 45 as a "but for" test for vertical practices. Exclusive licensing, in itself, is harmless as a vertical practice, but *horizontal*

[199]See s46 & 47 of the Patents Act discussed in the text at Parts IX B & C, and s22 of the Copyright Act which mandates the compulsory licensing of musical works for making sound recordings if the statutory formalities are complied with. See text at Part IV B.

exclusive licensing is an exclusionary practice outside of the scope of the intellectual property right.

The compulsory licensing provisions of the Patents Act limit the market power conferred by the patent monopoly, and section 66 of the Patents Act provides some useful per se prohibitions against gaining collateral advantages. Section 43 of the Commerce Act is unlikely to be of much use as an exemption for intellectual property practices, and section 7 operates by much the same principles as section 45.

Licensing terms which do not fall within section 45 will be subject to the usually competition law tests before the provisions of the Act can be breached, and licensing practices that are exempted are still examinable under section 36 and sections 37 & 38.

XII SECTION 36 OF THE COMMERCE ACT 1986 - REFUSALS TO LICENSE

As mentioned above,[200] passing on the exclusivity already inherent in an intellectual property right will fall within the section 45 exemption as, other things being equal, no collateral advantage is gained. However where the licensor is a dominant firm, and as a consequence there are few substitutes for the licensed product, maintaining exclusivity by refusing to license (or by licensing to only one firm) may foreclose market opportunities to competitors of the exclusive licensee who need the license or licensed product to compete. Because the section 45 exemption does not apply to section 36, refusals to license by dominant firms are subject to the Commerce Act.

Section 36(1) prevents a firm using a dominant position in a market for a proscribed purpose such as restricting market entry or inhibiting competition in a market. There are three elements to be satisfied, namely "dominance" in a market, "use" of that dominance,

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[200]See text above at Part VII B 1.

and "purpose". Additionally the assessment of dominance is to a large degree subject to the vagaries of defining the relevant market. Even if the elements of section 36(1) can be established, section 36(2) provides a limited exemption which is discussed below. Before analysing the elements of section 36, it is helpful to consider why a licensor may refuse to license.

XIII WHY REFUSE TO LICENSE?

Section 36 will apply when a firm in a dominant position uses that dominance to eliminate firms from a market, restrain firms from competing in a market, or to hinder competition in a market.[201] Section 36 is not breached when a dominant firm's conduct has one of these *effects*, but only when the firm uses its dominant position for one of these *purposes*. What rational motives will a licensor have for engaging in such conduct by refusing to license?

A *Efficiency of Exploitation*

Refusing to license, or refusing to license to more than one licensee, may permit the intellectual property right to be exploited more efficiently than with many licensees. If intellectual property rights holder refuses to license in order to reserve for itself the right to manufacture the product, or if it licenses to only one firm (perhaps a subsidiary or other closely related firm) then *intra*brand competition is restrained - that is, the competition between dealers of the same product. *Inter*brand competition is the competition between dealers of substitutable (ie competing) products and cannot be affected by a refusal to license. Thus while exclusive licenses may affect individual competitors, *the effect on the overall market can be pro-competitive because interbrand competition is promoted.*[202]

[201]Section 36(1)(a)-(c) of the Commerce Act.

[202]Note that the arguments in favour of limited vertical restraints are directed at achieving allocative, not innovative, economic efficiency. Furthermore these arguments apply only to allocative efficiency achieved by competition and not efficiency achieved by monopoly. Nonetheless these arguments still have relevance for intellectual property.

Thus in *Fisher & Paykel* v *Commerce Commission* the Court noted that "[w]hen dealing with a vertical restraint... it is important to look at the effect of the restraint on competition in the market and not at its effect on the competitiveness of individual buyers and sellers".[203]

The reasons for granting exclusive contracts for tangible goods can be applied to intellectual property goods,[204] and the most fundamental justification for exclusive territories or licensing[205] is the problem of the "free rider".[206] If licensees are not insulated from competing licensees then there will be little incentive for to engage in active promotion as other licensees will "free ride" on these efforts.[207] Licensees are also likely to

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[203]*Fisher & Paykel*, above n 157, 759-760. The case concerned exclusive dealing contracts, the reciprocal vertical restraint of exclusive territories, but the reasoning is still applicable. The Court cited the United States Supreme Court's decision in *Continental TV*, above n 102, 583, with disapproval. The Supreme Court, while acknowledging that "[v]ertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products", focused on the disadvantages of exclusive dealerships such as the inability of consumers to compare goods side by side etc. See *Fisher & Paykel*, 762-763.

[204]Note however that most of these arguments have been applied at the functional levels of manufacture and distribution rather than innovation and manufacture. Furthermore, arguments relating to ease of distribution that apply to tangible goods do not sit as easily with intangible goods - A licensor will only ever have to distribute the product to the manufacturer once whereupon the product can be duplicated by the licensee without further difficulties. A distributor of tangible goods must of course have access to a continual supply.

[205]Exclusive territories is the equivalent tangible products vertical restraint. Of course intellectual property exclusive licenses are usually limited to a particular territory also, but the territory is usually an entire jurisdiction rather than just a suburb.

[206]See G A Hay "The Free Rider Rationale and Vertical Restraints Analysis Reconsidered" 56 Antitrust Law Journal 27 (1987) generally.

[207]These arguments are frequently made in respect of parallel importation which is a simple means of circumventing an exclusive license. For example see Recording Industry Association of New Zealand (RIANZ) *RIANZ 1993 Yearbook* (RIANZ, Wellington, 1993), 21-22. "While RIANZ supports the Government's aim of encouraging competition it has to be recognised that market evidence of parallel imported records shows some prices being up to 100% higher than legitimate product. It is RIANZ's view that any relaxation of the Import provisions will only encourage unfair competition resulting in free-riding, profiteering and unjust enrichment which would be of no benefit to consumers and contrary to the public interest". The *Yearbook* also contains a 1988 independent report on parallel importation commissioned by the British Government. "The UK Trade an Industry Report... stated that the economic rationale for copyright law is that they [sic] create and protect property rights which promote economic efficiency. The incentive to invest now for profit later is maintained through copyright laws that prohibit opportunistic behaviour such as free riders skimming the market". This last proposition is not strictly true however. The incentive scheme of copyright is not compromised by parallel importing itself (or production by competing licensees) *as royalties have already been paid on the imported goods*. Only if

demand exclusive licenses before investing the sunk costs in tooling-up and developing markets.[208] The prospect of free-riding competitors is not much of an inducement to enter into, and develop, new markets when the fruits of the labour will be appropriated by other licensees.[209] In addition to free riding on promotional efforts, subsequent licensees may not produce goods of the same high standards as the incumbent licensees and may free ride on the existing reputation for quality and eventually damage the product's reputation.[210]

Because multiple licensees all pay royalties, the incentive for the rights holder to innovate is not diminished. Therefore refusals to license can only be justified if competing licensees would affect the marketing of the commodity[211] and that this intrabrand competition would lessen *overall sales*.[212] Overall sales will remain unaffected where "free riding" cannot occur because the product requires little promotion or market development,[213] or if the free riding does not deter licensees from entering the market.

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the activities of the parallel importing has the effect of disrupting marketing strategies to the point where *overall* sales are decreased can intrabrand competition affect the incentive to create.

[208]This "dynamic", rather than "static", aspect of allocative efficiency is often overlooked.

[209]These were the very arguments submitted in the Statements of Claim in the aborted Range Rover litigation. Motor Corp claimed that it had invested substantial amounts of money and effort into raising the profile of the Range Rover in New Zealand, and did not want Phillip Mills Motors free riding on its efforts by subverting the exclusive territorial license through parallel importation. See Hutchings above n 57.

[210]This argument was also raised by Motor Corp. Phillip Mills was importing Range Rovers made to overseas specifications. The engine had been manufactured for different fuel types, and the cars' use in New Zealand would damage the engines, and eventually the cars' reputation for reliability.

[211]Consideration should also be given to whether the exclusive license created the inducement for the "first" licensee to enter and develop the market.

[212]For example, a typical music industry marketing practice is not to release a new album until the artist tours the country. The album can then be "hyped". By capitalising on the anticipation and excitement of the tour, a carefully timed release can result in greater total sales than would otherwise arise. Competing manufacturers of the album, or the ability to parallel import, may frustrate the adoption of such marketing strategies. The disadvantage of this marketing strategy is that as New Zealand is a small and relatively unimportant market, consumers must wait for considerable periods of time for some albums to become available.

[213]See text at Part XIII D 1 where Volvo refused to license a competitor to manufacture its car body panels. Competition in door panel production could not affect overall sales, regardless of the frustration of

The commentators that believe restriction of intrabrand competition is permissible attach one qualification - that substantial interbrand competition needs to exist to temper the market power that would otherwise be accrue to exclusive licensees.[214] *Where the rights holder is in a dominant position however,*[215] *by definition, substantial interbrand competition will not exist.* Hence no matter how marketing plans are affected by free riders, if there are no substitutes for the product then the consumer cannot be diverted to a competing brand, and if the product is relatively essential, bad marketing strategies[216] will not affect overall demand as the consumer has no option but to purchase it.

B *Collateral Advantages*

In general, intellectual property rights holders (whether dominant or not) will want to gain "monopoly" profits on the innovation itself but at the same time keep the cost to the consumer as low as possible to encourage consumption. Licensing the most efficient manufacturer, or competing manufacturers (if marketing constraints do not exist), will achieve this goal.

When the licensor is in a *dominant* position in a market there is, by definition, no effective competition. Consumers must purchase from the licensor's designated manufacturers if they want the product. This permits pricing discretion on the part of the manufacturer, especially if the product demand is "inelastic" (ie the product is a necessity rather than a

marketing plans, because the consumer having previously purchased a Volvo car and then damaged the door must buy a replacement.

[214]See F H Easterbrook "Vertical Arrangements and the Rule of Reason" 53 Antitrust Law Journal 135 (1984) generally and Hay, above n 206, 30.

[215]Note that cases such as *Fisher & Paykel*, above n 157, and *Continental TV*, above n 102, have all been brought under statutory provisions such as s27 that do not require dominance for a breach but do require a lessening of competition.

[216]In any case the licensor can undertake to raise consumer awareness of the product. Note that the type of promotional effort often referred to as a justification for preventing dealer free riding is simply "in-store" service. See Hay, above n 206, 29. Such service will be unnecessary where the product is relatively essential, as in the latest patent innovation for industrial application or a copyright commodity such as recorded music when monopolised by a single collection society.

luxury and as a result sales are not significantly affected by price increases). In the modern world access to many types innovation is a "necessity" for business survival or leisure.[217] There is no need to restrict supply of such commodities to maintain "desirability".[218] While obtaining monopoly profits in respect of the innovation is permissible (as it provides the incentive to innovate), market dominance also permits obtaining monopoly profits on the *manufacture* of the innovation. Where the (inefficient) manufacturer is a *subsidiary* of the licensor, the licensor may refuse to license to a competing manufacturer in order to gain the collateral advantage of monopoly profits on the manufacture of the goods, or at least to keep the inefficient subsidiary in business.[219] *This furthers neither the policy objectives of intellectual property law nor competition law.*

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[217]Consider for example a "luxury" such as recorded popular music. The licensing of recorded music for broadcast is in a sense "monopolised" by the Australasian Mechanical Copyright Owners' Society ("AMCOS"). Yet AMCOS licensees the use of this commodity to competing radio stations. This intrabrand competition does not affect overall demand for broadcasted music because it is a relatively indispensable commodity and their is no interbrand competition. Yet it would be within AMCOS's power, if not restrained by competition law, to license only a single broadcaster. This single broadcaster could remain inefficient with impunity and could monopolise the market for radio broadcast in general. For example competing radio stations could not continue to broadcast the news without access to music and would be forced out of the market.

[218]Often greater general access to innovation heightens the necessity of access to the innovation in order to remain competitive. Consider the legal database LEXIS. If only a few firms nationwide have access, then LEXIS is not really a necessity. When *most* law firms have access to LEXIS, *every* firm must also have access to remain competitive and avoid malpractice suits. The same reasoning applies to many "luxuries" as well. When most people have a video recorder, it becomes regarded as a necessity. Sales do not then rely on any "novelty" or "exclusivity" factor.

[219]Note that Coase argued that an economically rational firm will expand and vertically integrate when the costs of contracting out work exceed the costs of expansion. In principle when the reverse becomes true, a firm should begin to contract out work again. See R H Coase (ed O E Williamson & S G Winter) *The Nature of the Firm: Origins, Evolution, and Development* (Oxford University Press, New York, 1991). The probable reasons for refusing to license in this situation are the gaining of anti-competitive advantages (if competition law does not intervene), empire building, and the costs already invested in the vertical integration which a corporation will be unwilling to abandon. See also K McMahon "Refusals to Supply by Corporations With Substantial Market Power" (1994) 22 Australian Business Law Review 7, 11. "The most important justification for a refusal to deal on efficiency grounds is vertical integration. A refusal to deal will often involve efforts to cut off a retailer in order to vertically integrate into the retail distribution of the market. It has been argued that a monopolist should only be permitted to take over the lower level operations of a distributor if it is at least as efficient as the lower-level firm. Substitution of the monopolist will then set the price to the consumer at the optimum monopoly level". If this argument is true then it follows that vertical integration should be *reversed* by compulsory licensing, or orders to supply, when the vertically integrated firm is *less* efficient than a potential competitor at the lower functional level. The integrated firm need not abandon the lower functional level altogether but must at least permit competition from more efficient firms.

In addition to licensors gaining collateral advantages by monopolising different functional markets (ie manufacture), refusals to license can also be used to monopolise different *product* markets. Consider the facts of *A B Volvo* v *Erik Veng*.[220] Volvo had the design copyright protection for the body panels for its cars, and refused to license the manufacturing rights to competitors. In the actual case, decided under article 86 of the Treaty of Rome,[221] the Court did not order a compulsory license, as the monopolisation of the different functional market of manufacture was considered within the scope of the intellectual property right and was therefore not a collateral advantage. This is discussed further below. Consider this variation of the facts however. Suppose that the case involved door panels specifically, and that most purchasers of new door panels have been involved in accidents. The consumer will want to purchase a *package of the door and the glass window*. Suppose that the market for door windows is competitive, and that Volvo competes in this market. If Volvo refuses to license the rights to door manufacture to competitors, even for a royalty reflecting the development costs, then Volvo is able to monopolise the *different product market* of glass windows. Eliminating competition in this associated product market would not encourage long term efficiency and would permit monopoly profits on non-innovation products that involve no development costs. Therefore the ability to monopolise different functional *and* product markets will be an incentive to refuse to license.

XIV THE ELEMENTS OF SECTION 36 OF THE COMMERCE ACT 1986

A *"Dominant Position" and Market Definition*

Section 36 of the Commerce Act has a threshold of market dominance, and the threshold is high.[222] The first issue under section 36 is what degree of market power is created by an

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[220] *A B Volvo* v *Erik Veng (UK) Limited* [1987] ECR 6211.

[221] See n 264 below for the full text of article 86.

intellectual property right? While intellectual property rights are sometimes described as statutory monopolies, it must be remembered that the monopoly granted is only over a single product. The Commerce Act is concerned with *market* dominance. Whether the intellectual property right creates market dominance will largely depend on whether there are substitutes for the protected product.[223]

The United States courts have readily inferred market power in the presence of intellectual property rights. In *US* v *Loew's* the Supreme Court observed that the "requisite economic power is presumed when the tying product is patented or copyrighted".[224] More recently the majority in *Jefferson Parish Hospital* stated that "if the Government has granted the seller a patent or similar monopoly over a product, it is fair to presume that the inability to buy the product elsewhere gives the seller market power".[225]

The term "market dominance", as used in *Loew's*, may have a different meaning in the United States,[226] and these assessments of market power resulting from intellectual

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[222]Section 3(8) of the Commerce Act states that a dominant position is where a firm may exercise a dominant influence over the production acquisition, supply, or price of goods or services in a market, and regard shall be had to market share, technical expertise, access to materials and capital, and the extent that the firm is constrained by the conduct of competitors, potential competitors, and suppliers and acquires of the goods or services. Generally speaking a dominant position involves an element of discretionary market power. See *Re Continental Can Co Inc* [1972] CMLR D11. In *Telecom Corp of NZ Ltd* v *Commerce Commission* [1992] 3 NZLR 429, 442 Richardson J emphasised the high threshold of section 36. "Clearly the dominance test sets a rigorous threshold. It is not sufficient that the influence be advantageous or powerful. It must be dominant. The word comes from the Latin dominus meaning master. Only one person can be dominant in a particular aspect of a market at any one time. Not surprisingly standard dictionaries give meanings such as 'ruling', 'governing', 'commanding', 'reigning', 'ascendant', 'prevailing', and 'paramount'". See M Berry et al. *Gault on Commercial Law* (Brooker & Friend, Wellington, 1994) CA3.12-13 generally.

[223]See OECD, above n 23, 16-17.

[224]*US* v *Loew's*, above n 59, 18, citing *IBM*, above n 101.

[225]*Jefferson Parish Hospital*, above n 86, 1560.

[226]*US* v *Loew's*, above n 59, 18. T Weston "Dominance: Where To?" Fifth Annual Workshop of the Competition Law & Policy Institute of New Zealand, 4, notes that prior to *Telecom* v *Commerce Commission* [1992] 3 NZLR 429 "dominant position" had been assumed in New Zealand to mean a "high degree of market power" which corresponded with the "monopoly power" test in §2 of the Sherman Act and with "dominant position" in article 86 of the Treaty of Rome (see n 264 below). Weston, 4, states that the Court of Appeal in *Telecom* attacked that assumption "head-on" creating a stricter threshold. The Court did not regard market share as determinative and emphasised the importance of market constraints

property rights must be considered in context for any useful application to section 36 of the Commerce Act. The above cases were both applying section 1 of the Sherman Act,[227] which is roughly equivalent to section 27 of the Commerce Act. Where market power is present however the section operates as a *per se* offence. In a tying situation *US* v *Loew's* indicates that the potential for coercion will indicate market power. The seller "by virtue of his position in the market for the tying product, has economic leverage sufficient to induce his customers to take the tied product along with the tying item".[228] This does not necessarily suggest that market power in the United States that would lead to a *per se* application of section 1 of the Sherman Act is the same as market dominance in the Commerce Act. Even if the threshold for dominance in the United States is as high as section 36, the approach to market definition in *Loew's* may be too flexible for the Commerce Act. The Supreme Court argued that sufficient economic power attached to each "unique" film but conceded that the films also had substitutes. The Court commented that:[229]

> ...the mere presence of competing substitutes for the tying product, here taking the form of other programming material as well as other feature films, is insufficient to destroy the legal, and indeed the economic, distinctiveness of the copyrighted product.

The result in *Loew's* may be a product of the difficult issue of market definition where *partial* substitutes exist which have a high cross-elasticity of demand,[230] but prima facie

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in assessing dominance (see s3(8)(c)). See also R H Patterson "Dominance: Where To?" Fifth Annual Workshop of the Competition Law & Policy Institute of New Zealand.

[227]See text at n 107.

[228]*US* v *Loew's*, above n 59, 18.

[229]*US* v *Loew's*, above n 59, 20.

[230]See G A Hay "Market Definition and Market Dominance: Issues from the Davids-QIW Merger Case" 1994 Fifth Annual Workshop of the Competition Law & Policy Institute of New Zealand Volume 2, for a discussion of *Davids Holdings Pty Ltd* v *Attorney General* (1994) ATPR ¶ 41-304 where the author considers the affect of "indirect" substitutes on market definition. In *Davids Holdings* the Court held that private retailer grocery supplies were not substitutes for chain-store "supermarket" grocery supplies with the effect that a merger of the only wholesaler supplying the private retailers created a a substantial degree of market power (the Australian equivalent, but lower threshold, of "dominant position in a market").

the case suggests that the dominance threshold is lower than in New Zealand. Steven J's comments in Jefferson were based upon precedent only and were unsupported by analysis. In the same judgment however O'Conner J disagreed with the traditional approach to market power and intellectual property rights.[231]

> A common misconception has been that a patent or copyright, a high market share, or a unique product that competitors are not able to offer sufficies to demonstrate market power. While each of these three factors might help to give market power to a seller, it is also possible that a seller in these situations will have no market power: for example, a patent holder has no market power in any relevant sense if there are close substitutes for the patented product.

O'Conner J's approach seems preferable, for if substitutes for the product exist it will be difficult for an intellectual property rights holder to gain collateral advantages by refusing to license.

The difference in the copyright and patent "monopolies" has bearing here. The threshold for copyright protection is low, but the product monopoly is not complete. Independent creation of the same work is permitted, and the underlying ideas of the work are not protected (when the idea-expression dichotomy is properly observed). As a result there may be many substitutes for a single copyright work, such as a novel or a textbook.[232]

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[231]*Jefferson Parish Hospital*, above n 86, 1571 n 7.

[232]Although some copyright works may fairly be said to have no substitutes and thereby confer market dominance. Consider Abraham Zapruder's film of President Kennedy's assassination which was the subject of copyright litigation in *Times Incorporated* v *Bernard Geis Associates* 293 F Supp 130 (1968). The film was purchased by Time magazine and released only to the federal agencies investigating the crime. Time magazine then published over the years select frames from the footage but not the complete film. Researcher J Thompson was consistently denied a copyright license to publish portions of the footage in his book on the assassination. Time's response to his requests was that "it 'was impossible' to grant permission to use the Zapruder frames, that it was corporation policy 'not to allow anyone the use of any part of this film in the United States', that the film was considered 'an invaluable asset of the corporation', and that 'its use will be limited to our publications and enterprises". See *Times Incorporated*, 138. Clearly this copyright work was so unique that no substitutes existed. Time's monopolisation of this "historic document" was not challenged in anti-trust law however, but was dealt with by the monopoly restraints implicit in the copyright scheme itself. Although a valid copyright subsisted in the film, Wyatt J held that Thompson's use of it was a "fair use" given the "public interest in having the fullest information available on the murder of President Kennedy". Moreover, Thompson was not a competitor of Times, and his use of

Contrast this with patent protection.[233] A total product monopoly is granted *precluding independent creation* and the protection extends to *ideas* which are at the forefront of technological advancement. The period of protection is shorter, and there are stringent registration requirements, but when in force the patent product monopoly is much more complete. Specific illustrations will highlight the differences. Holding the copyright in a novel will create no market dominance. A competitor can easily gain access to other novels, and as ideas are not protected, gain access to novels with similar story lines. Market dominance is only an issue in copyright cases where collection societies or large corporations are involved that hold many copyrights. Now consider patents. Where a firm has developed a new drug it may well be that there are few, if any, adequate substitutes. The same is true for many manufacturing innovations.[234] Furthermore, in highly competitive businesses access to the most up-to-date technology is crucial for success.

B *"Use" of a Dominant Position*[235]

Queensland Wire Industries Pty Ltd v *BHP Co Ltd* established that "use" was a distinct element in section 36[236] and should be interpreted without pejorative connotations.[237] Therefore "use" provides the causal link between the existence of market power and the

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the frames in his book could be expected to enhance the value of the film to Time. See *Time Incorporated*, 146.

[233]See R J Hoerner "The Antitrust Significance of a Patent's Exclusionary Power" 60 Antitrust Law Journal 867 (1992).

[234]Table 5-7 of the Contractor survey, above n 78, suggests that only 27% of patent licensors face no competition. This still means that large numbers of patentee's have market dominance however. See OECD, above n 23, 16.

[235]See Y van Roy in *Gault on Commercial Law*, above n 222, CA36.08 generally.

[236]Although note the comments of Gault J in *Geotherm* that "[t]here will be circumstances in which the use of the market position and the purpose are not easily separated but the two requirements must be kept in mind". Also see Gault J's comments in *Clear Communications*, 413, TCLR, that "[i]n most circumstances the use and the purpose will nt be easily separated and need not be".

[237]*Queensland Wire Industries Pty Ltd* v *BHP Co Ltd* (1989) ATPR ¶ 40-925.

anti-competitive purpose.[238] It is one of the most problematic elements of the Commerce Act.

1 *"Use" in Queensland Wire Industries Pty Ltd* v *BHP Co Ltd*

In *Queensland Wire* Broken Hill Pty Co ("BHP") manufactured the "Y-bar" - a component in star picket posts which were the most popular type of fencing posts in rural Australia. BHP manufactured 99% of Australia's star picket posts and did not supply the Y-bar (at affordable prices) to any other star picket post manufacturers. Y-bars were the only item of BHP's catalogue that it refused to supply. BHP also manufactured fencing wire and sold complete fencing packages which included wire and star picket posts. Queensland Wire Industries ("QWI") was a manufacturer of fencing wire and was BHP's only competitor for certain types of wire. QWI could not manufacture star picket posts because it could not obtain Y-bars at competitive prices. QWI argued that BHP was using its market power in Y-bars to prevent QWI from entering and competing in the market for star picket posts (and also as a consequence, the market for fencing packages).[239] The Australian High Court offered a test for "use":[240]

> In effectively refusing to supply Y-bar to the appellant, BHP is taking advantage of its substantial market power. It is only by virtue of its control of the market and the absence of other suppliers that BHP can afford, in a commercial sense, to withhold Y-bar from the appellant. If BHP lacked that market power - in other words, if it were operating in a competitive market - it is highly unlikely that it would stand by, without any effort to compete, and allow the appellant to secure its supply of Y-bar from a competitor.

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[238]*Natwest Australia Bank Ltd* v *Boral Gerrard Strapping Systems Pty Ltd* (1992) ATPR ¶ 41-196, 40,644.

[239]The fencing packages, which include wire, are an example of refusals to supply being used not just to gain collateral advantages from monopolising different functional markets, but also as a means to monopolise different product markets.

[240]*Queensland Wire*, above n 237, 50,011 per Mason CJ & Wilson J.

Applying this test in New Zealand the inquiry is whether the conduct was only possible because of market dominance, rather than the lower Australian threshold of market power. The test was applied in this way in *Union Shipping New Zealand Ltd* v *Port of Nelson Ltd*. The Port of Nelson was the only deep water port facility in the northern part of the South Island. Port of Nelson Ltd ("PNL") sought to tie stevedoring equipment services to wharfage fees.[241] Union Shipping objected. The Court held that the tie breached section 27 and section 36 of the Commerce Act. About section 36 McGechan J commented:[242]

> If a person simply acts in a normal competitive fashion, as he would whether dominant or not, that person hardly can be said to be "using dominance"... We do not accept that in imposing a requirement for plant hire, or additional payment, [Port of Nelson Ltd] is acting as it would in a competitive situation, and is not using its dominant position. Its present demands are possible only because of its dominant position. Its demands, at times stark, are a use of that dominance.

The difficulty with the *Queensland Wire* test is that it will not embrace conduct that may be engaged in by all firms but will only be anti-competitive when engaged in by firms with market dominance. Pricing at marginal cost is one example of a practice which is competitive when done by small firms but may be anti-competitive when done by dominant firms: Economies of scale resulting from the dominance mean that marginal price will be lower than that of market entrants and, where the dominant firm was previously pricing above marginal cost, the adoption of a marginal cost pricing structure then takes on a predatory nature that excludes competitors from markets.

The *Queensland Wire* test (arguably correctly) states that dominance *must* have been "used" if a non-dominant firm could not have acted in the same way, but this does not preclude a finding that dominance could have been "used" if the conduct was possible by a non-dominant firm. The effect of the *Queensland Wire* decision however is to focus the

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[241]Technically this is not a tie but an exclusive dealing arrangement as the consumer is not forced to take unwanted services but only prevented from obtaining these services from elsewhere.

[242]*Union Shipping New Zealand Ltd* v *Port of Nelson Ltd* (1990) 3 NZBLC ¶ 99-182, 101,645.

inquiry on the *potential* for action rather than the anti-competitive *effects* of the action. This fault in the *Queensland Wire* test has ramifications for intellectual property licensing which are discussed below.

There is some debate whether the High Court intended the *Queensland Wire* test to be exclusive for "use". In *Natwest Australia Bank Ltd* v *Boral Gerrard Strapping Systems Pty Ltd* the court states that:[243]

> There must be a causal connection between the conduct alleged and the market power pleaded such that is can be said that the conduct is a use of that power. *In many cases* the connection may be demonstrated by showing a reliance by the contravener upon its market power to insulate it from the sanctions that competition would ordinarily visit upon its conduct.

If the court in *Natwest Australia Bank* was correct that the *Queensland Wire* test is only one possible test for "use", then what other tests may be applied?

2 *"Use" in Electricity Corporation Ltd* v *Geotherm Energy Ltd*

In *Electricity Corporation Ltd* v *Geotherm Energy Ltd*[244] Geotherm wished to enter into the recently deregulated market for electricity production. Geotherm needed various planning and resource consents as well as access to various properties and Crown resources. Geotherm argued that Electricorp had breached section 36 by embarking upon a deliberate policy of excluding all competitors from the electricity production market,[245] and that to this end Electricorp had issued public statements calculated to deter customers and financiers from dealing with Geotherm, had entered into exclusionary and exclusive dealing contracts to Geotherm's disadvantage, had made representations resulting in the

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[243]*Natwest Australia Bank*, above n 238, 40,644 (emphasis added).

[244]*Electricity Corporation Ltd* v *Geotherm Energy Ltd* [1992] 2 NZLR 641.

[245]*Geotherm*, above n 244, 647.

exclusion of Geotherm from Crown land, and had "resisted at every stage on all possible grounds, many of them baseless, statutory applications required to be made by [Geotherm]".[246] The issue was whether Electricorp has used its dominant position by engaging in such conduct. With respect to Electricorp's public statements Gault J noted:[247]

> Such statements may be said to "use" a dominant position if it is the dominant position that gives the statements the force amounting to deterrence.

As any firm regardless of market power could issue public statements, this test is an acknowledgment that the test for "use" should not be limited to the test propounded in *Queensland Wire* - that is, was the conduct only possible because of dominance. Gault J emphasised that the "conduct in question must be considered in its commercial context".[248] Gault J's more flexible approach to "use" is emphasised in *Clear Communications Ltd* v *Telecom Corp of NZ Ltd*. This case concerned the price Telecom was able to charge for providing Clear with access to its domestic calls network, in particular whether Telecom could include in the price the opportunity cost of permitting Clear to have access. In deciding that a price above a fair commercial rate of return would breach section 36 Gault J discussed "use":[249]

> It is perhaps timely to caution against substituting a test helpful in applying the statutory rule for the rule itself. To focus upon what the firm in question... might do in a fully competitive situation... may merely complicate rather than solve the problem. It attracts the construction of theoretical economic models the material characteristics of which may give rise to differences of opinion among even the most expert economists. In circumstances where there is an absence of empirical evidence there will inevitably be elements of speculation. That, of course, is not to decry the importance of relevant economic principles but they must be employed to

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[246]*Geotherm*, above n 244, 644.

[247]*Geotherm*, above n 244, 650. Gault J also held that these comments were applicable to Electricorp's letters to the Crown attempting to foreclose access to Crown resources. See *Geotherm*, 653.

[248]*Geotherm*, above n 244, 649.

[249]*Clear Communications Ltd* v *Telecom Corp of NZ Ltd* (1993) 4 TCLR 413, 430.

> aid the application of the statute to proved commercial circumstances not to supplant the process. In cases involving direct dealings with, or refusals to deal by, a firm alleged to be dominant in a market by the ownership or control of facilities without access to which others cannot enter it may be helpful in determining whether there has been a use of a dominant position merely to consider whether the firm has acted reasonably or without justification.

Gault J's approach makes it clear that "use" should not be restricted to a particular test that may only be appropriate in certain situations. While the *Queensland Wire* test was sufficient for the cases in which it was employed, it should not restrict the development of other tests in situations that obviously amount to a use of dominance. However *Clear Communications* has since been appealed to the Privy Council which applied a test similar to that in *Queensland Wire*, but with the effect of permitting some types of conduct that may otherwise have fallen within the test for "use".[250]

> In their Lordships' view it cannot be said that a person in a dominant position "uses" that position for the purposes of section 36 [if] he acts in a way which a person not in a dominant position but otherwise in the same circumstances would have acted.

Hence to determine if dominance was "used" this test, like *Queensland Wire*, looks to whether the conduct is *possible* only because of dominance (rather than considering whether dominance is "used" because of anti-competitive *effects* that could only result from a dominant firm's actions). However, rather than stating, as the Court in *Queensland Wire* did, that if a non-dominant firm could not have acted in that manner then dominance *has* been "used", the Privy Council has framed the test in the negative stating that dominance *cannot* have been "used" if a non-dominant firm could have acted in the same way.[251] While the Privy Council did not comment on whether this test was to be exclusive,

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[250] *Telecom Corporation of New Zealand Ltd* v *Clear Communications Ltd* Unreported, 19 October 1994, Judicial Committee of the Privy Council, 22. The word "if" has been substituted for the Privy Council's use of the word "unless". Clearly the Privy Council's unaltered test is a writing error as such a test makes no sense at all. While a variety of alterations might make the test workable, the writer has assumed that the Privy Council meant "if".

the test has the effect of exempting from Commerce Act scrutiny any conduct which can be performed by a non-dominant firm, regardless of whether only a dominant firm's action would produce anti-competitive effects. This effect did not result from *Queensland Wire*.

3 *Implications of the different tests for "use" in refusal to license cases*

The importance of the test for "use" in refusal to license cases rests upon the fact that there may be legitimate and illegitimate reasons for refusals to license. The narrow approach to use in *Queensland Wire* and *Clear Communications* means that section 36 is unlikely to be breached by a dominant firm's refusal to license.[252] This is simply because intellectual property rights are inherently exclusive and maintaining this exclusivity in licensing may be the best means of effectively exploiting the right[253] *regardless of the firm's size*. Asking whether the firm could refuse to license without dominance would be futile. Consider the exploitation of a popular music record. The record will be licensed to one manufacturer and distributor. This permits effective promotion as there are no competing licensees to "free-ride" on the efforts of other promoters. Hence a non-dominant firm is as likely as a dominant firm to refuse to license in some situations. Under the test in *Clear Communications*, if a non-dominant firm could do it then it cannot be "use" of a dominant position.

Dominant firms gaining collateral advantages from that dominance should not be able to hide behind the general policy arguments relating to the ease of exploitation that apply to exclusive licensing for all firms. In such a situation it may be necessary to employ a broader test for "use" as suggested in *Geotherm*.[254] If the firm's dominance lends the anti-

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[251]The writer is indebted to Y van Roy for this observation.

[252]See *Gault on Commercial Law*, above n 222, CA36.08 p149.

[253]See text above at Part XII A.

[254]*Geotherm*, above n 244, 650.

competitive force to the conduct (ie the gaining of collateral advantages at the consumer's expense) then arguably dominance has been used.

If the *Clear Communications* interpretation of "use" must be accepted, the following "gangland lawyer" argument may bring refusals to license within section 36: While a firm of any size may license to a single manufacturer, only a firm with dominance could afford to license to a single *inefficient* manufacturer and gain second monopoly profits thereby because, if the firm was not dominant, market share would suffer through excessive price or poor product quality. The difficulty with applying this argument in New Zealand is that firms with substantial market power do not reach the section 36 threshold as they would in Australia where the threshold is one of market power rather than dominance. Therefore the argument cannot work if a firm with substantial market power could also afford to license to an inefficient manufacturer.[255]

C *"Purpose"*

For section 36 to be breached the licensor must have acted with one of the proscribed purposes in section 36(1)(a)-(c). These purposes are restricting market entry, hindering competitive conduct in a market, or eliminating a competitor from a market. The first of these purposes will be most applicable in refusal to license cases. "Purpose", rather than "use", is really the heart of section 36 as "purpose" supplies the pejorative element. As Gault J noted in *Geotherm*, the "distinction between vigorous legitimate competition by a corporation with substantial market power and conduct that contravenes the section is in the purpose of the conduct".[256]

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[255]"Substantial market power" implies that some substitutes exist, and it may be impossible for a firm with such market power to license to very inefficient manufacturers, especially if product quality suffers.

[256]*Geotherm*, above n 244, 649.

The anti-competitive reasons an intellectual property rights holder may have for refusing to license have already been discussed above,[257] and prima facie a refusal to license where no substitutes for the licensed products exist manifests the purpose of restricting market entry. Gault J's words in *Clear Communications*, where Telecom was reluctant to permit access to the essential facility of networks for domestic phone calls, have some relevance here:[258]

> In circumstances... where a competitor realistically cannot enter the market without access to the facilities of a firm in a dominant position, a separate investigation of the purpose of the behaviour is hardly necessary. The anticompetitive purpose is to be inferred from the inevitability of the consequences of refusing to deal except on terms that lead to competitive disadvantage... it is necessary to bear in mind s2(5)(b) which provides that so long as it is a substantial purpose it is sufficient if it is included in the purposes of the conduct.

As mentioned however, the licensor will argue that a refusal to license was for the purpose of efficient exploitation of the intellectual property right and was entirely independent of any anti-competitive intentions. In this situation the court will have to evaluate the relative importance of the two interests. Section 2(5)(a)(ii) deems conduct to have had a particular "purpose" if "[t]hat purpose was a substantial purpose".[259] Therefore to fall within section 36, the intention to gain collateral advantages by refusing to license need only be one of the licensor's purposes, as long as it is a substantial purpose.[260] The purpose must also be actively pursued rather than arising purely as a consequence of other action (such as marketing strategies).[261] Therefore if the efficiency arguments above cannot justify a

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[257]See text at Part XII B.

[258]*Clear Communications* v *Telecom* (CA) (1993) 3 TCLR 413, 437.

[259]Section 2(1A) in turn defines "substantial" as "real or of substance".

[260]See *Union Shipping* , above n 242, 710. "The subsidiary purpose, deliberately pursued and desired, to inhibit the use by others of non PNL plant and manpower, thus facilitating greater PNL plant utilisation... is an aim, and thus a purpose, deliberately pursued in its own right".

[261]*Union Shipping*, above n 242, 707, quoting Donald & Heydon *Trade Practices Law* (1989), 2621. "Intention to do an act, which it is known will have anti-competitive consequences, in itself is not enough. 'Purpose' implies object or aim. The requirement is that 'the conduct producing the consequences was

refusal to license on their own, and the intellectual property rights holder is benefiting from collateral advantages gained by monopolising further markets and obtaining monopoly profits on the manufacture of the product, it would be reasonable to infer that the motivation for the refusal to license is not purely to safeguard the intellectual property right exploitation but also includes the desire to gain the collateral advantages. Hence it is likely that an anti-competitive "purpose", such as deterring competition in a market, exists.

D *Are the Courts Likely to Include Refusals to License Within the Ambit of Section 36(1)?*

Ignoring for the moment the technicalities of "use" and "purpose", are the courts likely to include refusals to license within the ambit of section 36? In principle intellectual property should not be treated differently from tangible property under competition law. Intellectual property law disrupts competition only to the extent necessary to create a property right that maintains the incentive to innovate. Once the property right exists, it is subject to the same competition laws as tangible property. This Part examines the existing case law on compulsory licensing, considers whether compulsory licensing will actually provide any economic benefits, compares the positions of copyright collection societies and patent holders, and assesses significance of the proposed amendments to the remedies available under the Commerce Act.

1 *Precedent on refusals to license*

In *Queensland Wire* a refusal to supply tangible goods ("Y-Bars" for fencing) constituted the breach of the Australian equivalent of section 36.[262] The defendant was ordered to

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motivated or inspired by a wish for the occurrence of the consequences'". See also *Eastern Express Pty Ltd* v *General Newspapers Pty Ltd* (1991) 13 ATPR 52,876, 52,896 and van Roy in *Gault on Commercial Law*, above n 222, CA36.09, 3-152.

[262] Section 46 of the Trade Practices Act. The s 46 threshold is lower than in New Zealand requiring only market power rather than market dominance.

supply the goods to a competitor at a reasonable price. The incentive to produce the Y-Bars was not destroyed as the *competitor had to pay the market price for the goods*, but the monopolisation of secondary markets was restrained. Refusals to license are analogous. If a compulsory licensing order is given then royalties must be paid. The incentive to innovate is not compromised, but the monopolisation of a secondary market is restrained.

Several European Community cases have dealt with refusal to license situations. In *A B Volvo* v *Erik Veng* Volvo refused to license the design rights in car body panels.[263] The European Court of Justice held that an obligation to license rights to third parties, even in return for a reasonable royalty, would deprive the rights holder of the substance of the exclusive right and that "a refusal to grant [a license] cannot *in itself* constitute an abuse of a dominant position".[264] However the Court then noted that the exercise of an exclusive right may constitute use of a dominant position if it involves[265]

> certain abusive conduct such as the arbitrary refusal to supply spare parts to independent repairers, the fixing of prices for spare parts at an unfair level or a decision no longer to produce spare parts for a particular model...

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[263] *A B Volvo*, above n 220.

[264] *A B Volvo*, above n 220, 6235. The European Community equivalent of section 36 is article 86 of the Treaty of Rome. Article 86 provides that:

> Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between member states. Such abuse, in particular, may consist in:
> (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
> (b) limiting production, markets or technical development to the prejudice of consumers;
> (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
> (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature, or according to commercial usage, have no connection with the subject of such contracts.

[265] *A B Volvo*, above n 220, 6235.

The Court however stopped short of actually suggesting that the refusal itself amounted to an abuse of dominance as the exercise of an intellectual property right within the subject matter of the right is not subject to article 86 of the Treaty of Rome. In other words, the rights holder's freedom to license is within the scope of the intellectual property right.[266] With respect though the distinction is nice as it is difficult to see how the Court can then claim jurisdiction over the prices charged by the rights holder - a matter which arguably is more central to the rights holder's interests.[267]

The *Magill* litigation has taken article 86 a step further.[268] These cases concerned television program information that was protected by copyright. The three defendant television companies each separately published weekly program guides in their own magazines. The three companies sent the weekly listings to newspapers ahead of time but permitted only daily publication. There was no single source of weekly information for all three companies. Magill, without a license, published such a magazine. Magill argued that

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[266]For a discussion of *A B Volvo* and the subsequent cases that followed it see V Korah "No Duty to License Independent Repairers to Make Spare Parts: The Renault, Volvo and Bayer & Hennecke Cases" [1988] 12 European Intellectual Property Review 381. Also see Korah "Do's and Don'ts for Technology Licensing Into the European Community" (1991) 2 Intellectual Property Journal 3, 23.

[267]See Korah above n 266, 382 for discussion of the "unfair prices" issue. Korah was "concerned by the very concept of unfair prices in the absence of a competitive market. Industrial property rights are granted in order to enable the person paying for innovation to appropriate the benefits of his investment. Clearly, unfair prices appear as one of the examples of abusive exploitation in Article 86 and in several cases where the [Community] Court did not have to decide what level of prices would be fair, the Court has again confirmed that charging inequitable prices is abusive. It is, however, impossible to determine what prices are fair in the absence of a competitive market, and I had hoped that the Court might have given less emphasis to this concept now that is has extended the Article to prohibit anticompetitive abuses". Hence the present writer argues that the licensor should be free to set any (non-discriminatory) licensing fee provided the licensor can be compelled to license to more efficient manufacturers.

[268]*RTE* v *Commission* [1991] ECR II-485, *BBC* v *Commission* [1991] ECR II-535, and *ITP* v *Commission* [1991] ECR II-575.

the television companies had abused their dominant position by refusing to grant a license. The trial court held that[269]

> the copyright is no longer exercised in a manner which corresponds to its essential function... which is to protect the moral right in the work and ensure a reward for creative effort.

The copyright was used to monopolise the "derivative market of weekly television guides".[270] Excluding all competition "in order to secure the applicant's monopoly" went beyond the essential functions of copyright law.[271] In substance this decision abandons the distinction made in *A B Volvo*.[272]

The Australian case of *ASX Operations* v *Pont Data* concerned a refusal to license stock exchange information.[273] By statute ASX had a monopoly on operating stock exchanges in Australia.[274] ASXO was a wholly owned subsidiary of ASX and carried on business collating and supplying stock exchange trading information. ASXO retailed this information ("Signal C") through its JECNET service. ASXO also supplied Signal C to Pont Data, itself a retailer of stock exchange information and in competition with the JECNET service. New contracts were negotiated on terms to which Pont Data objected, essentially because the terms were designed to place Pont Data at a commercial

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[269]Rec. 71.

[270]*Radio Telefis Eireann* v *E C Commission (Magill TV Guide Limited intervening)* [1991] 4 CMLR 586.

[271]*RTE*, above n 270, 618.

[272]See text above at n 264. For this reason the decision is controversial and may be overturned. See G van der Wal "Article 86 EC: The Limits of Compulsory Licensing" [1994] 4 European Competition Law Review 230.

[273]*ASX Operations Pty Limited & Anor* v *Pont Data Australia Pty Limited* (1991) 13 ATPR ¶ 41-069.

[274]ASX, above n 273, 52,050. The Securities Industry Act 1980 as amended by the Australian Stock Exchange and National Guarantee Fund Act 1980 prohibits the creation of competing stock markets. ASX may also have had a valid copyright in the data resulting from the particular format in which the data was arranged. As new data had to be supplied each day however, and as only ASX had access to this data, ASX did not need to rely on any intellectual property right to maintain exclusivity. Purchasers of the data that did not abide by the contractual conditions of use could be cut off from future supply.

disadvantage vis-a-vis its competitor JECNET.[275] At trial Wilcox J held that section 46 of the Trade Practices Act had been breached and that it would be appropriate to order variation of the contract to comply with the Act. The difficulties setting a pricing structure for compulsory licensing invited comparison with the order for compulsory supply in *Queensland Wire*:[276]

> If ASXO operated in a competitive market, in the supply of Signal "C", guidance would be available as to a fair price for the signal. One could look at the price charged by ASXO's competitors. But there are no competitors and, as I have held, the fees charged by ASXO are a function of its monopolistic position and its misuse of market power... After its remission by the High Court, *Queensland Wire* was settled [by the parties]. Pincus J. was therefore relieved of the duty of determining what was a fair price at which to compel BHP to supply Y-bar to Queensland Wire. Had his Honour been required to undertake this task he would, no doubt, have considered evidence as to the cost of producing Y-bar and as to the profit margin normally obtained by manufacturers of steel products... Although the nature of the product [in that case] is very different, I think that the same comment applies in the present case. Once it is accepted that ASXO is not entitled to misuse its monopoly position, it ought not to be regarded as unfair to compel ASXO to supply Signal "C" at a price which reflects the cost of supplying that signal together with a margin of profit similar to that charged by competitive suppliers in the data industry... In a competitive situation [the low cost of collating and supplying signal "C"] would be reflected in a low price [to Pont Data].

Implicit in Wilcox J's judgment is recognition that ASX is entitled to a fair commercial return on the commodity supplied, but that it is not entitled to price in a discriminatory

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[275]There were five main complaints. (i) The contract required Pont Data to supply commercially sensitive client information to ASX, allegedly for royalty "monitoring" purposes. (ii) Terms of the contract described Pont Data as a "carrier" of information when in fact Pont Data manipulated the information to provide format suitable for its clients. The contract thus implied that ASXO's (cheaper) retail information service was the same as Pont Data's. Pont Data was required by the contract to present to it's clients an agreement representing it as a "carrier" of the information. (iii) The contract prohibited Pont Data from "wholesaling" the information (ie selling it on to another supplier). (iv) The fee structure discriminated against Pont Data by charging a "storage" fee because Pont Data supplied historical information to its customers in addition to the "real-time" information supplied. (v) Pont Data claimed that the fee levels were too high and were aimed at subsidising ASXO's own retail service, JECNET.

[276]*Pont Data Australia Pty Ltd* v *ASX Operations Pty Ltd & Anor* (1990) 12 ATPR ¶ 41-007, 51,132.

fashion to deter competition in a secondary market.[277] The argument is applicable to intellectual property that has an innovative component. The rights holder is entitled to a fair commercial return on the innovation, which would reflect the development costs, but is not entitled to use monopoly power to prevent competition with its subsidiary in the market for manufacture.

2 *The counter-argument: Will compulsory licensing actually restrain abuses of dominance and reduce the anti-competitive effects of market power?*

One significant counter-argument exists to the "refusal to license - collateral advantage" theory expounded above.[278] In *Queensland Wire* BHP was ordered to supply the Y-bar at a reasonable price (ie one that would exist in a competitive situation). What will be a reasonable price for the products of innovation? For intellectual property law to function, monopoly profits must be obtainable on the innovation itself. The intellectual property rights holder is free to license at whatever price is deemed to be most effective for recovering the fixed costs. As the marginal cost of intellectual property goods is low, such pricing strategies will usually involve restriction on output to maintain high returns. If it is accepted that monopoly profits should be reflected in a licensing fee,[279] what then is the difference between 1) the charging of high licensing fees to non-exclusive licensees and 2) the charging of moderate license fees to a subsidiary which makes additional monopoly profits in the secondary market of manufacture? Either way the licensor makes the same profit and the consumer pays the same price. The licensor cannot be ordered to make

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[277]The Full Federal Court upheld Wilcox J's decision in respect of s 46(1)(c) - that ASXO had deterred competitive conduct in the retail information market. See *ASX*, above n 273, 52,068-52,069 and 52,071.

[278]See text above at Part XII B.

[279]Note that this proposition is itself challengeable. Intellectual property rights permit price to be raised above marginal cost, but only need to allow enough profits to maintain the incentive to innovate. "Monopoly" profits may be above the level of profit needed to sustain innovation, particularly given that the lower the marginal cost, the less the repeated exploitation exhausts the product. See OECD, above n 23, 12. Article 86(a) of the Treaty of Rome, above n _, appears to permit judicial intervention when the profit is "unfairly" high.

lower profits as this strikes at the heart of the incentive structure of intellectual property law.

In response to this argument, compulsory licensing can be justified in two ways. First, the argument above is too neat. Licensing to an inefficient subsidiary shielded from competition may permit rights holders to justify excessive product cost to the consumer on the basis of *production costs rather than innovative investmen*t. The innovative investment may be minimal and therefore much of the profits gained are social deadweight losses. The losses are obscured by the vertical integration. Naked profiteering from intellectual property right exploitation may attract the attention of law reformers[280] or regulatory bodies.[281] Compulsory licensing would limit the exercise of intellectual property rights by firms with market dominance to remuneration commensurate with the costs of innovation.

Secondly, profiteering may attract judicial attention. European courts consider it within their power to restrain excessive profits under equivalents of section 36.[282]

Thirdly, the arguments raised in *Jefferson Parish Hospital* are applicable. While refusals to license may not affect the ultimate price or quality of the goods that reach the consumer, *refusals to license permit the rights holder to monopolise secondary markets with potentially long term detrimental effects*. These secondary markets can be either different functional or different product markets as explained above. Even the relatively Chicago-school orientated judgment of O'Conner J acknowledged this effect as detrimental. Section

[280]Vertical integration in the pharmaceutical industry may obscure the nature of profits derived. It would be difficult to achieve legislative action to extend the patent term to 20 years if compulsory licensing had exposed the attainment of excessive profits from innovative activity.

[281]The Copyright Tribunal is one example of a regulatory body with powers to adjust license fees. See Part V of the Copyright Act

[282]See van der Wal, above n 272. Note that the Privy Council in Clear Communications considered monopoly pricing for access to essential facilities acceptable under the Commerce Act. If price control is required then Part IV of the Act should be used (see *Clear Communications*, above n 250, 28).

36 itself supports this conclusion as the proscribed purposes are couched in terms of *preserving a competitive commercial environment* for long teem economic efficiency - In other words, using a dominant position for monopolising markets is undesirable in itself. If this was the dominant firm's purpose, then compulsory licensing is justified irrespective of whether this would affect the dominant firm's profits.

3 *Copyright collection societies*

The Department of Justice considered the activities of copyright collection societies in "The Copyright Act 1962 - Options for Reform".[283] The department noted the lack of regulation for such bodies and the consequent potential for abuse of monopoly powers,[284] especially when collection societies arrange reciprocal agreements between themselves. Although the Department was most concerned with the effects of monopoly on the authors of copyright works, the Report mentioned the potential effects on copyright users, quoting from the November 1988 Monthly Review of the World Intellectual Property Organisation (WIPO):[285]

> A concentration of authors' rights in the hands of one collecting society can lead to a degree of power that brings certain dangers with it... [A] collecting society can exploit its monopoly by demanding excessive remuneration from users... or even by refusing altogether to grant licenses.

The Report recommended legislative regulation of collection societies, but the Copyright Bill 1994 does not address these concerns. So far as copyright users are concerned it would seem that the Commerce Act already offers some protection.

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[283]Department of Justice *The Copyright Act 1962 - Options for Reform* (Department of Justice, Wellington, 1989).

[284]Department of Justice, above n 283, 24.

[285]Department of Justice, above n 283, 24-25.

The issue of refusals to license arose in the context of *Australian Performing Right Association Ltd* v *Ceridale Pty Ltd.*[286] The collection society for the performance of musical works, APRA, sought payment from Ceridale (a nightclub) of overdue license fees. When Ceridale refused to pay, APRA cancelled Ceridale's licenses and sought injunctions to prohibit further performance of music by Ceridale. Ceridale alleged that APRA was using its market power to restrain competition in a secondary market in order to enforce a disputed debt. The Court held that APRA possessed sufficient market power but that APRA did not have the requisite purpose. This case suggests however that a refusal to license action is possible against collection societies.[287]

4 *Patent vs copyright - Can a distinction in principle be made?*

In theory, refusals to license to obtain monopoly profits on manufacture go beyond the protection offered by intellectual property rights. The incentive to create is not jeopardised as the licensor can charge monopoly prices for the license. As long as the license pricing is not discriminatory (eg *vis-a-vis* the license fees charged to a subsidiary) the licensor cannot recover monopoly prices for manufacture. Intellectual property rights holders are unlikely to greet this proposition with enthusiasm however. Many vertically integrated firms are likely to view the exclusive right to manufacture as a legitimate incident of the intellectual property right. This is especially true of patent holders. The issue therefore is whether intellectual property law envisages licensing exclusivity as an integral part of the right and essential for maintaining the incentive to create.[288] It has been argued that

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[286]*Australian Performing Right Association Ltd* v *Ceridale Pty Ltd* (1991) ATPR 41,074. See P Armitage "Regulating the Terms of Supply - When can Copyright Owners Refuse to License?" (1993) 3 Australian Journal of Corporate Law 91.

[287]See M Ryan "Copyright and Competition Policy - Conflict or Peaceful Co-existence?" (1991) 2 Intellectual Property Journal 206, 218 for a contrary view.

[288]Undoubtedly this second monopoly would aid creator's, but is it *essential* for creativity to proceed? As mentioned above the limited nature of intellectual property rights is aimed at providing only *enough* protection to encourage creativity.

copyright law does not envisage this right,[289] so can a distinction be made in principle for patent law?

At first glance actions for refusals to license seem more "acceptable" for copyright than patent. This is probably because the copyright industries are traditionally less vertically integrated, and the nature of copyright exploitation is different. Collection societies may be subject to section 36 for refusals to license. Market dominance is uncontested in these cases, but where a patent is deemed to create market dominance, there is no reason in principle why it should be treated differently.

Given the market structure of patent exploitation it is possible that compulsory licensing will deter firms from innovation, or at least act as a deterrence to using the patent system. Innovators may prefer to keep innovations secret and rely on breach of confidence actions, rather than patent law, for protection.[290] Thus compulsory patent licensing may frustrate one of patent law's primary objectives - diffusion of knowledge. Furthermore, innovations not subject to patent law will never fall into the public domain on the expiry of the patent protection term, and can therefore be monopolised indefinitely.

5 *Section 89 of the Commerce Act 1986*

Perhaps the most persuasive evidence that compulsory licensing for breach of section 36 is envisaged is the proposed amendments to the Patents Act and Commerce Act as part of the GATT reforms. Clause 20 of the GATT (Uruguay Round) Bill 1994 amends section 89 of the Commerce Act by permitting the court to grant compulsory patent licenses as part of the general remedies available to a court under section 89 for breaches of Part II of

289 See text above at Part XIII D 3.

290 See F M Scherer *Innovation and Growth* (MIT, 1984). Scherer found that compulsory licensing in the United States did not affect the level of investment in research and development, but that it did affect the levels of patenting activity, especially for those firms that had been subject to compulsory licensing orders. See OECD, above 23, 13.

the Commerce Act.[291] The terms of clause 20 go beyond permitting orders for mere *variations* of licenses (which might be necessary where collateral advantages are gained in licensing agreements), but instead extend to granting entirely *new* licenses. The rationale for this power cannot lie in the failure to adequately exploit a patent,[292] or in the inclusion of terms that would be void under section 66 of the Patents Act, as these actions are subject to scrutiny under the Patents Act and not the Commerce Act. The compulsory license remedy is thus available for breach of the Commerce Act, and the most logical explanation for this power to grant new, non-exclusive, licenses is when an intellectual property rights holder with market dominance has refused to license for one of the purposes proscribed in section 36.

An argument can be made however that the amendments to section 89 result from the proposed repeal of section 47 of the Patents Act and therefore that section 89 is not intended to permit compulsory licensing. As mentioned above,[293] section 47 permits compulsory licensing where the trade in materials not the subject of the patent is unfairly prejudiced by licensing terms imposed by the licensor. Article 31(k) of the TRIPS agreement permits such provisions in patent acts to be repealed if adequate protection exists in domestic competition laws. This would suggest that the purpose of the section 89 amendments is to provide remedies in cases of licensing agreements directed at gaining

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[291]Clause 20 of the Bill amends the Commerce Act by inserting the following subsection after subsection 1 of section 89:

> (1A) Without limiting the orders that may be made under subsection (1) of this section, an order may be made under that subsection that a patentee (as defined in section 2(1) of the Patents Act 1953) grant a license to use a patented invention in respect of which that patentee is the grantee or proprietor of the relevant patent.
>
> (1B) Any order referred to in subsection 1A of this section may be made on such terms and conditions as the Court thinks fit.
>
> (1C) Any license granted pursuant to an order referred to in subsection (1A) of this section-
>
> (a) Is not exclusive:
>
> (b) Must not be assigned otherwise than in connection with the goodwill of the business in which the patented invention is used:
>
> (c) Is limited to the supply of the patented invention predominantly in New Zealand.

[292]See s46 of the Patents Act.

[293]See the text at Part IX B.

collateral advantages, and thus replace section 47. The difficulty with this explanation is that Article 31(b) of the TRIPS agreement states that compulsory licensing is only permissible where the proposed user has "made efforts to obtain authorization from the right holder on reasonable commercial terms and conditions and that such efforts have not been successful...". This leads back to the conclusion that section 89 permits compulsory licensing in "refusal to license" situations, rather than "oppressive" licensing situations, and therefore as a consequence, that a refusal to license can breach section 36.[294]

XV SECTION 36(2) OF THE COMMERCE ACT 1986

Section 36(2) provides that:

> For the purposes of [section 36(1)], a person does not use a dominant position in a market for any of the purposes specified in paragraphs (a) to (c) of subsection (1) of this section by reason only that that person seeks to enforce any statutory intellectual property right within the meaning of section 45(2) of this Act in New Zealand.

Section 36(2) presents three issues. First, while "enforce" undoubtedly applies to legal action in the courts, does it also apply to refusals to license? Secondly, do the words "by reason only" exclude from the exemption the "enforcement" of statutory intellectual property rights for *collateral* advantages. Thirdly, if a particular instance of judicial action fro intellectual property rights enforcement does not fall within the section 36(2) exemption, what is the significance of the Australian case law on the "use" of an intellectual property right, and also the New Zealand case law on the "use" of legal rights?

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[294]At the time of writing it appears that the amendments to section 89 will not now proceed. Some submissions on the GATT Bill were concerned that compulsory licenses may be granted as a remedy for *any* breaches of Part II of the Commerce Act, whether intellectual property licensing was involved or not. For example, Fisher & Paykel was concerned that its "Smart Drive" technology could be licensed as a sanction for price fixing! These concerns seem a little extreme, as there are many other equally inappropriate sanctions a court could impose under the Commerce Act. In any case there is arguably the scope under section 89 as it stands to grant compulsory licenses. (Telephone discussion with Ministry of Commerce, November 23, 1994).

These issues are dealt with as they arise in the context of refusals to license and legal actions.

A *The Application of Section 36(2) to Refusals to License*

A Department of Trade and Industry paper on the Commerce Bill 1985 suggests that the purpose of clause 36(2) was to exempt the legitimate enforcement of legal rights in the courts from the Commerce Act.[295] The submissions to the Select Committee considering the clause 36 of the Commerce Bill did not raise concerns about refusals to license being subject to the Commerce Act.[296] This is more contentious, the only two academic commentators to address this issue disagreed. Eagles argues that a "person does not enforce or seek to enforce a right by doing nothing".[297] A refusal to license, being only passive conduct, does not fall within the exemption. Calhoun argues that subjecting a simple refusal to license to the Commerce Act would undermine the exclusivity that intellectual property rights confer, and hence section 36(2) should apply to refusals to license.[298] It may be that given the presence of the words "by reason only" in section 36(2) that both of these arguments are academic.[299]

1 *"Seeking to Enforce"*

Other things being equal, competition law should allow a rights holder to maintain the exclusivity that the right confers as an incentive to create. While court action to restrain

[295]Department of Trade and Industry paper *Commerce Bill: Intellectual Property Rights* addressed to the Chairman of the Parliamentary Select Committee on Commerce and Marketing, 5.

[296]Some submissions however were concerned that an intellectual property "monopoly" create a dominant position. The Department of Trade and Industry considered that this concern arose from a misconception about the difference between "property" monopolies and economic monopolies. See Paper, above n 295, 5.

[297]Eagles, above n 17, 55.

[298]Calhoun, above n 97, 15.

[299]See text below at Part XIV A 2.

infringement is clearly within the section 36(2)'s ambit, refusals to license are also directed at maintaining exclusivity. It is arguable that "seeking to enforce" should also include refusals to license because maintaining exclusivity by either means causes the same economic impact:[300]

> [I]t would not be too strained an interpretation to say that in declining to give a licence, and in so doing reiterating his exclusive rights, a right holder would be doing no more than *seeking* to enforce (in the sense of compelling observance of) his rights.

However the absence of any exemption in the Trade Practices Act for section 46 seems to suggest that section 36(2) may have been only an afterthought intended to protect judicial action from attack.

2 *"By reason only"*

Whether "seeking to enforce" includes refusals to license may be academic because the words "by reason only" mean that refusals to license in order gain collateral advantages will not be exempted. When a rights holder refuses to license to a competitor, or will license only on onerous terms, and the rights holder can adduce no evidence of marketing constraints, then there will be good ground for inferring that the rights holder's motives go beyond the purpose of gaining monopoly profits on the innovation itself and instead extend to the monopolisation of secondary markets. A refusal to license in such circumstances could not be said to be "by reason only" of a desire to maintain exclusivity. If no collateral advantage is sought then it is unlikely that section 36(1) would be breached by a refusal to license in any case (irrespective of whether section 36(2) applies to refusals to license), as the requisite purpose would be absent.

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[300]Calhoun, above n 97, 15.

B *The Application of Section 36(2) to Litigation for Infringement of Intellectual Property Rights*

Because intellectual property can not be possessed, appropriation is easy.[301] Litigation for infringement of intellectual property rights is therefore more likely than for tangible property. Section 36(2) functions to protect rights holders from breach of section 36(1) claims by reason only that intellectual property rights are enforced in court. A section 36(1) claim may allege that the rights holder is deterring competition by imposing unnecessary legal costs and adverse court decisions[302] on the competitor. In the United States this is known as "sham litigation".

In *Geotherm* Gault J stated that "it is difficult to suppose that a contravention of [section 36(1)] will be established by the mere reasonable rights of objection...".[303] The inference is that some types of legal action, when brought for a proscribed purpose, may breach section 36. In *Geotherm* the defendant claimed that Electricorp had embarked upon a policy to exclude competitors which included the exercise of legal rights that imposed costs upon the prospective market entrant.[304] Such conduct may involve the use of a dominant position but more importantly would be acting for a proscribed purpose. If this was the case, the firm could not argue it was seeking only to enforce a statutory intellectual property right.

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[301]Appropriation is also facilitated by the hazy boundries of some intellectual property rights. In copyright cases, for example, it may be difficult to determine what are the "ideas" and "expressions" in any given work. Only the latter are protected.

[302]Sham litigation does not just encompass *judicial* decisions but includes the decisions of regulatory approval boards and members of the executive arm of government.

[303]*Geotherm*, above n 244, 655.

[304]*Geotherm*, above n 244, 651-652. *Geotherm* is a classic illustration of many sorts of non-price predation.

Section 36(2) has been mentioned twice in sham litigation cases. In *Electricity Corporation* v *Geotherm* Gault J noted that section 36(2) was introduced to permit the "reasonable exercise" of legal rights.[305] In *Telecom* v *Clear* Smellie J noted that a legal action for breach of copyright was expressly excluded from the conduct proscribed by section 36(1).[306] Neither of these judgments specifically focused on the words "by reason only". While Smellie J appears to discount them, Gault J's judgment implies that judicial actions brought in the context of a policy to exclude competitors are not brought "by reason only" of the enforcement of an intellectual property right:[307]

> It is difficult to envisage a situation in which there will be a contravention by the reasonable exercise of rights of objection. The allegations here, however, are as to the manner of exercise of the rights by way of implementation of a policy to exclude competitors which incorporates this and other conduct. Whether that amounts to use of market dominance will be a matter for evidence. That the introduction of s36(2) was considered necessary to exclude the enforcement of the statutory intellectual property rights seems consistent with this approach.

Gault J does not say "what" approach however, and so his decision can be read in two ways. First, section 36(2) provides that section 36 is not infringed "by reason *only* that that person seeks to enforce any statutory intellectual property right...".[308] This implies that a successful legal claim may be unreasonable if in the context of a "policy to exclude competitors".[309] However Gault J may have meant that the exemption is intended to permit *any* valid intellectual property claims regardless of context. The former interpretation is preferable as it is more consistent with the actual words of the statute.

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[305]*Geotherm*, above n 244, 652.

[306]*Telecom* v *Clear* [1992] 3 NZLR 247, 254.

[307]*Geotherm*, above n 244, 651-652.

[308]Section 36(2) of the Commerce Act (emphasis added).

[309]*Geotherm*, above n 244, 652. Section 36(2) can also carry another meaning. "Enforce" may extend to refusals to license. If a monopolist refuses to license for ulterior motives then section 36 may be breached.

Nonetheless Australian courts have not had to depend on an exemption such as section 36(2) to permit the legitimate enforcement of intellectual property rights in court. In two cases the Australian courts have held that the enforcement of an intellectual property right in the courts is not "taking advantage" of (ie "using") market power but is only the use of the intellectual property right. In *Cadbury Schweppes Pty Ltd* v *Kenman Developments Pty Ltd* Kenman complained that Cadbury had "an improper motive in commencing and continuing with [legal] proceedings which [Kenman] believes to be untenable, unreasonable and doomed to failure".[310] Olney J noted that[311]

> [t]here may well be circumstances in which the unreasonable pursuit of a claimed legal right against a less powerful competitor by a corporation with substantial market power could amount to taking advantage of that power...

Olney J held that no use of dominance had occurred in this case because the claims were not unreasonable (ie not "doomed to failure"). This confuses "use" and "purpose" however.[312] Whether a legal action is likely to succeed has no bearing on whether it was possible to bring the action in the first place. Probability of success will thus be more indicative of the plaintiff's purpose in bringing the action, and will not relate to whether dominance was used to bring the action. In *Warman International* v *Envirotech Australia Pty Ltd* Wilcox J noted that[313]

> [t]o exercise in good faith an extraneous legal right, though the effect may be to lessen, or even eliminate competition, is to take advantage of that right, not market power...

310*Cadbury Schweppes Pty Ltd* v *Kenman Developments Pty Ltd* (1991) 13 ATPR ¶ _ , 52,749.

311*Cadbury*, above n 310, 52,757.

312The probability of success may be an *evidential* factor pointing towards "use" as only firms with market power can afford to bring fruitless legal actions. The threshold in New Zealand fro the application of s36 is market dominance not market power however, and as many firms below the dominance threshold have the resources to sham-litigate, probability of success may be less helpful as an indicator of "use" in New Zealand.

313*Warman International* v *Envirotech Australia Pty Ltd* (1986) ATPR para 40-714, 47,827. Note that this case was decided prior to *Queensland Wire*.

The operative words are "good faith" however. Although this comes closer to a test for "use", it is again related to "purpose". Section 46 of the Trade Practices Act has no equivalent exemption to section 36(2). In seeking to protect the reasonable exercise of legal rights from section 46, because no statutory exemption is provided, the Australian courts have adopted a strained interpretation of "use".[314] The test does not determine whether the legal action was possible because of market power,[315] or whether the effects of the action were detrimental only because of the firm's market power.[316] If the legal action is brought reasonably to protect an intellectual property right, then this would suggest that the firm's *purpose* was not to fetter competition, although this may be an unavoidable consequence of the action.[317] This is a different matter from whether dominance was "used". With respect, the Courts in the above cases seem to have been reluctant to hold that a dominant position had been "used" because of the mistaken belief that to hold there had been a "use" would establish contravention of the section.[318] The test in the above cases therefore involves the legal fiction that market power has not been "used" when the purpose is legitimate. This fiction should be abandoned as it obscures the object of section 36 (and section 46 of the Trade Practices Act) which is to punish conduct only where a dominance has been used for a proscribed purpose: "Use" is merely a causal link.[319]

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[314]The Australian analysis has been applied to a degree in New Zealand in respect of the enforcement of other legal rights for which there is no Commerce Act exemption such as Fair Trading Act 1986 complaints.

[315]This is the *Queensland Wire* and *Clear Communications* test for "use".

[316]This is the extended test for "use" in *Geotherm*.

[317]See text above at n 261.

[318]As the Privy Council stated (correctly) in *Clear Communications*, above n 250, 20, "[t]he use of a dominant position otherwise than for one of those purposes [in section 36(1)(a)-(c)] does not constitute a breach".

[319]See text above at n 238.

In summary, the words "by reason only" do not exempt the judicial enforcement of intellectual property rights from section 36(1) where the legal action is part of an anti-competitive policy. Furthermore, the Australian cases show that an exemption for judicial enforcement is unnecessary for legal actions intending only to enforce the intellectual property right. While the Australian cases have mistakenly considered the motivation for the enforcement under the element of "use", the same factors can validly be considered under "purpose" which will lead to the same result.

XVI CONCLUSION

This paper has examined the economic rationales for intellectual property law and competition law. In spite of the seeming conflicts between the two areas of law, both aim to promote economic efficiency, and both areas of the law can be reconciled by adherence to two simple principles. First, an intellectual property rights holder is entitled to divide and assign the totality of the right granted by intellectual property law in the manner that the rights holder considers will best achieve efficient exploitation. Secondly, competition law cannot attack the existence of intellectual property rights but will scrutinise the conduct of intellectual property rights holders where licensing terms, or refusals to license, are aimed at procuring anti-competitive advantages collateral to those permitted by the intellectual property right. Applying these principles to the application of section 45 the types of licensing provisions that infringe competition law have been identified.

These principles can also be applied to refusal to license by firms with dominant positions in markets. A dominant firm may seek to gain collateral advantages by refusing to license in order to gain monopoly profits on the manufacture of the intellectual property goods (in addition to the monopoly profits in the innovation) or to monopolise the secondary functional market or a even secondary product market. Section 36 of the Commerce Act is equipped to deal with such situations but the restrictive tests for "use" of a dominant position put forward in *Queensland Wire* and *Clear Communications* may frustrate the operation of section 36 in this context.

Section 36(2) of the Commerce Act provides a limited exemption from section 36(1). The exemption will permit the enforcement of an intellectual property right in court to be exempt from claims of abuse of legal process. The inclusion of the words "by reason only" in section 36(2) means that legal actions with collateral motives such as sham litigation will not be exempt. It is uncertain whether section 36(2) applies to refusals to license. The argument is academic however as the words "by reason only" involve much the same criteria as "purpose" under section 36(1): If section 36(2) applies as an exemption in a particular instance, then the requirements for "purpose" under section 36(1) would not be satisfied.

APPENDIX A - *Transfield Pty Ltd* v *Arlo International Ltd* (1980) ATPR ¶ 40-166.

Arlo were the owners of a patent for a telescopic pole (the "Arlo Pole") used in the construction of electric transmission lines. Arlo granted an exclusive license to Transfield to make, use, and vend the Arlo pole over the whole of Australia. Transfield paid an up-front fee and would pay further royalties on its use of the Arlo pole. Transfield was already one of the 3 main operators in Australia constructing transmission lines. The Arlo pole was found to be unsatisfactory in some situations, mainly due to either design or manufacturing faults, and Transfield designed a similar pole for use in these situations. The new pole did not infringe the patent of the Arlo pole, but it effectively destroyed the market in Australia for the Arlo pole. Arlo sought to restrain Transfield's use of this new pole. Transfield contested two clauses in the license. Clause 7 stated that:

> The Licensee [Transfield] covenants during the period of the Power Transmission Line License at all times to use its best endeavours in and towards the design fabrication installation and selling of the ARLO PTL pole throughout the licensed territory and to energetically promote and develop the greatest possible market for the ARLO PTY pole.

The case raised issues in both the Trade Practices Act 1974 (Cth) and the Patents Act 1952 (Cth). Section 51(1) of the Trade Practices Act is equivalent to our section 45 exemption of the Commerce Act, although not worded as tightly. Section 112(1)(a) of the Patents Act 1952 (Cth) provides that licensing conditions that restrict the licensee from using patented or unpatented articles not supplied by the licensor are void. Section 112(7)(a) of the Patents Act 1952 (Cth) provides that section 112(1)(a) does not affect licensing provisions that restrict the licensee from selling goods other than those of the licensor. Sections 112(1)(a) and 112(7)(a) of the Patents Act 1952 are equivalent to sections 66(1)(b) and 66(5) of the New Zealand Patents Act 1953 respectively. The case is a typical High Court of Australia judgment in so far as all of the judges reach different conclusions upon different grounds.

A best endeavour clause is usually a covert means of implementing an exclusive dealing contract prohibiting the licensee from dealing with people other than the licensor. An exclusive dealing contract is by its nature anti-competitive and subject to scrutiny. Without deciding whether this particular clause would be anti-competitive, Barwick CJ stated that:[1]

> The effect of a best endeavour clause is not, in my opinion, to prohibit or restrict the promisor from using articles not supplied or owned by the promisee. There is nothing in the terms of cl. 7 which, in my opinion, would produce that effect.

Thus clause 7 did not fall foul of section 112(1) of the Patents Act. Although Transfield would not be successful in striking down clause 7, Barwick CJ's interpretation robs it of its intended effect. Barwick CJ went on to consider the effect of the Trade Practices Act 1974 on clause 7. Strictly speaking this was unnecessary given his interpretation of clause 7, but he nonetheless concluded that the Trade Practices Act provisions would not apply. "[I]t is enough to say that sec. 51(1)(a) of [the Trade Practices] Act, by excepting things authorised by the *Patents Act*, provides an answer".[2] This somewhat brief analysis has the effect of exempting just about any anti-competitive clause in a licensing agreement from competition law scrutiny. It is suggested that Barwick CJ's interpretation is not correct. Section 53(1)(a) of the Trade Practices Act provides that in determining whether section 46 [contracts substantially lessening competition] has been breached regard shall not be had, in the case of a license granted by the owner of a patent, to any condition of the license relating to the invention to which the patent relates. To read this provision as permitting any clause to be included in a patent license would be wrong. It is doubtful whether a clause requiring the licensee only to use the licensed products would be immune from the Trade Practices Act. Such a clause would not exclusively relate to the licensed article.

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[1]*Transfield Pty Ltd* v *Arlo International Ltd* (1980) ATPR ¶ 40-166, 42,303.

[2]*Transfield*, above n 1, 42,303.

Stephen J's judgment was more detailed. He discussed at length the relationship between section 112(1)(a) and section 112(7)(a) of the Patents Act, which are the equivalents of section 66(1) and section 66(5) in our Patents Act respectively. Section 112(1)(a) states that clauses restricting the use of other articles are void. Section 112(7)(a) states however that nothing in section 112(1)(a) affects a condition which restricts the right of a licensee to *sell* other articles. Stephen J held that clause 7 required Transfield not to sell competitors poles, and that this restriction was thus valid. It follows that he viewed the act of including poles in the larger manufactured product of whole a transmission line was the act of selling rather than just of using. It would be possible however to argue that in this case section 112(7)(a) was intended only to allow restrictions upon licensees selling poles wholesale and *separately* from any other product. Stephen J then went on to consider the Trade Practices Act. He declined to address the exemption clause as he did not believe this contract to be one that substantially lessens competition in any case.

Mason J held that clause 7 did not place any restrictions on the licensee's ability to use or sell other poles as this was not the clause's purpose or effect. Clause 7 was "susceptible of an interpretation which preserves its validity by not bringing it into conflict with sec. 112. This is the interpretation which should be given to it".[3] Mason J's comments on section 53 of the Trade Practices Act warrant quotation in full.[4]

> I take the view that sec. 51(3)(a)(i) and sec. 51(3)(a)(iii) of the *Trade Practices Act* would provide a defence to a case of contravention of sec. 45(2) arising out of the presence of cl. 7 in the agreement... [Transfield] submitted that cl. 7 of the Agreement does not only relate to "the invention" or to "articles made by the use of that invention" but it goes beyond the terms of sec. 51(3)(a)(iii) and related to other products, that is, it relates to not using any other poles. This submission... attributes to the word "relates" a meaning which is too narrow, thereby giving sec. 51(3) an overly restrictive operation.

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[3] *Transfield*, above n 1, 42,309.

[4] *Transfield*, above n 1, 42,310.

> In bridging the different policies of the Patents Act and the Trade Practices Act, sec. 51(3) recognizes that a patentee is justly entitled to impose conditions on the granting of a licence... in order to protect the patentee's legal monopoly. Even under American antitrust law, where there is no equivalent exception to sec. 51(3), the patentee is entitled to exercise some measure of control over the licensee consistent with the scope of the patent monopoly, though there has been some controversy as to the scope of permissible control...
>
> Section 51(3) determines the scope of restrictions the patentee may properly impose on the use of a patent. *Conditions which seek to gain advantages collateral to the patent are not covered by sec. 51(3)* [emphasis added].

Although strictly obiter, Mason J's comments are the fullest judicial examination of the interface between intellectual property law and competition law in either New Zealand or Australia. The passage illustrates some of the difficulties that arise by the use of the word "relates" in exemption clauses. This word was dropped from Section 45 of the Commerce Act here by the 1990 amendment. Because of the use of the word "relates" Mason J was required to consider the policy of this legislation. Essentially he adopts the test of "collateral advantage". He determined that *if* clause 7 had required Transfield to use only Arlo poles, then this would not be seeking any collateral advantage: Arlo is seeking simply to ensure exploitation if their pole. The words "to protect the patentee's legal monopoly" appear to be used somewhat loosely though, as technically the legal monopoly relates only to the Arlo pole, and not to any other. Implicit in the his judgment therefore is that as a practical matter of exploitation such an exclusive dealing clause is permissible, as a hostile licensee possessing an exclusive license could deprive the licensor of any remuneration for that invention within the area of the exclusive license by simply marketing only competing its own poles (ie Transfield's). This would result in *removing* a competitor from the market. If a clause was any wider though, perhaps mandating the purchase of raw materials or other types of products from nominated persons, then this could be a collateral advantage under Mason J's reasoning. The difficulty with Mason J's reasoning is that exclusive dealing contracts may not contravene the Trade Practices Act, and therefore there is no reason to grant an outright exemption for all exclusive dealing contracts.

Murphy J dissented from the majority. He did not consider the Trade Practices Act, but rather confined his reasoning to the Patents Act.[5]

> The *Patents Act*... provides monopoly rights in respect of inventions and allows the monopolist to license others to make the article or use the process invented. In order to confine the monopoly within suitable limits, the Act contains provisions calculated to prevent the obtaining of collateral advantages.

Interestingly Murphy also imports the collateral advantages test, although in respect of the Patents Act. Murphy J went on to consider section 112(7)(a) which permits clauses restricting the sale of goods other than those of a particular person. He commented that this section "permits a degree of restrictive practice which does not fit with modern legislative policies".[6] Nonetheless the section is still law. Murphy J thus held, contrary to Stephen J, that the "circumstances out of which the alleged breach occurred was not 'selling' but '*using*' poles".[7] Hence section 112(7)(a) could not excuse the conduct prohibited by section 112(1)(a):[8]

> Clause 7, on the construction contended for by [Arlo] and accepted by the Court of Appeal, is a restrictive device, capable of being used, as was sought in this case, to inhibit the use by a licensee of another product which competes with the patented one. This is the very kind of mischief at which sec. 112 is aimed.

Wilson J reached the conclusion that clause 7 did not impose an obligation on Transfield to use and sell only the Arlo pole, rather that Transfield merely had to use its best efforts to promote the pole. Therefore section 112 of the Patents Act was not infringed. Wilson J went on to consider the Trade Practices Act. Here he concluded that the clause on any

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[5] *Transfield*, above n 1, 42,310.

[6] *Transfield*, above n 1, 42,310.

[7] *Transfield*, above n 1, 42,311 (emphasis added).

[8] *Transfield*, above n 1, 42,311.

interpretation operated to increase competition rather than to lessen it. He nonetheless commented on section 51(3).[9]

> [T]hat section provides that sec. 45 shall not be taken to have been contravened by reason of a condition of a licence granted by the owner of a patent to the extent that the condition relates to articles made by the use of the invention to which the patent relates. Clause 7 would seem to fall squarely within that provision.

A majority of the Court held therefore that Clause 7 was still valid, but that clause 7 did not operate to require Transfield to use and sell only the Arlo pole. *Transfield* illustrates some of the difficulties of the law in this area even with a relatively simple fact situation such as this. It would be an understatement to say that the law is left in some confusion. Note the different findings on whether a best endeavour clause is an exclusive dealing contract, whether Transfield was "selling" or "using" the poles, whether the infringement test is gaining a collateral advantage, and what in fact does constitute a collateral advantage: All this confusion even before issues such as substantially lessening competition are addressed!

For a contemporary commentary on *Transfield* see D Shavin "Trade Practices" 1980 Australian Business Law Review 417.

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[9]*Transfield*, above n 1, 42,313.

APPENDIX B - The "Spare Parts" Exemption

In *British Leyland* v *Armstrong Patents*[10] the House of Lords addressed the issue of copyright in the market for spare parts ("after-markets"). The defendants were component manufacturers who copied the exhaust pipe of an Austin motorcar and sold it in competition with the manufacturer. The exhaust pipe, not being an innovation, was unprotected by patent. The manufacturer sought to restrain the defendant on the grounds of breach of copyright. Lord Templeman described the position as follows:[11]

> [British Leyland ("BL")] have obtained an injunction which effectively prevents Armstrong from manufacturing replacement exhaust pipes for the Marina. If this injunction was rightly granted it follows that any motorist who drives a BL car must buy his spare parts from BL at the prices fixed by BL or bear the burden of a royalty payable to BL for the privilege of buying his spare part from someone else. The purchase of a BL car sells his soul to the company store... This appeal has wide implications because the injunction granted to BL creates or recognises a monopoly in replacement parts enjoyable not only by BL and by all vehicle manufacturers, but also by all manufacturers of mass-produced machinery in respect of repairs.

The Law Lords held that the defendant had indirectly breached the plaintiff's copyright in the drawn plans by reverse engineering the exhaust pipe. The plaintiff's copyright was however subject to the right of the purchaser of a car (or any subsequent owner) to keep the car in good repair and working order. Furthermore "[w]hat the owner needs, if his right of repair is to be of value to him, is the freedom to acquire a previously manufactured replacement exhaust system in an unrestricted market".[12] Therefore the defendant had a valid defence to copyright infringement. The Law Lords ostensibly based the judgment on the doctrine that a grantor (ie British Leyland) may not derogate from the grant, but the

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10 *British Leyland* v *Armstrong Patents* [1986] 1 All ER 850.

11 *British Leyland*, above n 10, 864.

12 *British Leyland*, above n 10, 861, per Lord Bridge.

speeches repeatedly refer to the absurd consequences of some aspects of industrial copyright.[13]

> Copyright protection for functional designs, as extended to articles of functional utility manufactured in accordance with those designs, would certainly seem to be capable of abuse as a means of obtaining many of the advantages conferred by the patent monopoly while circumventing the many stringent conditions and safeguards to which patent protection is subject.

Necessarily the speeches also refer to monopoly:[14]

> [I]t seems to me within the capacity of the common law to adapt to changing social and economic conditions to counter the belated emergence of the manufacturer's attempts to monopolise the spare parts market in reliance on copyright in technical drawings by invoking the necessity to safeguard the position of the owner.

Implicit in this quotation is recognition that the car owner's interests are in *competitively priced* consumer goods, as there was never an issue of availability: Allocative efficiency in markets ought not to be disrupted unless necessary to encourage innovative activity. However the approach of the House of Lords may not be the best means of dealing with the interface. A compulsory license may have been preferable for otherwise the rights holder is precluded from gaining monopoly rents on the innovation itself. If the Law Lords believed that copyright protection for exhaust pipes is too expansive they may have been better to hold that an exhaust pipe, the shape of which is determined purely by functional considerations and contains no capricious design elements, may have exhibited insufficient originality to warrant protection in the first place. Once it is accepted that copyright subsists however, the courts should not remove the protection that the legislature deems necessary to encourage innovation.

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[13]*British Leyland*, above n 10, 859, per Lord Bridge.

[14]*British Leyland*, above n 10, 862, per Lord Bridge.

The spare parts exception has been argued in two New Zealand cases, but was not upheld. In *Mono Pumps* v *Karinya Industries* Amalgamated proposed to import spare parts (made without license in India) for Mono pumps.[15] The pumps were originally protected by patent but the patent term of protection had expired.[16] Mono therefore claimed that the spare parts for its pumps were protected by copyright and succeeded in gaining an interlocutory injunction preventing Amalgamated from importing the spare parts. Subsequently the House of Lords delivered its judgment in *British Leyland* and Amalgamated moved for a new order overturning the injunction. Prior to 1985 the functional copyright law of England and New Zealand was substantially the same.[17] Tompkins J declined to follow *British Leyland* however stating that the 1985 amendments to the Copyright Act 1962 addressed this issue. The New Zealand Parliament had expressly recognised copyright in three dimensional works industrially applied (ie functional goods) and had dealt with the problems of functional copyright by limiting the period of protection to 16 years.[18]

In *Dennison Manufacturing* v *Alfred Holt* the plaintiffs had designed a labelling gun for attaching price tags to clothes.[19] The defendants sought to manufacture and supply the tags which the plaintiff claimed were protected by copyright. The Court held that the spare parts exception was not applicable.

The spare parts exemption seeks to address the excess of market power conferred on the holders of functional copyrights. While judicial attempts to mitigate this power by limiting

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[15]*Mono Pumps (New Zealand) Ltd* v *Karinya Industries Ltd* 7 IPR 25.

[16]The pumps operated on the principle of the Archimedian screw which has been in use for pumping water for centuries. Presumably Mono had found a new application or means of manufacture in order to gain patent protection.

[17]*Mono Pumps*, above n 15, 31.

[18]Section 20B(1) of the Copyright Act 1962.

[19]*Dennison Manufacturing Co & Another* v *Alfred Holt Co Ltd & Others* (Unrep. Hight Court, Auckland Registry, 5 March 1987, A 736/78, Smellie J).

the *scope* of the intellectual property right appear to have failed, there may an alternative means. The European courts have considered this issue in the context of refusals to license. An order to license to a competitor permits the competitor to compete in the manufacture of the goods, and at the same time permits the licensor to gain the benefits of the "innovation" through license fees. This solution is less favourable to the competitor, who, under the decision in *British Leyland*, does not have to pay royalties. The *British Leyland* approach seems unsustainable however as Parliament's clear intention, whether a good intention or not, was to confer copyright protection on mundane functional goods. Resolving the issue in a "refusal to license" context at least encourages efficiency in the market of *manufacture* of the intellectual property goods and prevents the long term effects of monopolisation of secondary markets.

APPENDIX C - Table 4-4 from F J Contractor *International Technology Licensing: Compensation, Costs and Negotiation* (1981) in OECD *Comeptition Policy and Intellectual Property Rights* (OECD, 1987) 13.

Table 1[12].
Restrictions sought in agreements

Restrictions	Percentage of responding licensor firms
Territorial limitation on manufacture	82.4
Limitations on licensee's export quantity	14.7
Limitations on licencee's export price	5.9
Export only through designated agent	23.5
Prohibition handling competitor's products	23.5
Materials to be purchased from licencors or designated agents	11.8
Grantbacks from licensees	70.6
Quality controls on materials	29.4
Quality controls on finished product	55.9

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