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Submission to the Commerce Commission

Guidelines on Application of Competition Law to Intellectual Property

14 February 2023

INTRODUCTION

1. Russell McVeagh is grateful for the opportunity to submit to the Commerce Commission ("**Commission**") on its Draft Guidelines on the Application of Competition Law to Intellectual Property Rights ("**Draft IP Guidelines**").

2. As outlined in our recent submission on the Commission's draft guidelines on the new market power prohibition, we consider that the recent amendments to the Commerce Act 1986 ("**the Act**"), both the change to the market power prohibition and the repeal of the intellectual property ("**IP**") exceptions, represent some of the most significant changes to New Zealand's competition law framework in recent years. We commend the resource that the Commission has committed to drafting guidelines on both law changes to assist businesses in their decision-making. This submission sets out our views on how the Commission could further enhance its Draft IP Guidelines to best provide businesses with certainty on the Commission's approach, and therefore the ability to self-assess their conduct efficiently and accurately.

EXPANSION OF EXAMPLES

3. As expressed in our previous submissions to the Ministry of Business, Innovation and Employment ("**MBIE**") and the Select Committee during the legislative process, much of our concern regarding the repeal of the IP exceptions is the potential for legal uncertainty and, resultingly, the potential chilling of pro-competitive investment in IP and licensing of IP to third parties. Given the need for clarity for the business community, we would encourage the Commission to:

   (a) Not only provide examples of the factors it would consider, but also step through hypothetical examples of its approach to assessing those factors and its likely conclusions (on the hypothetical examples) applying that approach.

   (b) Include examples both of conduct that the Commission considers unlikely to be problematic, as well as examples of conduct in relation to IP that it considers is likely to be problematic.

   (c) Include its views on further factual scenarios raised by submitters during the consultation process (including those we set out below).

Restrictive licences and their application to section 30

4. Exclusive licences limited to certain geographic territories, identified fields-of-use or customer groups "may be pro-competitive to the extent that they encourage the licensor to licence its IP where it otherwise would not do so, or to charge lower prices for licences..."[1] However, where the licensee and licensor are actual or potential competitors, clauses that have the purpose or effect of restricting the licensee "will be cartel provisions unless an exception under the

[1] At [66].

Commerce Act applies".[2] We propose the following amendments or additions based on this inherent tension:

(a) Provide several factual examples that deal with licencing to actual or potential competitors in the context of section 30.[3]

(b) Explain how pro-competitive conduct would become cartel conduct, and how the Commission proposes to factor in pro-competitive considerations, including through its assessment of the relevant counterfactual and / or consideration of efficiencies in its assessment.

(c) Articulate which cartel exceptions are most likely to be available for cartel conduct related to IP rights.

(d) Provide specific further information on the Commission's approach the vertical supply contract exception in the context of IP rights (given that exception hinges on the purpose of the otherwise offending provision, which raises questions for businesses given the provision in question is often "restrictive" in nature and, therefore, creates uncertainties in seeking to rely on that exception).

5. Further, we note that the example of exclusive licensing on page 13 concerning a hypothetical arrangement whereby Firm A licences its smart ear sensors to Firm B for the manufacturer of non-smart ear tags appears to consider section 27 without contemplating that this arrangement could also potentially be caught by section 30.[4] The scope of this example, including the potential application of section 30, should therefore be clarified.

Nascent and developing markets and their application to section 36

6. A common concern raised by submitters and not contemplated in the Draft IP Guidelines, is the application of section 36 to a scenario where an innovation or new technology creates a novel market. In such a scenario, it is likely that the IP rights holder will gain a natural monopoly or substantial market power. The removal of section 36(3) creates uncertainty as to whether the rights holder is obliged to offer a licence before having an opportunity to realise a return on its R&D, particularly when the market power exists only for a short period. The two refusal to licence hypotheticals on pages 9 and 10 are in the context of already-established markets. The Commission should consider supplementing these with a novel market refusal to licence example.

POTENTIAL INCONSISTENCIES IN THE TREATMENT OF THE CARTEL PROHIBITION

Potential inconsistencies in relation to the approach to vertical arrangements that lead to downstream sales

7. From our read, the Draft IP Guidelines appear to define "competitors" inconsistently compared to paragraph 42 / figure 4 of the Competitor Collaboration Guidelines,[5] and previous cases

[2] At [67].

[3] Particularly given the serious implications if section 30 is breached.

[4] For example, if the restriction on Firm B was not just on sub-licensing to a competitor of Firm A, but also prevented Firm B from manufacturing or distributing smart ear tags in competition with Firm A, this could be viewed as a non-compete clause and cartel conduct.

