New Zealand Law Society
Te Kāhui Ture o Aotearoa

Commerce Amendment Bill 2021

30/04/2021

Submission on the Commerce Amendment Bill 2021

1 Introduction

1.1 The New Zealand Law Society | Te Kāhui Ture o Aotearoa (**Law Society**) welcomes the opportunity to comment on the Commerce Amendment Bill 2021 (**Bill**).

1.2 This submission has been prepared with input from the Law Society's Intellectual Property Law Committee and focuses on the proposed repeal of exceptions in the Commerce Act 1986 (**Act**) relating to the enforcement of intellectual property rights or agreements relating to intellectual property rights. These exceptions are currently set out in sections 7(2), 36(3) and 45 of the Act.

1.3 This proposed repeal is problematic because the Bill will make unlawful, and potentially criminal, routine behaviour relating to the licensing of intellectual property. This appears to be an unintended consequence of the Bill. The Law Society recommends several key changes to address this unintended consequence.

1.4 The Law Society wishes to be heard.

2 Executive summary

2.1 The Law Society considers that the removal of the intellectual property exceptions in the Commerce Act could have significant negative effects when the impact of such removal is combined with the impact of:

(a) recent changes to the Commerce Act (namely the increased scope of the prohibition on cartel conduct under section 30 in force since 2017, and the criminalisation of cartel conduct in force from April 2021); and

(b) the proposed changes in the Bill to the test for the misuse of market power in section 36.

2.2 As a consequence of the Bill, conduct that will have a high risk of breaching competition law (and amounting to a criminal offence) is the granting an intellectual property licence for patented technology where the licence is limited to just one geographic area, or to just one particular field of use.

2.3 This is the result of expanding the test for what amounts to cartel conduct under section 30 (and the new criminal offence provision in section 82B) to include arrangements that allocate markets or restrict supply, *combined with* the proposed removal of the current intellectual property exception in section 45.

2.4 Further, in some cases (where a patent holder has significant market power) even the very refusal to license patents will now have a high risk of breaching competition law.

2.5 This is the result of changing the test for misuse of market power in section 36 to an effects test, *combined with* the proposed removal of the current intellectual property exception in section 36(3).

2.6 We have set out below the implications of:

(a) first, the removal of section 45 against the background of the recent amendment to section 30, and we suggest an amendment to the wording of section 45 to address issues arising from the settlement of intellectual property litigation since the amendment to section 30 in 2017;

(b) secondly, the removal of section 36(3) against the background of the proposed amendment to section 36 to provide for an effects test for misuse of market power; and

(c) thirdly, the removal of section 7(2) in relation to breaches of confidence.

Clause 15 – proposed repeal of section 45 (exceptions in relation to intellectual property rights)

3 <u>Background to removal of section 45 – recent reform of prohibitions on cartel conduct</u>

3.1 We provide the following commentary on the background to the proposed removal of section 45, setting out the recent reforms in relation to prohibitions on cartel conduct, to explain why section 45 should not be removed.

3.2 Up until 2017, section 30 of the Commerce Act (when read together with section 27) contained a simple prohibition on price fixing conduct. Price fixing conduct under the law applicable prior to 2017 was defined as contracts or arrangements between competitors that had the purpose, effect or likely effect of fixing, controlling or maintaining price. Price fixing conduct so defined was deemed to substantially lessen competition in breach of section 27 (which prohibited contracts or arrangements which substantially lessened competition in a market).

3.3 In 2017, section 30 was amended to become a standalone prohibition on cartel conduct (rather than operating as a deeming provision for the purpose of section 27). The 2017 amendments also substantially increased the scope of cartel conduct prohibited by section 30. Rather than just prohibiting price fixing, section 30 was extended to prohibit arrangements between competitors that allocate markets or restrict output (with a wide definition of restricting output that includes restrictions on supply).[1]

3.4 While the Commerce Commission has suggested that such prohibitions were already inherent in the prohibition on price fixing,[2] that was not the case. At least one Court of Appeal decision has made it clear that restricting output/supply does not necessarily fix or control price at all.[3] The prohibition on "*restricting output*" in section 30A(3) is very wide, and captures a number of quite common commercial arrangements that would not have been caught by the old law.

3.5 This significant expansion of the prohibition on cartel conduct was only tempered by the introduction of new exceptions in relation to collaborative activity (section 31) and vertical supply contracts (section 32).

3.6 The new definition of cartel conduct was similar but not identical to the definition contained in Australian law. However, the exceptions in the Act to what is caught by cartel conduct are quite different. In particular, the New Zealand prohibition on cartel conduct is not subject to an exception of similar scope to the Australian exclusive dealing (anti-overlap) exception.[4]

3.7 The Australian exclusive dealing exception effectively excludes from the scope of the Australian cartel prohibition arrangements which might potentially fall within the Australian prohibition on exclusive dealing and makes such arrangements subject to a test of whether

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1 Section 30: replaced, on 15 August 2017, by section 8 of the Commerce (Cartels and Other Matters) Amendment Act 2017 (2017 No 40).

2 Commerce Commission Competitor Collaboration Guidelines January 2018 at p3.

3 *Todd Pohokura Ltd v Shell Exploration NZ Ltd* [2015] NZCA 71 at [276].

4 Section 45AR Competition and Consumer Act 2010 (Cth).

they substantially lessen competition.[5] The New Zealand cartel prohibition is subject to an exception for provisions contained in supply contracts (the vertical supply contract exception in section 32) but this exception does not appear to cover the same kinds of restrictions on supply as does the Australian exclusive dealing exception.

3.8 The wide new definition of cartel conduct is now (from April 2021) also further supported by criminal offence provisions (section 82B). An offence will be committed by anyone who intentionally enters into contracts or arrangements that include a provision amounting to price fixing, market allocating or output restricting.

3.9 For an individual, the penalty for committing such an offence is up to 7 years in prison or a fine of up to $500,000 (section 82B(2)). For a company, the penalty is a fine of up to $10 million or three times the value of any commercial gain (or 10% of corporate group turnover if commercial gain is not readily ascertainable) (section 82B(3)).

3.10 Against that background, the proposed removal of the intellectual property exception in section 45 is therefore of serious concern. The consequence is to make unlawful (and potentially criminal) a number of common and reasonable arrangements for the licensing of intellectual property. This is illustrated by the four hypothetical examples that follow below.

4 <u>Section 45</u>

4.1 Section 45 contains an exception that is currently relevant to both:

(a) the prohibition in section 27 on arrangements that substantially lessen competition, and

(b) the prohibition in section 30 on cartel provisions (provisions between competitors that fix prices, allocate markets or restrict supply).

4.2 Section 45 exempts arrangements in so far as they contain a provision authorising any act that would otherwise be prohibited by reason of the existence of a statutory intellectual property right.

4.3 Section 45 has not been the subject of decided court cases. However, it is of real and important relevance in practice, particularly given the recent expansion of the prohibition on cartel conduct in section 30.

4.4 Section 45 makes it clear that granting a licence to use and exploit intellectual property will not, by itself, amount to a breach of sections 27 or 30.

4.5 So, for example, providing a competitor with a licence to use intellectual property in just one geographic section of the market would not amount to market allocation in breach of the recently expanded definition of cartel conduct in section 30. Section 45 would apply to provide an exception to the prohibition on cartel conduct.[6]

4.6 Similarly, providing a competitor with a licence to use intellectual property solely for certain applications or fields of use would not amount to restricting output in breach of the expanded definition of cartel conduct.

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5 Section 47, Competition and Consumer Act 2010 (Cth).

6 John Land, Competition law and the removal of exceptions for intellectual property rights, LawTalk 926, March 2019 at 46, 48.

4.7 Further, providing a competitor with a licence to use intellectual property only for certain limited quantities of production would not amount to restricting output in breach of the expanded definition of cartel conduct, in light of section 45.

4.8 The granting of limited intellectual property licences in this way is common. They are appropriate ways in which holders of intellectual property (and particularly patent rights) exploit their intellectual property rights.

4.9 If the removal of section 45 meant that these types of limited intellectual property licences breach section 30, this would be a significant problem. It would substantially detract from the value of intellectual property rights because it would significantly limit the options that intellectual property holders have for exploiting their rights.

4.10 Where patent holders are not able to fully exploit their invention themselves, they can gain additional revenue by licensing the patent for use in particular geographic markets, or for particular fields of use, or to certain quantitative limits. Not being able to do so will naturally devalue the patent rights.

4.11 We set out below four hypothetical examples to illustrate the point.

5 <u>Hypothetical example 1</u>

5.1 AvoPack are the largest packhouse for avocados in the Bay of Plenty. They have come up with an exciting new invention for a method of packing avocados that will enhance the life and quality of avocados. This means they are able to add real value to the avocados produced by Bay of Plenty avocado farmers who supply avocados to AvoPack.

5.2 AvoPack have not to date licensed their new technology to any other party. However, they see an opportunity to license the technology to other packhouses but are only willing to enter into a licence agreement that permits the use of the technology outside the Bay of Plenty. AvoPack wish to preserve their own exclusive right to exploit their own technology in their local (Bay of Plenty) market.

5.3 Such a limited licence agreement (under which AvoPack only license technology for use outside the Bay of Plenty) would likely amount to cartel conduct under section 30. This is because the licence agreement would constitute an agreement between competing packhouses (or at least potentially competing packhouses) that amounts to *"market allocating"* (as the licensee packhouses cannot provide a service in the Bay of Plenty to avocado farmers using the technology) (see section 30A(4)(b)).

5.4 The limited licence agreement also likely amounts to cartel conduct as "*restricting output*" as it restricts the supply by the licensee packhouses of services to some avocado farmers in competition with AvoPack (see section 30A(3)(c)).

5.5 Currently this is not a concern because section 45 would protect this type of licence arrangement. The conferral of the licence to use the technology outside the Bay of Plenty would authorise an act (the use of the patented technology) that would otherwise be prohibited by AvoPack's patent rights in relation to the technology.

5.6 Section 45 will therefore provide an exception for AvoPack and its licensees and prevent those parties from breaching section 30 and from committing an offence under section 82B. The protection of section 45 is clear in this example, and appropriate from a policy perspective.

5.7 Section 45 allows an IP owner to partially license its rights. In the absence of that, the IP owner (in this case AvoPack) might not choose to licence its rights at all.

5.8 The new vertical supply contract exception in section 32 might possibly help in this example. Section 32 can protect a cartel provision (such as market allocation) in a contract for the supply of goods or services where the provision relates to the supply and does not have the dominant purpose of lessening competition between supplier and customer. The supply of intellectual property rights can be considered to be the supply of goods under the Act (see definition of goods in section 2).

5.9 However, the section 32 exception is limited in scope, and there is a very high risk that it would not apply in this example. The main reason for the restriction in this case is the natural concern of AvoPack that it alone should be able to exploit its invention in its home market of Bay of Plenty. It is therefore difficult to argue that the dominant purpose of the restriction is not to lessen competition between AvoPack and the licensee. If so, section 32 cannot apply (see s32(1)(b)(ii)).

5.10 Accordingly, if section 45 is repealed, the lack of a relevant exception means that this quite reasonable commercial conduct in licensing IP rights for certain geographic areas (i.e. all areas outside the Bay of Plenty) would likely amount to a breach of section 30 of the Commerce Act.

5.11 More seriously, the licence arrangement would also likely amount to a criminal offence under section 82B.

5.12 The removal of the exception in section 45 therefore undesirably decreases the incentives to invent and to license technology. In does so by placing restrictions on patent holders' ability to grant licences for particular geographic areas.

6 <u>Hypothetical example 2</u>

6.1 Under our second example, we adjust slightly our first example.

6.2 AvoPack are the largest packhouse for both avocados and kiwifruit in the Bay of Plenty. They have come up with an exciting new invention for a method of packing avocados that will enhance the life and quality of avocados. However, and quite unexpectedly, they have now realised the invention is also a complete 'game changer' in relation to the packing of kiwifruit and will provide AvoPack with a huge market advantage in the kiwifruit market.

6.3 The potential market advantages from the technology in the kiwifruit market are so great that AvoPack decides it is only willing to license the technology to other packhouses for use with packing avocados, but not for use with packing kiwifruit.

6.4 AvoPack enters into licence agreements with competing packhouses to allow those packhouses (on payment of a licence fee) to use AvoPack's patented technology for the packing of avocados. The licence agreement does not, however, permit the use of the technology for the packing of kiwifruit.

6.5 This likely amounts to cartel conduct as "restricting output" as it restricts the supply by the licensee packhouses of services to kiwifruit farmers in competition with AvoPack (see section 30A(3)(c)).

6.6 It probably also amounts to "market allocating" as it limits the persons or classes of persons to whom the licensee packhouses can supply services using the technology (the licensee packhouses can only supply avocado farmers, not kiwifruit farmers) (see section 30A(4)(a)).

6.7 Again this licensing arrangement would clearly be protected by section 45 at the moment. Section 45 would provide an exception to what otherwise likely amounts to cartel conduct. However, that is of no use if section 45 is repealed.

6.8 As with the previous example, the vertical supply contract exception in section 32 will not apply.

7 <u>Hypothetical example 3</u>

7.1 The following example was prepared by Brent Fisse, a leading Australian competition law practitioner and Honorary Professor at the University of Sydney Law School.[7]

> *A devises a new resin for use in fibreglass and supplies fibreglass products using this resin in several fields, namely boats, planes, and swimming pools. It has strong distribution and marketing channels in the fields of boats and planes, but not in that of swimming pools. B is a competing supplier in all three fields but has a particularly strong position in the field of swimming pools. A decides to maximise the value of its patented formula for the new resin by licensing the patent to B in the field of swimming pools*.

7.2 Brent Fisse comments as follows:[8]

> "*An IP licensing condition of this kind is not unusual and will rarely be anti-competitive. The orthodox view is that:*
>
> *(a) patent owners may grant licences extending to all uses or limited to use in a defined field; and*
>
> *(b) the possibility of anti-competitive effects should be tested by assessing the competition effects, not by resorting blindly to per se liability.*[9]*"*

7.3 Brent Fisse's reference in this quote to "*per se liability*" is to a prohibition such as the one in section 30, which prohibits cartel conduct without investigating the actual competitive effects of the conduct in question.

7.4 The patent licence in this example contains a cartel provision that falls within the prohibition in section 30. A and B are competitors in the supply of swimming pools, and the provision falls within the definition of "*restricting output*". The provision restricts or limits the supply of goods made by B with the use of A's patent in a market.

7.5 Brent Fisse considers that the provision would constitute a cartel provision under the equivalent Australian prohibition on restricting output.[10]

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7 Brent Fisse Harper Report Implementation Breakdown: Repeal of Section 51(3) of Competition and Consumer Act (Cth) and Lack of Proposed Supply/Acquisition Agreement Cartel Exception (20190 47 ABLR 127 at 132-133 (Example 2)).

8 Ibid, at 132, para 30.

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

10 Brent Fisse Harper Report Implementation Breakdown: Repeal of Section 51(3) of Competition and Consumer Act (Cth) and Lack of Proposed Supply/ Acquisition Agreement Cartel Exception (20190 47 ABLR 127 at 133, para 31).

7.6 However in New Zealand at the moment, section 45 would protect this provision from amounting to cartel conduct in breach of section 30 (and from amounting to an offence under section 82B).

7.7 Again, we consider that is appropriate. We agree with Brent Fisse that a field of use restriction of the kind in this example is not unusual and is rarely anti-competitive.

7.8 We also agree that it is certainly not appropriate for such a restriction to be considered automatically unlawful under a prohibition like section 30 that does not even assess the competition effects of the relevant restriction.

7.9 However, if section 45 were repealed, such a restriction would seem to be prohibited by section 30.

7.10 As with the previous examples, we consider that it is unlikely the vertical supply contract exception in section 32 would protect the provision.

7.11 The clear purpose of the restriction is to remove potential competition by competitor B with the patent holder A in the fields of boats and planes. That being the case, section 32 does not apply as a result of section 32(1)(b)(ii).

8 <u>Hypothetical example 4</u>

8.1 The following example appears in the ACCC's guidelines relating to the impact of the repeal of the IP exception in section 51(3) of the Competition and Consumer Act 2010.[11]

> *Firm A is a steel manufacturing company that owns a patent over the only method of producing a particular high-strength, low-weight steel. Firm A is a small manufacturer, so it decides to license its method to Firm B as well. Firm B is a major steel manufacturer.*
>
> *Firm A wants to make it a condition of the licence that Firm B only produce a specified maximum amount of the high-strength, low-weight steel over the life of the licence. The two firms come to an agreement about that maximum amount, include the restriction in the licence, and proceed to behave in accordance with that agreement.*

8.2 The restriction in this example would appear to be a cartel provision as a provision "*restricting output*". This is because the restriction is an arrangement between two competitors (in the market for manufacturing and wholesale supply of steel) that restricts the quantity of steel manufactured by Firm B, and therefore restricts the production of goods by one competitor (see section 30A(3)(a)).

8.3 The ACCC in their guidelines did not consider that the Australian cartel prohibition would be breached. The reason given in the guidelines was that firms A and B could not have intended that the provision restricted or limited the supply of steel by firm B (given that firm B can supply more steel than it could before entering into the license). In Australia, an arrangement restricting output will only be a cartel provision if it had the purpose of restricting or limiting supply by one of the parties.

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11 Australian Competition & Consumer Commission Guidelines on the repeal of subsection 51(3) of the Competition and Consumer Act 2010 (Cth), August 2019.

8.4 However, the test in New Zealand is not whether the licence arrangement as a whole has the purpose of limiting supply. The test under section 30A is whether the particular *provision* has the purpose or effect or likely effect of preventing, restricting or limiting the production of goods, or preventing, restricting or limiting the supply of goods (see in particular sections 30A(1) and 30A(3)(a) and (c)).

8.5 Applying New Zealand law to this ACCC example, there would in our view be a cartel provision falling within section 30A. There is an arrangement between competitors that includes a provision which restricts or limits the production of steel (using the method of Firm A's patent) by Firm B. The limit imposed of the maximum quantity of this steel that Firm B can produce is a restriction on the production of goods in terms of section 30A(1).

8.6 Therefore, while the ACCC may consider that the provision would not breach the Australian prohibition on cartel conduct, in our view it likely breaches the New Zealand prohibition.

8.7 The provision would currently be saved by the intellectual property exception in section 45. If section 45 is repealed, however, then the provision will likely breach the prohibition on cartel conduct. The provision will again likely not be saved by the vertical supply contract exception in section 32.

8.8 Accordingly, again, a reasonable commercial arrangement which assists competition overall would now be prohibited due to the repeal of section 45. Further, that reasonable commercial arrangement would likely amount to a criminal offence under section 82B.

9 ***<u>Recommendation – do not proceed with proposed repeal of section 45</u>***

9.1 The repeal of section 45 will have a significant impact on the ability of holders of patent rights to sufficiently exploit their intellectual property.

9.2 Licensing patented technology only in particular geographic areas, or only for particular fields of use, or for limited quantities of production, will risk breaching section 30 and potentially also amount to an offence under section 82B.

9.3 Yet those are common ways in which patented technology is exploited.

9.4 Exclusive rights to exploit a patent for 20 years are granted as part of a social contract under which full disclosure of how to work the invention is disclosed so that other persons can utilise the invention after that 20 year period has expired.

9.5 The exclusive rights provide the incentive to innovate. Commonly, a patent application is filed before the relevant technology is fully developed (to avoid the risk of the technology becoming known in the marketplace which in turn would negate the ability to obtain patent rights due to lack of novelty). Accordingly, usually a significant part of the 20 year exclusivity period is lost before an invention can be commercialised.

9.6 In the period that remains, the patent holder should be able to fully exploit the patent in such a way as maximises its revenue as the reward for creating the invention.

9.7 It would be unfortunate if the patent holder cannot do that because the removal of section 45 means that certain forms of limited licensing of patents attract a substantial risk of breaching section 30 (and amounting to an offence under section 82B).

Suggested minor amendment to section 45

10 Suggested minor amendment to section 45 in relation to settlement of intellectual property litigation

10.1 Rather than repealing section 45, we suggest that the section is merely in need of some modest amendment.

10.2 The underlying issue is that the expansion of the prohibition on cartel conduct in 2017 has inadvertently caught certain conduct associated with the enforcement of intellectual property rights. The conduct caught concerns certain standard provisions in agreements for the settlement of claims brought to enforce intellectual property rights.

10.3 A common expected outcome of proceedings for the enforcement of intellectual property rights is to remove the defendant's product (which is said to infringe the claimant's intellectual property rights) from the marketplace.

10.4 That outcome may be the result of a court judgment upholding the claimant's intellectual property rights. However, it may also be the result of an out of court settlement.

10.5 It is well accepted that good faith out of court settlements of litigation are in the public interest. Such settlements reduce not only the parties' costs of litigation, but also the burden on the court system and taxpayers.

10.6 However, where parties to intellectual property litigation settle such litigation through out of court settlements, there is now (since 2017) a risk that such settlements breach section 30 if (as is commonly the case) the claimant and defendant are competitors.

10.7 It is very common that intellectual property litigation between competitors results in one of the competitors agreeing to no longer produce or supply products which infringe the other competitor's intellectual property.

10.8 Before the expansion of the definition of cartel conduct in 2017, there was no problem with such a provision. An agreement by the claimant and defendant that the defendant withdraw from the market as part of settlement of intellectual property litigation was unlikely to be considered to amount to price fixing under the old form of section 30.

10.9 However, after 2017 the prohibition on cartel conduct was extended to agreements between competitors that restricted or prevented the production or supply of products by one or other of such competitors. Such an agreement falls within the scope of the prohibition on "restricting output" in section 30A(3)(a) or (c).

10.10 Accordingly, the expansion of the definition of cartel conduct in section 30 has had the effect that good faith settlements of intellectual property litigation are likely in many cases to amount to a breach of section 30 (and also to a criminal offence under section 82B).

10.11 Commentators in Australia have recently noted that the same issue arises with the Australian prohibition on cartel conduct. In other words, a resolution of intellectual property litigation which involves the defendant agreeing to withdraw the infringing product from the market also breaches the cartel provisions of the Competition and Consumer Act 2010.[12]

12 Dr Dimitrios Eliades, Has the Repealed Limited Exemption for Intellectual Property Rights in sub-section 51(3) of the Competition and Consumer Act 2010 (Cth) Finally Been Put to Rest? IP Forum 33 (December 2020) at 34 and 41.

10.12 Settlements of this kind are very common. A simple example is provided below. For a further example, see the recent article by Dr Dimitrios Eliades which gives an example of a party bringing intellectual property enforcement proceedings against a competitor for copyright infringement in relation to a software program, resulting in the competitor agreeing to discontinue making or selling its infringing product.[13]

11 <u>Hypothetical Example 5</u>

11.1 Company A is the producer worldwide of a very successful innovative new coronary stent used in medical procedures to improve blood flow in patients with blocked arteries. It has patents for this stent in many countries around the world including New Zealand. Company B starts manufacturing and supplying a very similar stent utilising the same technology in various countries including New Zealand. Company A alleges that Company B is infringing its patents and brings patent infringement in multiple jurisdictions including New Zealand. Company B initially counterclaims seeking revocation of Company A's New Zealand patent. Eventually, however, a global settlement is reached. This settlement includes, in relation to New Zealand, agreement by Company B to cease manufacturing its infringing stent and to cease supplying that stent into the New Zealand market.

11.2 This settlement agreement, while a very common form of settlement of intellectual property enforcement litigation, would technically breach section 30 as a cartel provision.

11.3 The agreement is clearly an agreement between competitors, and it amounts to a provision which has the purpose and effect of "restricting output" within the definition of cartel provision.

11.4 First, company A and company B have agreed in the settlement agreement that company B will no longer manufacture the infringing stent product. That is a provision that prevents or restricts the production of a good by Company B. That is restricting output within section 30A(3)(a).

11.5 Secondly, company A and company B have agreed in the settlement agreement that company B will no longer supply the infringing product in the New Zealand market. That is a provision that prevents or restricts the supply of goods by company B. That is restricting output in terms of section 30A(3)(c).

11.6 However, such a settlement agreement is a normal and appropriate way of resolving intellectual property enforcement proceedings. If the proceedings had not been settled, then (as long as company A's patent was valid) the court would itself likely have made orders preventing company B from infringing the patent by manufacturing and supplying the infringing stent.

11.7 Parties should not be at risk of breaching section 30 just because they choose to settle intellectual property proceedings out of court by agreeing remedies that a court would be likely to impose in any event in the case of infringement of intellectual property rights.

11.8 If that were the case, then parties would be disincentivised from settling intellectual property proceedings before trial. If a court order not to produce or supply infringing products will not breach the Act, then a settlement to similar effect should not be a breach of the Commerce Act.

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13 Ibid, at 39-40.

11.9 Unlike the four hypothetical examples above, however, the current wording of section 45 would not protect against the settlement agreement amounting to a breach of section 30 (or to a criminal offence under section 82B).

11.10 If the settlement of the IP enforcement action results in the infringer agreeing to discontinue production or supply, then there is no question of the settlement agreement "authorising any act that would otherwise be prohibited by … a statutory intellectual property right" in terms of section 45(1)(a).

11.11 In the case of this example, the problem has arisen through the expansion of the definition of cartel conduct in 2017 without appreciation of the impact of this on common forms of settlement agreements in intellectual property litigation.

12 <u>Recommendation – wording of proposed minor amendment to section 45</u>

12.1 The Law Society therefore recommends a minor amendment to section 45. This is necessary so that this common form of settlement agreement does not have the perverse consequence of incentivising parties to intellectual property litigation not to settle litigation in order to avoid being held to have committed cartel conduct (and a criminal offence).

12.2 We suggest a new section 45(1)(c) as follows:

> (*1*) *Nothing in this Part, except sections 36, 36A, 37 and 38, applies –*
>
> *….*
>
> *(c) to the entry into, or giving effect to, any contract arrangement or understanding which results from the settlement of action (including court proceedings or threatened court proceedings) to enforce a statutory intellectual property right in so far as it contains a provision which prevents, limits or restricts the production or supply of goods or services prohibited by the statutory intellectual property right.*

12.3 This provision would do no more than ensure that parties who settle intellectual property litigation would not be held to have engaged in cartel conduct when they agree that an infringer of intellectual property cease manufacturing or supplying product that amounts to an infringement of intellectual property. In other words, the parties are doing no more than agreeing to relief which a court would likely impose in any event.

Clause 14 – (proposed repeal of section 36(3) and cross-heading replaced)

13 <u>Background to the proposed removal of the IP exception in section 36(3) – the reform of the test for misuse of market power</u>

13.1 The proposed reform of section 36 in the Bill would prohibit conduct by a firm with substantial market power that has the purpose, effect or likely effect of substantially lessening power in a market. This is essentially the same test as was recently adopted by Australia in section 46 of the Competition and Consumer Act 2010.

13.2 The existing New Zealand test for misuse of market power does not capture all conduct that a prohibition on misuse of market power should capture. This is largely due to the current "take advantage of" element in the current section 36 and the way that requirement has been interpreted by the courts.

13.3 The courts have interpreted the take advantage element as meaning that the firm will only breach section 36 if it engages in conduct that it would not engage in if the firm was in a competitive market.[14] This test has been described as a "counterfactual" test.

13.4 The counterfactual test has been the subject of significant criticism. It requires a firm's conduct to be assessed against a hypothetical market in which the firm's existing market power is assumed not to exist. In deciding whether a firm has "taken advantage" of market power, it is necessary to consider what the firm would have done in that hypothetical market. For example, in the *Telecom* case it was necessary to consider what Telecom would have done in a hypothetical market in which there was another provider of a PTSN competing with Telecom's own PTSN network.

13.5 Such counterfactual analysis is often seen as not particularly helpful in assessing whether there is a real harm to competition in the market as a result of the impugned conduct. The issue is that conduct that is quite benign when undertaken in a competitive market can have quite serious anti-competitive effects when engaged in by a firm with substantial market power.

13.6 Accordingly, the desire to reform the test for misuse of market power is understandable. The proposal in the Bill has two key aspects designed to address the issues with the current law.

13.7 First, the current requirement to prove that a firm has "*taken advantage*" of its market power will be removed. That in turn means the end of the counterfactual test discussed above.

13.8 Secondly, the current focus on whether a firm has a purpose of restricting, deterring or eliminating a particular competitor will be replaced with a test that considers whether there is a purpose or effect of substantially lessening competition in the market as a whole. This can be referred to as the introduction of an "*effects test*" for misuse of market power.

13.9 We agree that section 36 should be reformed and that adopting a similar effects based test to that used in Australia is appropriate.

13.10 The problem, however, is the proposal to also remove the current intellectual property exception to section 36 at the same time as introducing an effects test for breach of section 36.

13.11 The issue is that the *combination* of these two matters gives rise to a concern because it risks making the enforcement of intellectual property rights a breach of section 36.

13.12 The enforcement of such rights can in some circumstances mean that there is substantially less competition in the market than there would be if a firm with important intellectual property rights simply permitted its potential competitors to freely use that IP without sanction.

14 <u>Removal of the IP exceptions relevant to section 36</u>

14.1 Relevantly to section 36, the Bill proposes the repeal of sections 36(3) and 7(2).

14.2 Section 36(3) is an exception that is directly relevant to the current prohibition on misuse of market power. It states that a person does not take advantage of a substantial degree of

14 *Commerce Commission v Telecom* (2008) 12 TCLR 168 at [55].

power in a market (within the prohibition in section 36) by reason only that the person seeks to enforce a statutory intellectual property right.

14.3 Section 7(2) provides that the Commerce Act does not limit or affect any rule of law relating to breaches of confidence.

14.4 The question is whether removal of the exception in section 36(3) undesirably decreases the incentive to invent, by placing restrictions on intellectual property holders' ability to enforce their IP rights or to refuse to license their IP?

14.5 Further, does removal of the savings provision in section 7(2), combined with the proposed changes to section 36, unfairly restrict firms from being able to protect confidential information?

14.6 There is very little case law interpreting the provisions and their scope is not entirely clear. That does not mean, however, that they are not serving a purpose and that the repeal of the provisions would not be important.

15 Enforcing patent rights as a misuse of market power

15.1 One important example of a situation affected by the removal of the IP exceptions concerns the enforcement of intellectual property rights currently protected by section 36(3). This example takes on more importance, given the proposed reform of section 36 to include an effects test and to remove the current counterfactual test.

15.2 By way of example, a firm with market power may seek to enforce its patent rights by bringing patent infringement proceedings against its only competitor. Under the current law, there would be no breach of section 36 due to a combination of the application of the counterfactual test and the exception in section 36(3).

15.3 For a firm to be taking advantage of market power it must (under the counterfactual test) be engaging in conduct that it would not engage in if it were in a competitive market.

15.4 That then means that an enforcement of IP rights is unlikely to be considered a taking advantage of market power under the current law, because a firm with IP rights will normally want to enforce those rights regardless of whether it has market power.

15.5 The exception in section 36(3) then puts the point beyond all doubt. However, at the moment that exception adds little, given that an enforcement of IP rights is unlikely to be considered a taking advantage of market power in any event.

15.6 In the context of the proposed new effects test for section 36, however, the absence of an exception that protects the enforcement of IP rights is much more important.

15.7 Rather than looking at whether a firm without market power would have enforced its IP rights anyway (and so was not "taking advantage" of market power), the question is instead whether as a matter of fact the enforcement of IP rights had a meaningful[15] impact on the level of competition in the market.

15.8 The action of enforcing the patent might be argued to have the likely effect of substantially lessening competition in the market under the new effects test proposed for section 36.

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15 We use the word "meaningful" given the acceptance in a number of cases that a lessening of competition can be said to be substantial when it is meaningful to the competitive process- *ANZCO Foods Waitara Ltd v AFFCO New Zealand Ltd* [2006] 3 NZLR 351 at [246] (CA).

That might be so for example where enforcing IP rights prevents the entry into the market of a significant competitor who might have been able to use the IP to quickly and effectively enter the market in competition with an existing dominant player whose dominance largely depends on the market advantage that its IP rights confer. An obvious example is a pharmaceutical company that is the first to develop a new class of drugs to treat a particular condition.

15.9 Enforcing common law rights in relation to breaches of confidence might potentially give rise to similar concerns in the absence of the savings provision in section 7(2).

16 Refusal to license intellectual property

16.1 The position is similar in relation to a refusal by a firm with market power to license intellectual property. Such conduct is unlikely to be a breach of the current form of section 36.[16]

16.2 A firm with important IP that gives it a key market advantage is just as likely to refuse to license its IP if it does not have market power than if it does have market power. Accordingly, a refusal to license IP is unlikely under the current counterfactual test to be considered a taking advantage of market power.

16.3 However, the refusal to license IP could be a potential breach of the proposed new form of section 36. The new form of section 36 does not include a counterfactual test and can be contravened by a simple adverse *effect* on competition.

16.4 A firm with market power that refuses to licence its patents could potentially achieve an outcome that has the effect of substantially lessening competition in the market. In doing so it would breach the new form of section 36.[17]

16.5 If the current IP exception in section 36(3) was retained (and appropriately amended to reflect the new wording of the substantive prohibition on misuse of market power in section 36), then it would protect a firm who seeks to enforce its intellectual property rights from breaching section 36. Arguably refusing to license intellectual property is simply one way in which intellectual property rights are enforced.

16.6 It is important to note that there are conflicting views as to whether refusing to license a patent does in fact amount to enforcement of intellectual property rights within the current section 36(3) exception.

16.7 We agree with the view of Douglas Calhoun and Brendan Brown (now Brown J) that the exception currently does apply to a refusal to license patents.[18] Accordingly, if the exception is removed the risk that a refusal to license patents could breach section 36 increases significantly.

16.8 In our view, the section 36(3) exception should be retained with appropriate changes in wording (as discussed further below). Further, given the debate as to whether the current wording of the exception does in fact protect refusals to licence intellectual property, we suggest that this point be made absolutely clear in the new wording of the exception.

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16 See for example *APRA v Ceridale* (1990) 97 ALR 497 in relation to then equivalent Australian prohibition.

17 Lai "*Competition Law and/ versus Patent Law in New Zealand*" (2017) 23 NZBLQ 112 at 124.

18 Calhoun and Brown "*New Zealand: Interface between Misuse of Dominant Position and the Exercise of IP Rights*" (1990) 12(2) EIPR 437 at 442)

16.9 It should be acknowledged that in Europe the refusal to license intellectual property has been held to be an abuse of dominance in exceptional circumstances.[19]

16.10 However, the combination of the proposed repeal of section 36(3) and the introduction of an effects test for section 36 runs the risk that a refusal to licence IP can amount to a breach of section 36 in more than just exceptional circumstances.

17 <u>Recommendation – do not repeal section 36(3)</u>

17.1 In the Law Society's view, section 36 should continue to provide for an exception for the enforcement of intellectual property rights (including the refusal to license such rights).

17.2 The current wording of section 36(3) would no longer be appropriate, given the changed substantive test for misuse of market power. However, rather than section 36(3) being simply repealed, it should be replaced with a similar provision that continues to provide an exception for enforcement of intellectual property rights.

17.3 The following replacement wording would be appropriate:

> *(a) A person does not contravene s36(1) by reason only that the person seeks to enforce a statutory intellectual property right, within the meaning of s45(2), in New Zealand.*
>
> *(b) Without limiting s36(3), a refusal by a person to license the use of a statutory intellectual property right shall be considered enforcement of that right*.

17.4 Obviously, for the purpose of this drafting we assume that the intellectual property exception in section 45 is also retained as submitted above.

17.5 In the event, however, that section 45 was not retained, the definition of statutory intellectual property right currently contained in section 45(2) could instead be added to section 2 of the Act (or even to section 36 itself).

Clause 6 – proposed repeal of section 7(2)

18 <u>Section 7(2)</u>

18.1 Given the concern that enforcement of breaches of confidence may also be argued to breach section 36, the Law Society also considers that section 7(2) should not be repealed.

18.2 In the context of the proposed new effects test for section 36, any action to prevent or stop the misuse of confidential information (for example by a former employee) might be argued to have the likely effect of substantially lessening competition in the market.

18.3 The savings provision in section 7(2) is useful therefore in stating that nothing in the Act limits or affects any rule of law relating to breaches of confidence.

Herman Visagie
NZLS Vice-President
30 April 2021

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19 See O'Donoghue and Padilla *The Law and Economics of Article 102 TFEU*, 2nd ed, 2013 at pp 530-537 and particularly the *Magill* and *IMS Health* cases referred to there.