[5] https://comcom.govt.nz/__data/assets/pdf_file/0036/89856/Competitor-Collaboration-guidelines.pdf.

taken by the Commission.[6] Namely, the Draft IP Guidelines state at paragraph 48.1 that "where a firm is not currently supplying a substitutable good or service, and is unlikely to do so without the agreement, the parties are unlikely to be in competition", suggesting that if, in the absence of the licence in question, the licensee could not supply the particular goods and services then the licensee and licensor would not be considered actual or potential competitors. However, from our perspective, the approach indicated by this statement appears inconsistent with the Commission's treatment of situations where a retailer is considered to be a competitor of a wholesaler despite the retailer relying on supply from the wholesaler relationship in order to compete in the downstream market (for example, as indicated by paragraph 42 / figure 4 of the Competitor Collaboration Guidelines and the *Milfos* proceedings).[7] It would be helpful for the Commission to resolve or clarify this apparent discrepancy.

Potential inconsistencies in relation to the different types of cartel conduct

8. From our read, the Draft IP Guidelines appear to apply an inconsistent approach to the market allocation prohibition on one hand, and the price fixing / output restriction prohibitions on the other. Namely:

   (a) In relation to licences that allocate markets, footnote 29 of the Draft IP Guidelines, suggests that where a restrictive provision restricts sales to certain geographic territories, fields-of-use or customer groups, but relates to a licensed product only and parties continue to compete in other substitutable products, then it may be that a provision does not have the purpose / effect of market allocation because the parties will still be able to supply other competing products;

   (b) However, paragraph 70 of the Draft IP Guidelines does not provide the same approach in relation to the price fixing or output restriction prohibitions. For example, where a restrictive provision restricts a downstream customer from selling a licensed product only, but the parties continue to compete in other substitutable products, then applying the approach suggested at footnote 29, then equally it may be that a provision does not have the purpose / effect of market allocation because the parties will still be able to supply other competing products.

9. It would be helpful for the Commission to resolve or clarify this apparent discrepancy so that businesses are clear on its approach.

OTHER SUBMISSIONS

10. **Definition of "FRAND"**: Paragraph 55 of the Draft IP Guidelines refers to "Fair Reasonable and Non-Discriminatory" ("**FRAND**") being a factor suggesting conduct is less likely to harm competition. While "FRAND" is a known theoretical concept, how it applies in practice could differ. It would be helpful for the Commission to provide examples of how it would step through an assessment of whether terms meet its expectation of "FRAND" in practice.

11. **Definition of margin squeeze**: The refusal to license example of page 10 of the Draft IP Guidelines refers to "margin squeezing" as a consideration when the Commission assesses potential harm to competition, without defining the term. The concept of margin squeezing

[6] *Commerce Commission v Gea Milfos International Limited* [2019] NZHC 1426.

[7] *Commerce Commission v Gea Milfos International Limited* [2019] NZHC 1426.

may not be commonly understood by businesses. We suggest the Commission provides a definition of margin squeeze or a hyperlink to other Commission guidelines on the topic.

12. The Commission should also consider providing guidance on the Commission's approach to assessing a "margin squeeze" where the licensor of the IP charges the licensee an annual fixed-fee for the licence as opposed to a licence fee calculated by reference to how much the licensee produces using the licence.

13. **Definition of 'business justifications'**: The Draft IP Guidelines mention "business justifications" in the examples on pages 12 and 18, however with no example criteria provided there is limited colour to this reference. Explaining that the business justification must not be to, for example, prevent or restrict a competitor in this context, and providing examples of conduct that is justifiable and "legitimate" will be important for businesses' ability to self-assess.

14. **The market definition process**: It is helpful that the Draft IP Guidelines set out a separate section on "In Competition". However, we consider that the Draft IP Guidelines also need a separate section outlining how the Commission defines a "market". That is because, while IP rights may often provide owners with a "monopoly" over a particular technology or process, that does not necessarily provide the owner with a monopoly over a particular market or an essential input if there are other technologies or processes that are substitutable (as a matter of commercial common sense) with that owner's IP right. Providing a clear articulation of the Commission's approach to market definition will assist businesses to self-assess their position and will also assist businesses to understand the various references to the concept of substitutability throughout the Draft IP Guidelines.

CONCLUDING COMMENTS

15. As outlined above, Russell McVeagh is grateful for the opportunity to submit on the Draft IP Guidelines. We consider that the Draft IP Guidelines serve as a useful initial tool for businesses seeking to understand how IP rights will be treated by the Commission under the new regime. However, we would urge the Commission to consider the submissions we have outlined above.

16. All enquiries on this submission may be directed to: