Refusals to Licence Intellectual Property

Navigating the Interface between Competition Law and Intellectual Property

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To my supervisor, Barry Allan, for his advice and guidance,

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Contents

I. Introduction

For all the claims by academics that intellectual property (IP) and competition law harmoniously "share the larger policy objective of maximising wealth and minimising costs",[1] inescapable tensions between the two regimes lie roiling beneath the surface. The almost unprecedented deference that competition courts and legislators have seen fit to afford intellectual property at various points throughout its history has foreclosed meaningful economic deliberation as to its benefits and disbenefits. That this should occur at the intersection between doctrines for which economic theory is so central to their existence is unfortunate. In this dissertation I investigate a specific, potentially anticompetitive practice involving IP, namely, the refusal to licence IP, in order to illuminate and highlight the broader tensions that exist between intellectual property and competition law. At various points throughout this dissertation, it will therefore be prudent to step back from the specific (refusals to licence), to the general (the IP and competition regimes), to note those areas of IP and competition law that are not simply obstructive to meaningful resolution of the 'refusals to licence' question, but to reconciliation between the broader regimes themselves. With such a spirit in mind, this dissertation argues that the current test for monopolistic conduct fails entirely to navigate the interface between IP and competition law, because its focus on commercial common sense and purpose run completely counter to the economic investigation into the effect of firm conduct that IP demands. It further argues that the exceptions to liability under the Commerce Act 1986 created by ss 36(3) and 45 are similarly misguided insofar as they prioritise the form of the defendant's conduct over its function, and preclude any investigation into the effect of the conduct itself.

[1] Ian Eagles "Talking Past Each Other: Intellectual Property and Competition Policy" (2001) 6 Int'l Intell Prop L & Pol'y 100-1 at 100-1.

II. *Bridging the Gap between Competition and Intellectual Property*

A. IP rights

'Intellectual property' refers to those intangible products of creativity or invention that have been deemed by statute to be deserving of legal protection. Examples include: patents, copyright, designs, and trademarks. Each example of IP is controlled by a corresponding statute: the Patents Act 2013, the Copyright Act 1994, the Designs Act 1953, and the Trade Marks Act 2002. Each Act contains an internal set of requirements that an applicant must satisfy if he or she wishes to obtain legal protection for his or her inventive work.

Once an invention, a design, or a work of creativity has been deemed to fall under the ambit of one of the 'IP statutes', it is protected by certain proprietary and non-proprietary rights. Most significantly, IP rights "confer on their owner the exclusive right to exploit the intellectual property in issue."[2] The philosophical and economic justifications for conferring such rights will be discussed in more depth in subsequent sections.

B. Refusals to deal in tangibles, and corresponding static concerns

'Refusal to deal' describes a situation in which a firm refuses to allow competitors access to an input that it owns or controls. The firm therefore generally asserts its right as owner of property to exclude others from its use.

Although the general position of virtually all OECD jurisdictions is that firms are free to choose who they contract with,[3] refusals to deal may, when made by monopolists, raise competition concerns for the following reasons:

- Strategic refusals to allow access to property (such as a telecommunications grid) may foreclose potential competitors from entering the market.
- Refusals to deal may also leverage power from the market in which market power exists (such as the computer market), to a second dependent market (such as the market for computer peripherals), again to the exclusion of potential competitors. [4]
- Economically, refusals to deal may lead to higher prices and lower output than would be found in competitive markets.[5] Because there are fewer competitors in the market,

[2] Matt Sumpter *New Zealand Competition Law and Policy* (CCH, Auckland, 2010) at 319.
[3] At 305.
[4] See *Community v International Business Machines* (1984) 3 CMLR 147.

there is less competition driving prices down. Firms are free to produce fewer products and charge artificially high prices. This leads to a situation of allocative inefficiency, in which not everybody who wishes to purchase the product at the cost of its production is able to do so, either because prices are higher than they are willing to pay, or there are too few units to meet demand.[6]

- Even if competitors are not foreclosed outright from access to the market in question, the denial of a necessary input could deprive consumers of comparative efficiencies the denied firm may have gained from access to the input. Shelanski notes as an example that "foreclosure of access to distribution channels owned by the upstream firm could prevent the downstream firm from achieving viable economies of scale",[7] and therefore passing those savings on to consumers.

These concerns are predicated upon a 'static' view of a market, which is concerned with the most efficient allocation of resources at any one fixed (static) point in time, hence the focus upon allocative and productive efficiencies.

C. Refusals to licence IP, and the dynamic element

A refusal to deal in intellectual property (also called a refusal to license) occurs when a firm with a statutorily-granted intellectual property right refuses another firm access to that intellectual property right, or imposes such unsatisfactory conditions on an IP licence as to make the other firm's rejection of the licence an inevitability (known as a 'constructive refusal to license).[8] An active enforcement of IP rights with a view to preventing a firm from utilising them may also be conceptualised as a refusal to deal.[9]

The static concerns described above apply equally to IP refusals to license. In 1942 however, Joseph A. Schumpeter attacked the traditional static analysis of markets, arguing that the

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[5] Howard A Shelanski "Unilateral Refusals to Deal in Intellectual and Other Property" (2009) 76(2) ALJ 369 at 371.
[6] Sumpter, above n 2 at 304.
[7] Shelanski, above n 5, at 371.
[8] Sumpter, above n 2, at 305.
[9] *Broderbund Software Inc v Computermate Products (Aust) Pty Ltd* [1992] ATPR 41-155. Broderbund brought proceedings to prevent importation of copyrighted goods without a licence. It was alleged in a cross-claim that Broderbund had thereby infringed the abuse of market power section. The judge held that Broderbund had simply enforced its rights given in the Copyright Act 1968 (Cth), and had therefore acted reasonably in pursuing its claim.

long-run (dynamic) view of markets was far more accurate a measure of overall efficiency.[10] Under this dynamic analysis:[11]

> A system – any system, economic or other – that at *every* given point of time fully utilises its possibilities to the best advantage may yet in the long run be inferior to a system that does so at *no* given point in time, because the latter's failure to do so may be a condition for the level or speed of long-run performance.

Greater appreciation of long-run efficiencies may lead one to the conclusion that IP rights should be able to offend against static efficiencies at will, because the dynamic efficiencies implicit in their grants outweigh static concerns. This dissertation argues that this conclusion is flawed, and that IP rights do not always drive markets dynamically to such an extent as to consistently deserve the deference of competition law.

There has not been a case directly dealing with refusals to licence IP in either New Zealand or Australia.[12] The section that follows suggests an ideal approach to the issue in New Zealand, stressing that IP should be treated just like any other property right, and that distracting analogies and presumptions should be rejected. It suggests that the sections of the Commerce Act 1986 that carve out exceptions from liability under Part 2 of the Commerce Act for certain conduct involving IP, are unduly concerned with the form of that conduct rather than effect. Similarly, it proposes that the counterfactual test in NZ should be amended so as to focus more on the effect of firm conduct, rather than the purpose.

D. The theory of IP law

W Fisher identifies four main schools of theoretical justification for IP law: utilitarianism, Lockeanism, the theory of personality, and the social planning theory.[13] This dissertation focuses on the first two justifications, as they attract by far the most discussion. Utilitarianism argues that when shaping property rights, lawmakers should prioritise the maximisation of net welfare. This requires a balance to be struck between the power of exclusive rights to stimulate the creation of inventions on the one hand, and the partially offsetting tendency of such rights to curtail widespread public enjoyment of those creations. Lockeanism argues that

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[10] FM Scherer "Antitrust, Efficiency, and Progress" (1987) 62 N Y U L Rev 998 at 1000.

[11] J Schumpeter *Capitalism, Socialism and Democracy* (5th ed, George Allen & Unwin (Publishers) Ltd, UK, 1976) at 83.

[12] Ian Eagles and Louise Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics* (Hart Publishing, Oxford and Portland, Oregon, 2011) at 182.

[13] William Fisher "Theories of Intellectual Property" in *New Essays in the Legal and Political Theory of Property* (Cambridge University Press, 2001) at 1.

a person who labours upon resources that are either unowned or "held in common" has a natural property right to the fruits of his or her efforts – and the state has a duty to respect and enforce that natural right.

For reasons that will be expanded upon later, it is suggested that none of these theories accurately describes the situation in New Zealand. Overwhelmingly, the statute books themselves seem to eschew Lockean and personality theories in favour of the motive of incentivising innovation by awarding exclusive property rights. This motive, it will be recalled, comprises half of the balance inherent in utilitarian theory, the other half being the public interest in free enjoyment of inventions and works. This latter half however, is insufficiently addressed in New Zealand, as in most IP regimes, in order to give effect to the goal of net welfare that utilitarianism seeks. Patent and copyright terms are fixed and unrelated to the effort and expenditure involved in the invention. It cannot therefore be claimed that utilitarianism has prevailed, but rather that one half of its balancing act – the incentivising of innovation – has emerged triumphant. The first Copyright statute, the Statute of Anne 1710, bore the full title, "An Act for the Encouragement of Learning by Vesting the Copies of Printed Books in the Authors or Purchasers of Such Copies."[14] In the long title, one can clearly see the aim of promoting the dissemination of knowledge and encouraging further creativity. Bestowing the protections inherent within the statute was considered the best way to incentivise such creativity. In the US context, the US Constitution similarly bears such justifications, stating: [15]

> 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.

Intellectual property law in New Zealand is the result of a "virtually wholesale" importation of the IP laws of the United Kingdom.[16] Our IP law therefore reflects the same underlying policy justifications as do the UK statutes. In the copyright context, the incentivising of new works and the dissemination of knowledge, originally expressed in the Statute of Anne, continues in our Copyright Act 1994.[17] In the patent context, the link between property,

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[14] Statute of Anne 1710 (GB) 8 Anne, c 18.
[15] United States Constitution, Art 1, s 8, cl 8.
[16] Susy Frankel "Towards a Sound New Zealand Intellectual Property Law" (2001) 32 VUWLR 47 at 48.
[17] At 63.

reward, and incentive was identified by Blackstone as early as 1765.[18] Since the reign of Elizabeth I, letters patent had been granted giving monopolies for new inventions "to encourage the establishment of new industries within the realm."[19] The Patents Act 1953 (NZ) "is a substantial re-enactment of the Patents Act 1949 (UK)."[20] One can strongly infer therefore that the same spirit has translated into the NZ context.

Two further indications may be noted of the primacy of the motive of incentivising innovation in the IP law of New Zealand. First, a new Patents Act 2013 received royal assent on 13 September 2013. That Act amends the Patents Act 1953, and inserts a new Purpose section 3, which prioritises, inter alia:[21]

> an efficient and effective patent system that – promotes innovation and growth while providing an appropriate balance between the interests of inventors and patent owners and the interests of society as a whole…

Second, it must be noted that NZ is a signatory to the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS Agreement). The TRIPS Agreement is Annex 1C of the Agreement Establishing the World Trade Organisation 1994, and is administered by the WTO.

The TRIPS Agreement prioritises the:[22]

> Promotion of technological innovation and… the transfer and dissemination of technology, to the mutual advantage of producers and users of technical knowledge and in a manner conducive to social and economic welfare.

The statute books are therefore unequivocal in their support for intellectual property as a means of encouraging creativity or innovation. The potential disbenefits to static efficiency that arise from IP protection, such as the creation of legal monopolies, are seen as sacrifices that are worth making to achieve greater innovation and dynamic efficiency. It follows therefore that the scope of IP protection should be limited to that which is necessary to advance those goals. To go further would be to damage the competitiveness of the market

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[18] W Blackstone *Commentaries on the Laws of England* (15th ed, Professional Books, London, 1809) vol 2 at 4, 7.
[19] *Laws of New Zealand* Patents and Inventions Vol I: Introduction (online ed) at [3].
[20] At [3].
[21] Patents Act 2013, s 3(aa)(i).
[22] Trade Related Aspects of Intellectual Property Rights Agreement (Annex 1C, World Trade Organisation, Marrakesh Agreement) (opened for signature 15 April 1994, entered into force 1 January 1995), art 7.

with no identifiable benefit to dynamic efficiency. As David Vaver writes: "IP abridges freedoms and so needs to be constantly justified."[23] This theory is also supported by NZ case law. In *Re Union Foundries Ltd's Application* it was held that "patent law is intended to foster, not harass, industry…".[24] In *Pharmac* it was observed that the patent system "rests on the policy that a limited term monopoly will be granted as an incentive to innovation".[25]

It should be stressed that as much as the statute books and the common law point overwhelmingly to a desire to incentivise innovation, this is not necessarily equivalent with, or motivated by, an understanding of economic theory. The evolution of IP rights has been as much about social policy and partisan politics as economics.[26] Indeed, its inception arguably predates the development of any coherent economic theory.[27] The result is a theory that desperately needs economic justification if it is to make any logical sense whatsoever, and yet which lacked any such economic empiricism in its inception. This strengthens, rather than undermines, the substance of this dissertation. If the *a priori* assigning of rights in the IP context is hampered by a legislative regime that makes only mere attempts at economic coherence thanks to its historical pedigree, surely competition provides a valuable means of redressing such issues *ex post*.[28]

It has also been suggested that at the penumbra of IP law it is possible to discern other theories of property at work. This is perhaps most commonly seen in the copyright sphere. Speaking of copyright law, Craig observes that "the interpretation and application of copyright law in the courts is frequently incongruous with its purported nature as a utilitarian construct."[29] Craig notes that property rights are often seen as bestowed by the copyright statute as a reward for innovation. That reward is seen as deserved, and once deserved, it is

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[23] David Vaver *Intellectual Property Law: Copyright, Patents, Trade-Marks* (2nd ed, Irwin Law Inc, Toronto, 2011) at 22.
[24] *Re Union Foundries Ltd's Application* (18 August 1927, Commissioner Atkinson).
[25] *Pharmaceutical Management Agency Ltd v Commissioner of Patents* [2000] 2 NZLR 529, [2000] RPC 857; (1999) 9 TCLR 429 at [8].
[26] E. Richard Gold "Commentary: Mending the Gap – Intellectual Property, Competition Law, and Compulsory Licensing" in Marcel Boyer, Michael Trebilcock and David Vaver (eds) *Competition Policy and Intellectual Property* (Irwin Law Inc, Toronto, 2009) 396 at 398.
[27] Letters Patent existed in England as early as 1331, see J R Jones (ed) *Terrell on Patents* (8th ed, Sweet & Maxwell, London, 1934). The "effective birth of economics as a separate discipline" has been argued to have been the publication of Adam Smith's *The Wealth of Nations* in 1776, see Mark Blaug "The Social Sciences: Economics" in *The New Encyclopaedia Britannica* (Encyclopaedia Britannica Inc, United Kingdom, 2010) vol 27 at 343.
[28] Gold, above n 26, at 398.
[29] Carys J. Craig "Locke, Labour and Limiting the Author's Right: A Warning Against a Lockean Approach to Copyright Law" (2002) 28 Queen's L.J. 1 at 12.

seen as an entitlement.[30] These "presumptions of moral entitlement" as described by Craig, "inevitably distort rather than facilitate a nuanced understanding of the copyright system."[31] Indeed, this criticism of presumptive treatment of IP will be levelled in more detail in the broader context of the competition law regime shortly. As an example Craig cites the English case of *Walter v Lane,*[32] in which it was held that the law must protect the fruits of one's efforts from appropriation by another, by finding "that the *labour* of reproducing the spoken works… makes the person who has so acted… an *author*."[33] Jeremy Waldron argues that "although the official line about copyright is that it is a matter of social policy, judicial and scholarly rhetoric on the subject retains many of the characteristics of natural rights talk."[34] This may be the case because the works protected by copyright are less often seen as welfare-enhancing in the commercial sense. Whereas patent law protects methods of new manufacture,[35] which contribute to the dynamic fluctuation of markets, copyright protects for example literary, musical, and dramatic works. Given that the public and economic interests in lifting the monopolies bestowed by copyright can be comparatively less important, it may seem more reasonable to consider copyrighted works to be protected for their own sakes, and give effect to a Lockean conception of inherent and intrinsic ownership. That the legislatively mandated monopoly period for copyright is far longer than that granted by patent law also potentially speaks to the fact that Parliament considers a monopoly over a copyrighted work to be less injurious to the public interest and the dynamism of the economy than a patent monopoly.

While in the case of novels, music and artistic works this may be true, it should also be remembered that copyright is frequently used in commercial settings as a way of protecting intellectual property and potentially wielding market power. Indeed, this commercial aspect has arguably risen to the fore.[36] Further, the fact that copyright protection vests automatically in creative works makes it an easier property right to acquire than a patent, and means that the issue of whether copyright has vested at all is one often decided by courts *after* a refusal to licence has occurred and litigation has commenced, rather than by a government body like

[30] Craig, above n 29, at 15.
[31] Craig, above n 29, at 3.
[32] *Walter v Lane* [1900] AC 539 (HL).
[33] At 546.
[34] Jeremy Waldron "From Authors to Copiers: Individual Rights and Social Values in Intellectual Property" (1993) 68 Chicago-Kent L Rev 841.
[35] Statute of Monopolies 1624 (Eng) 21 Jac 1 c3, s 6.
[36] David Vaver *Intellectual Property Law: Copyright, Patents, Trade-Marks* (2nd ed, Irwin Law Inc., Toronto, 2011) at 58.

the patent office. The philosophical justifications for copyright's existence underpinning these courts' decisions are therefore of utmost importance. The distinction between Lockean and (quasi) utilitarian justification is thus not merely nitpicking between arcane conceptualisations. As Waldron notes, if an author is seen as having a natural right to profit from the fruits of his efforts, then we will view copiers as thieves, whereas if the author is seen as the beneficiary of a statutory monopoly, it may be easier to see the copier as simply embodying free enterprise.[37]

It would therefore be a mistake to consider the enforcement of copyright to be somehow less damaging to the competitive process simply because a substantial amount of copyright is vested in works that contribute little to the dynamism of the economy. Indeed, that copyright is in fact a more commonly used protection than patent rights by innovating firms in New Zealand speaks to the dangers of considering copyright to be any more protected by natural Lockean rights than patents.[38] It must also be remembered that IP is a creature of statute. This was acknowledged by the House of Lords as early as 1774,[39] and continues to be upheld today.[40] The link between public benefit and reward identified by Blackstone in 1765 must remain the cornerstone. The statutory grants of monopoly bestowed by Parliament on the understanding that they will lead to a recognisable public benefit should not be interpreted as absolute rights of ownership, enforceable in-and-of-themselves, and impenetrable by competition law scrutiny.

E. The theory of competition law

In New Zealand, as in other jurisdictions, it is now a "mainstream proposition that competition is a means to economic efficiency."[41] Such efficiency is, as the purpose section of the Commerce Act 1986 makes clear, "for the long-term benefit of consumers within New Zealand".[42] It has been observed that a Traditionalist approach to competition policy may be seen in the Commerce Act, in that effective competition is pursued as a means to the greater and varied ends of economic efficiencies and consumer welfare, rather than as an end in

[37] Waldron, above n 34, at 842.
[38] In the 2 years up to August 2007, 28% of innovating businesses surveyed in New Zealand stated they used copyright to protect intellectual property, compared to the 25% who claimed to use patent protection. See Statistics New Zealand "Innovation in New Zealand: 2007" (Statistics New Zealand , Wellington, 2008).
[39] *Donaldson v Becket* (1774) 4 Burr. 2408, 1 ER 837 (HL).
[40] *Compo Co. Ltd. v Blue Crest Music et al.,* [1980] 1 SCR 357 at 372, 105 DLR (3d) 249.
[41] Sumpter, above n 2, at 12.
[42] Sumpter, above n 2, at 13.

itself.[43] Dogged and relentless arguments by Chicagoans who advocate economic efficiency as the sole goal of competition law have been "consistently rejected".[44]

In its pursuit of effective competition, competition law hypothesises a situation of 'perfect competition' in which neo-classical economics claims net social welfare is maximised.[45] This is achieved through the maximisation of allocative and productive efficiencies, and therefore the maximisation of social wealth. [46] In a perfectly competitive market:[47]

> Firms can enter and exit markets instantly and without costs, products are homogenous, and everyone is perfectly informed. Firms are so numerous that none of them is large enough to influence prices by altering output, and all act independently. Supplier competition for sales thus drives prices for products and services down to the costs of providing them…

Competition is, however, not perfect. In reality, unlike the neoclassical ideal, barriers to entry may exist, firms may collude to raise prices to supracompetitive levels, and dominant firms may wield powers that negatively impact upon the ability of other firms to compete in a market. As well as noting that perfect competition is impossible to achieve in reality, it has also been argued that it undesirable. It has been accepted for some time that dynamic efficiency plays a greater role in long term economic and consumer welfare than static efficiency gains.[48] Baumol has argued that in situations of perfect competition, in which many small or medium-sized firms vigorously compete, each individual firm lacks the resources required to innovate.[49] Indeed, some economists have contended that there is an inverted U-shape relationship between competition and innovation, such that as one moves away from monopoly, innovation is stimulated to a peak, and then decreases as one moves towards perfect competition.[50]

It is for this reason that economists and lawyers alike have advocated an increased recognition of the importance of dynamic efficiency to consumer welfare, and have argued

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[43] Rex Ahdar "An Antitrust Decalogue: The Ten Commandments of Australasian Competition Law" (2009) 37 ABLR 324 at 326.
[44] At 327.
[45] Richard Whish *Competition Law* (5th ed, LexisNexis, UK, 2003) at 2.
[46] At 2.
[47] Einer Elhauge and Damien Geradin *Global Antitrust Law and Economics* (2nd ed, Thompson Reuters, Foundation Press, New York, 2011) at 1.
[48] Sumpter, above n 2, at 44.
[49] WJ Baumol *The Free-Market Innovation Machine: Analysing the Growth Miracle of Capitalism* (Princeton University Press, Princeton NJ, 2002) at 44-45.
[50] Philippe Aghion, Nick Bloom, Richard Blundell, Rachel Griffith and Peter Howitt "Competition and Innovation: An Inverted-U Relationship" (2005) Quarterly Journal of Economics 701at 702.

that where tension between static and dynamic principles exist, emphasis should be placed on the latter.[51]

F. IP and competition law as congruent goals?

From the above discussion, several conclusions may be drawn as to the degree of harmony between competition law and IP regimes.

Both regimes aim to increase social and consumer welfare, and acutely appreciate the value of incentivising innovation to that goal. In the case of IP, the desire to incentivise innovation is the sole reason for the existence of both patent and copyright law (though it will be recalled that other philosophical justifications for IP can be found intermittently in case law and academic literature). In the case of competition law, the fact that innovation as a dynamic force can drive markets and result in greater consumer welfare has been widely accepted for some time. On a broad reading therefore, a convincing argument may be made for congruence.

This argument however becomes less persuasive on closer analysis of the means by which each regime employs to achieve such goals.[52] Whereas intellectual property "seeks to create rents" by bestowing on the IP-holder a temporary legal monopoly,[53] competition law seeks to "maintain a competition that decreases rents and moves prices towards marginal costs."[54] Whereas intellectual property has the incentivising of innovation in the long term as its immediate touchstone, competition law in New Zealand prioritises the maintenance of the competitive process in the short term, with efficiency and welfare as assumed corollaries of that state.[55]

There is therefore an unavoidable tension between IP and competition regimes. The answer to the question of what to do about that tension depends ultimately on the weight one gives to each doctrine. If IP is seen as some kind of intrinsic or natural Lockean right, with accompanying connotations of inalienability, then the relationship between IP and

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[51] Sumpter, above n 2, at 48.
[52] Ian Eagles "Intellectual Property and Competition Policy: The Case for Neutrality" in Charles E F Rickett and Graeme W Austin (eds) *International Intellectual Property and the Common Law World* (Hart Publishing, Oxford and Portland Oregon, 2000) 285 at 321.
[53] Beatrice Dumont and Peter Holmes "The Scope of Intellectual Property Rights and their Interface with Competition Law and Policy: Divergent Paths to the Same Goal?" (2002) 11 Economics of Innovation and New Technology 149 at 151.
[54] At 152.
[55] See the ultimate goal of competition in Commerce Act 1986, s 1A.

competition law could not realistically be defined by reference to public policy.[56] If, however, one views IP as a "statutory right which derives from the state and which can be reassigned as is necessary to achieve economic policy goals,"[57] as Dumont and Holmes contend IP should be viewed, then the tension between the regimes can, at least in practice, be diminished. Under that view, IP would be just as subject to competition law scrutiny as any other property right, and when competition law identified an anticompetitive effect without an exculpating suggestion of increased dynamic efficiency, it could intervene. As will no doubt be clear from the preceding section on the philosophy of IP law, and as will hopefully become further understood in later sections, this dissertation supports this latter interpretation of IP law as a statutory grant subject to reassigning as is economically required.

[56] Dumont and Holmes, above n 53, at 152.
[57] Dumont and Holmes, above n 53, at 152.

III. The Proposition

This dissertation makes specific recommendations regarding an ideal regulatory approach to the issue of refusals to licence IP. The recommendations are:

A. IP should be treated just like any other property right

At various points in its history, IP has been treated as an overriding property right; part of a special regime that exists outside of regular competition scrutiny.[58] It was an expressly granted statutory right, and so surely an express revocation was needed to limit it. Further, as Shumpeterian economic thought grew in prevalence, the vital importance of IP to the dynamic process became more apparent. IP rights have been argued to possess various unique economic characteristics that mean they should be given primacy in an antitrust dispute. Such characteristics include the significant social benefits that accompany innovation, the greater danger of 'free-riding', and the risk of not recovering sunk R&D costs.[59] All such characteristics have been argued to require robust legal protection in order to be optimised.

Several important observations may be made about this argument. Most significantly, the argument for robust legal protection has been taken so far that IP rights are, in some instances, grossly overprotected. It is certainly true that in some cases, the appeal of monopoly profits provides a powerful impetus to innovate. In other markets however, overprotection of IP rights has led to 'patent thickets', in which a would-be innovator finds itself bogged down by patents held by other firms over components that it needs for its own innovation. The corresponding requirement to 'invent around' pre-existing patents in order to achieve the same functional result is often, even on a dynamic analysis, an inefficient allocation of resources. In other situations, patents may lack economic value and never be enforced, or may be developed for purely defensive reasons to 'block' competition.[60] Simply, it is false to assume that greater IP protection leads to greater incentives to innovate.[61] Evidence for such a claim is, at best, contradictory.[62] It must be remembered that none of the general observations about intellectual property – that they incentivise innovation, lead to novel

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[58] Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics*, above n 12, at 12.
[59] James Langenfeld "Intellectual Property and Antitrust: Steps Toward Striking a Balance" (2001-2002) 52 Case W Res L Rev. 91 at 94.
[60] Shelanski, above n 5, at 385.
[61] Dumont and Holmes, above n 53, at 152.
[62] Aghion, Bloom, Blundell, Griffith and Howitt, above n 50, at 702.

inventions, suffer from greater risks of free riding, and need strict protection in order to recoup R&D investment – can be made in the abstract. Rather, they are fact-specific inquiries that depend on the state of the market being investigated. That this is a contentious or conceptually troubling claim is evidenced by the fact that the level of innovation or R&D expenditure of a particular work has no bearing on the level of protection it gets from the IP statute. The term of every patent is 20 years from the date of filing, no matter how societally valuable it is,[63] or how much effort was put into its creation. The term of every copyright in a literary, dramatic, musical or artistic work is 50 years after the author's death, again regardless of how necessary the length of that term is, or would be, to the incentivising of the author.[64] A contradiction is therefore embedded within the legislation: on the one hand, the purpose of the legislation is to incentivise innovation (which goal may be either helped or hindered by lengthy IP protection, depending on the market); on the other, the IP statutes set blanket periods of duration for IP protection, taking no account of the market or sector in which the invention exists.

Second, there is no reason to consider the IP regime to be any more 'special' than the competition law regime. Nor is there any reason to consider intellectual property to be any different to tangible property. The various IP statutes provide for the circumstances in which a legal person can own intellectual property, in just the same way as the Crimes Act 1968, Sale of Goods Act 1908 etc provide for the circumstances in which a person can be said to own tangible property. The boundaries of IP ownership are just as, if not more, clearly delineated by the four corners of their respective statutes as is the case for physical property. Patents grant rights to exclude in the same way that the laws of trespass give rights to exclude from physical property.[65] That competition law is able to cut across such tangible property rights in the context of refusals to deal has been well shown, whether the tangible in question be chemical substances,[66] train tracks,[67] power grids,[68] or steel products.[69] The case should be no different for IP. As the court in *Microsoft* wryly put it: To claim that IP rights cannot be

[63] Patents Act 2013, s 20.
[64] Copyright Act 1994, s 22(1).
[65] Frank H. Easterbrook "Intellectual Property is Still Property" (1990) 13 Harv J L & Pub Pol'y 108 at 109.
[66] *ICI and Commercial Solvents v European Commission* [1974] ECR 223, [1974] 1 CMLR 309.
[67] *United States v Terminal Railroad Association* 224 US 383 (1912).
[68] *Otter Tail Power Co v United States* 410 US 366 (1973)
[69] *Queensland Wire Industries v The Broken Hill Pty Co Limited* [1989] HCA 6, (1989) 167 CLR 177.

limited would be as erroneous as claiming "that use of one's personal property, such as a baseball bat, cannot give rise to tort liability."[70]

Finally, on a practical level, as intellectual property rights become more prevalent,[71] to treat IP rights as uniquely protected would be to provide powerful protections to those firms that possess some form of IP and wish to conduct monopolistic behaviour. Treating IP rights just the same as tangible property rights "places fewest obstacles in the path of a case-by-case economics-based approach."[72]

B. A distinction between proactive arrangements and unilateral exercises of power is arbitrary

If the aim of a competition law regime is to protect the competitive process, as New Zealand's regime is,[73] and to focus on the effect on that process that actual or proposed conduct has,[74] then to draw a distinction between proactive arrangements such as tying, and unilateral exercises of market power such as refusals to licence is arbitrary. Both types of conduct may involve IP rights, both are conscious choices made by a firm, and both may detrimentally impact upon the competitive process. Despite this fact, both ss 36(3) and 45 of the Commerce Act can be argued to make such a distinction, as shall be shown.

C. Unhelpful concepts such as 'exceptional circumstances' and 'essential facilities' should be resisted

In various overseas jurisdictions, courts have intermittently relied upon presumptive doctrines and principles when considering refusals to deal, in lieu of proper economic analysis. The essential facilities doctrine suggests that a firm that owns or possesses an un-duplicable facility, access to which is essential to another firm's ability to compete, may be required to provide access on reasonable terms. The star of the essential facilities doctrine enjoyed rapid ascension in US law until it was snuffed out by the Supreme Court in *Trinko*.[75] It has been replaced not by a rule of reason approach, but by a de facto presumption of the right to refuse,

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[70] *United States v Microsoft* 253 F 3d 34 (2001).
[71] As of 2011 there were 2,113,628 patents in force in the United States, and 35,700 patents in New Zealand. See World Intellectual Property Organisation (2013) IP Statistics Data Center <http://ipstatsdb.wipo.org/ipstatv2/ipstats/patentsSearch>.
[72] Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics*, above n 12, at 235.
[73] Commerce Act 1986, s 1A.
[74] As this dissertation contends the law of competition should be.
[75] *Verizon Communications Inc v Law offices of Curtis V. Trinko* LLP 540 U.S. 398, 414 (2004).

displaceable by evidence of essentialness.[76] In the EU, the essential facilities doctrine continues to have force, and an 'exceptional circumstances' test exists to ensure that the right to refuse is displaced very infrequently.[77] In Australia, the doctrine was rejected by *Queensland Wire* because it was unclear, made no provision for a legitimate business purpose, and was harder to apply to the case in point- that of a vertically integrated monopolist.[78]

However in 2004, the High Court of Australia revived the essential facilities doctrine in *NT Power*,[79] confirming that s 46, the Australian misuse of market power section, does import an alternative access regime that could compel owners of essential facilities to provide access.[80] Corones argues that "section 46 now operates in a way similar to the United States essential facility doctrine."[81] Matt Sumpter has also speculated that future refusal to deal cases could well be analysed under essential facilities jurisprudence.[82]

New Zealand courts have displayed little enthusiasm for the essential facilities doctrine. Both *Port Nelson*,[83] and *Telecom*,[84] expressly rejected the doctrine's applicability in New Zealand. In *Commerce Commission v Bay of Plenty Electricity Ltd*,[85] the Court observed that the US essential facilities doctrine has not been accepted into New Zealand, and that to the extent that any general obligation on a dominant firm to supply can be said to exist in New Zealand, it must be in line with the refusals to supply 'test' discerned in *Queensland Wire,* rather than

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[76] Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics*, above n 12, at 236.
[77] At 236.
[78] *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd* (1988) 17 FCR 211 at 221-222.
[79] *NT Power Generation Pty Ltd v Power and Water Authority* (2004) 219 CLR 90 at 122 [85].
[80] I use the word "alternative" here because Australia also contains a Part IIIA of the Competition and Consumer Act 2010, which provides for the regulation of access to services that in the US would be essential facilities. Part IIIA is arguably broader than Part 4 of the Commerce Act 1986, in that firms may make applications to the Council for access to facilities (unlike in NZ where regulation must be initiated by the Minister), see s 44F. It does not however address refusals to licence, because the definition of "service" in s 44B expressly excludes the use of intellectual property.
[81] Stephen G. Corones *Competition Law in Australia* (4th ed, Lawbook Co, Sydney, 2006) at 438
[82] Sumpter, above n 2, at 331. Sumpter is more cautious in his prediction, noting the hesitancy of NZ courts to adopt the essential facilities doctrine in the past.
[83] *Port Nelson v Commerce Commission* (1996) 5 NZBLC 102,239; 12 TCLR 168 (HC).
[84] *Telecom Corp of New Zealand Ltd v Clear Communications Ltd* (1994) 5 NZBLC 103,552; [1995] 1 NZLR 385 (PC) at NZBLC 103,565; NZLR 402-403.
[85] *Commerce Commission v Bay of Plenty Electricity Ltd* HC Wellington CIV-2001-485-917, 13 December 2007.

US jurisprudence.[86] The *Bay of Plenty* Court considered *Queensland Wire* to stand for the proposition that there is a general obligation to supply where:[87]

a) The facility or input is not practically duplicable, has no close substitutes, and is necessary for competition in the pleaded market. Where the product in question is an input for a product in a downstream market, there must be no substitutes in that market either; and
b) The defendant firm must control the facility or input, and it must not be available elsewhere.

Subsequent New Zealand cases, such as *Commerce Commission v Telecom Corporation of New Zealand Ltd,*[88] have chosen to rely neither on US essential facilities jurisprudence nor a "nascent New Zealand equivalent",[89] instead simply assuming an obligation to supply in situations where a non-dominant firm would not rationally have refused.[90] In other words, where a refusal to deal is found to be anticompetitive under the NZ counterfactual, there will be an obligation to supply.

Importation of US or EU essential facilities jurisprudence would be ill-advised. The essential facilities test, as Areeda argued in 1989, was created as a reaction to the idea that there was a right to refuse to deal, and has therefore never cogently and consistently been justified in terms of economic efficiency or social welfare.[91] Subsequent developments and equivocations within the doctrine, such as the formulation of a test of exceptionality in the EU, are merely attempts to achieve results that are more economically rational and attractive, within a doctrine whose initial conception lacked any kind of economic rationale at all. If an ideal competition regime would focus on the presumed effect of regulatory intervention on a refusal to deal, then doctrines predicated on presumptions of illegality or legality avoid the real issue entirely. Regulators should not need to perform complex conceptual gymnastics to sidestep the Lockean proposition that there is a right to refuse to deal in one's own property.

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[86] At [397].
[87] At [388].
[88] *Commerce Commission v Telecom Corporation of New Zealand Ltd* HC Auckland CIV-2004-404-1333, 9 October 2009
[89] *Telecom Corporation of New Zealand Ltd v Commerce Commission* [2012] NZCA 278 at [132].
[90] At [132], upholding the finding of the HC in *Commerce Commission v Telecom Corporation of New Zealand Ltd* HC Auckland CIV-2004-404-1333, 9 October 2009.
[91] Phillip Areeda "Essential Facilities: An Epithet in Need of Limiting Principles" (1989) 58(3) ALJ 841 at 841.

The competition law regime already exists as a means of cutting across property law to achieve pro-competitive results.[92]

The approach taken in *Commerce Commission v Telecom*, it is submitted, is the most appealing, avoiding as it does the presumptive conceptual distractions of the US doctrine that *NT Power* seems to consider. Its greatest weakness is the inadequacy of the New Zealand counterfactual itself, rather than any conceptual difficulty in compelling supply if the counterfactual is breached. The inadequacy of the New Zealand counterfactual will be discussed shortly.

D. The 'scope of the grant' principle has no economic support, and should be avoided

The scope of the grant principle varies in specificity and ambit. In its broadest conception however, the principle stands for the proposition that because IP grants are bestowed freely by parliament, they therefore require similar parliamentary intervention to remove or limit them. It can therefore lead to the fallacious conclusion that IP rights cannot, and should not, be circumscribed by competition law or indeed by anything other than an express statutory intention.

The scope of the grant principle is logically untenable. It adopts the principle of *generalis non specialibus non derogant* and enshrines it in law, contending that the 'special' property rights granted by IP statutes should not be eroded by the 'general' law of competition. As Eagles and Longdin observe, intellectual property rights are no more 'special' than any other laws, and no more exempt from competition scrutiny.[93] This is not to say that the intended scope of the IP grant should never be considered. On the contrary, the scope may speak to the reasonableness of a firm's enforcement of the IP right, and therefore may be a relevant factor in the 'business justification' stage of the counterfactual, as indeed it was in *Broderbund Software Inc*.[94] But it should not be permitted the status of a legal presumption.

In the United States intellectual property has, at times in its history, been considered presumptively immune from antitrust scrutiny unless the monopolist strays beyond the scope

[92] Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics*, above n 12, at 7.
[93] Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics*, above n 12, at 12.
[94] *Broderbund Software Inc v Computermate Products (Aust) Pty Ltd*, above n 9. Broderbund brought proceedings to prevent importation of copyrighted goods without a licence. It was alleged in a cross-claim that Broderbund had thereby infringed the abuse of market power section. The judge held that Broderbund had simply enforced its rights given in the Copyright Act 1968 (Cth), and had therefore acted reasonably in pursuing its claim.

of its IP right. In *CSU v Xerox*,[95] for example, the Federal Circuit noted that there was "no reported case in which a court had imposed antitrust liability [under the US misuse of market power provision] for refusal to sell or licence a patent."[96] The Court proceeded to outline what was intended to be a *per se* rule of legality,[97] rebuttable only by evidence of fraudulent or sham patents.[98] This can be seen as a scope of the grant conception of IP antitrust liability. It is also clearly fallacious. To extrapolate from the premise that to extend power from within to without of the IP grant is illegal, to the conclusion that what happens within the scope of that IP grant is never illegal, is to commit a *non sequitur*. To give such faulty logic presumptive status is to enshrine such a fallacy permanently within the law.

The scope of the grant principle can be argued to be at work in NZ law, specifically in the operation of ss 36(3) and 45 of the Commerce Act 1986. The extent to which this is the case, as well as the implications for NZ law, will be discussed shortly.

E. Regulators should be neutral, and should favour an approach based on case-by-case empirical analysis

Competition scrutiny should operate "even-handedly across all sectors of the economy and all forms of business activity."[99] It has been contended that certain 'high-tech' industries are possessed of such significant economic idiosyncrasies that "allowing firms with market power in high-tech industries to exploit that market power is a sensible price to pay for a vibrant innovative economy."[100] An economic argument may be made using the rubric of investment displacement theory to dispute this contention.[101] According to investment displacement theory, over protection of market A will encourage investors to pour money into that market, to the detriment of markets B and C. To presume certain markets to be less amenable to competition analysis would therefore potentially overly encourage investment in those markets, to the detriment of others. If there is a case to be made for the diversion of

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95 *Re Independent Service Organisations Antitrust Litigation ('CSU v Xerox')* 203 F 3d 1322 (Fed Cir 2000).
96 At 1326.
97 Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics*, above n 12, at 141.
98 *Re Independent Service Organisations Antitrust Litigation ('CSU v Xerox')*, above n 95, at 1326.
99 Ian Eagles and Louise Longdin, Discussion Paper presented at 3rd Law and Economics of Intellectual Property and Information Technology Conference at Queen Mary College Centre for Commercial Legal Studies, University of London, 5-6 of July 2007.
100 Robert Pitofsky "Antitrust Analysis in High-Tech Industries: A 19th (Nineteenth) Century Discipline Addresses 21st (Twenty-First) Century Problems" (1999) 4(1) Texas Review of Law and Politics 129 at 133.
101 Eagles "Intellectual Property and Competition Policy: The Case for Neutrality", above n 52, at 339.

investment to IP markets, competition law is not the best mechanism for achieving that redistribution.[102] Eagles and Longdin also note that as well as the economic justification for neutrality, another Rawlsian advantage may be obtained, as such neutrality "commands the widest possible degree of support among market players before [regulatory intervention] is applied to them, and without the need for any ability on their part to predict their own future behaviour."[103]

The contention that regulators should prefer an empirical case-by-case analysis could be seen as the other side to the 'presumptions should be rejected' coin. In their formalistic quest for *ex ante* certainty, judges run the risk of enshrining bright-line rules (hopefully based on some degree of empirical economic analysis) into the law. At that point, "economics is effectively banished from the courtroom", as the rule acts as a substitute for case-by-case analysis.[104] The court in *Carter Holt* stressed the importance of *ex ante* certainty in s 36 cases,[105] but academics have argued that in the context of a provision that must necessarily be so broad as to catch a vast range of monopolistic conduct, attempts at *ex ante* certainty may in fact obstruct the "need to tailor policy actions to individual circumstances."[106]

[102] At 339.
[103] Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics*, above n 12, at 7.
[104] Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics*, above n 12, at 23.
[105] *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* [2004] UKPC 37; [2006] 1 NZLR 145 at [23].
[106] W Comanor, "Is There a Consensus on the Antitrust Treatment of Single Firm Conduct?" (2008) Wisc L Rev 387 at 389.

IV. The Law of Australia

A. The variety of legislatively endorsed tests

The Australian misuse of market power section is s 46 of the Competition and Consumer Act 2010. While expressed at more length and in greater detail than s 36 of the Commerce Act 1986, it operates to the same effect.

Unlike the New Zealand section, which as shall be shown, can be satisfied only by one methodology, the Australian section has spawned several judicially-created methods of satisfying the statutory requirements.

1. The would/could counterfactual

Although the various methodologies found in Australian case law can be said to be true alternatives, and not competing for supremacy,[107] the counterfactual test expressed by the High Court of Australia in *Queensland Wire*[108] is certainly the most widely used. In *Queensland Wire*, an upstream steel producer, BHP, enjoyed substantial market power both in the production of steel and the supply of steel and steel products. One of those products was Y-bar, a material used to make star-picket fences. BHP only sold Y-bar to its downstream retailer/subsidiary, AWI. It refused to supply Queensland Wire Industries (QWI), a firm that sought to enter the fence post market.

In deciding whether BHP had abused its market power, a four-judge majority of the High Court held that a defendant cannot be said to have taken advantage of its market power if it would, or could,[109] have acted in the same way without that power.[110]

2. Material facilitation

Conceived in *Melway*, this formulation posits that:[111]

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[107] Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics*, above n 12, at 184.
[108] *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd* (1989) 167 CLR 177.
[109] This contradiction derives from the fact that two of the judges (Mason CJ and Wilson J) use the word "would" when construing the counterfactual, while two judges (Dawson and Toohey JJ) use the word "could".
[110] *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd* above n 108, at [28].
[111] *Melway Publishing Pty Limited v Robert Hicks Limited* ('Melway') [2001] HCA 13; (2001) 205 CLR 1 at [51].

> In a given case, it may be proper to conclude that a firm is taking advantage of market power where it does something that is materially facilitated by the existence of the power, even though it may not have been absolutely impossible without the power.

The material facilitation test has since been applied by the High Court in *Rural Press*,[112] and the Full Federal Court in *Australian Competition and Consumer Commission v Australian Safeway Stores Pty Ltd*.[113]

3. *Power plus purpose*

In *Queensland Wire*, Deane J put forward a 'purpose test' to suggest that 'taking advantage' could be inferred from the combination of substantial market power and purpose.[114] The test essentially flips the counterfactual on its head, asking whether the purpose of the alleged anticompetitive conduct could only be achieved with a substantial degree of market power. It has been argued to be a more appropriate test in cases where the conduct would only be anticompetitive if carried out by a firm with market power,[115] as the standard 'could' counterfactual is blind to the distinction.[116]

4. *The resulting bevy of tests*

In 2008 the Australian government responded to the proliferation of s 46 tests by creating s 46(6A), a non-exhaustive set of tests that courts may use to determine the s 46 issue. Courts may thus consider any one of:

a) Whether the conduct was materially facilitated by its substantial degree of power in the market;
b) Whether it engaged in the conduct in reliance on its substantial degree of power in the market;
c) Whether it is likely it would have engaged in the conduct if it did not have a substantial degree of power in a market;
d) Whether the conduct is otherwise related to its substantial degree of power in the market.

[112] *Rural Press Ltd v Australian Competition and Consumer Commission ('Rural Press')* [2003] HCA 75, (2003) 216 CLR 53 at [51].
[113] *Australian Competition and Consumer Commission v Australian Safeway Stores Pty Ltd* [2003] FCAFC 149.
[114] *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd*, above n 108, at 197-98.
[115] Y Van Roy "Taking Advantage of Market Power: Should New Zealand Adopt the Approach of the High Court of Australia?" (2005) 11 NZBLQ 319 at 347.
[116] Paul G Scott "Taking a Wrong Turn? The Supreme Court and Section 36 of the Commerce Act" (2011) 17 NZBLQ 260 at 275.

The legislative preference for a 'would' rather than 'could' test should be noted. Eagles and Longdin contend that this opens the door to a consideration of legitimate business practice into the counterfactual test, despite no express reference in the legislation.[117]

B. Refusals to deal in Australia

Refusals to deal in tangibles in Australia have been dealt with under several of the tests discussed above. In *Queensland Wire*, it will be recalled, the High Court applied the counterfactual test that asked whether the defendant would/could have acted in the same manner if it lacked market power. In that case, the defendant was found to have taken advantage of its market power for the proscribed purpose of preventing or deterring the entry of a competitor into a downstream market.[118] A refusal to deal was therefore found to be anticompetitive.

In *Melway*, the Court observed that s 46 is not concerned with protecting individual competitors, and so a refusal to deal that only damages a competitor will not be of concern. Melway owned the copyright in street directories for Melbourne and Sydney. For many years it had operated a distribution system for its directories, subdividing the retail market into smaller zones and allocating wholesalers to each zone. Melway ended an arrangement with one such wholesaler, and refused to supply that wholesaler with directories, thinking that they would bypass Melway's distribution system and sell them to anybody. The court held:[119]

> Section 46 aims to promote competition, not the private interests of particular persons or corporations. If Melway was otherwise entitled to maintain its distribution system without contravention of the Act, it is not the purpose of s 46 to dictate to Melway how to choose its distributors.

The Court analysed the refusals to deal issue using its new 'material facilitation' formulation.

Finally, a refusal to deal may be anticompetitive if the product or good being refused is an essential facility. As has already been discussed, the essential facilities doctrine has arguably been revived in Australia by *NT Power*, in which the court confirmed that s 46 does import an access regime that could compel owners of essential facilities to provide access.

[117] Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics* above n 12, at 188.
[118] *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd*, above n 108, at 185.
[119] *Melway Publishing Pty Limited v Robert Hicks Limited* ('Melway'), above n 111, at [17]-[19].

C. *Refusals to Licence Intellectual Property*

In the *NT Power* case, the court expressly held that the misuse of market power section could be used to compel a firm to deal in its intellectual property rights.[120] There followed the "demolition of the property defence",[121] in which the court held that to distinguish between the taking advantage of market power and the taking advantage of a property right is to establish a false dichotomy that has no basis in law.[122] The combination of these two assertions seems at first glance to put paid to the scope of the grant principle.

Less appealing is the court's assertion that IP rights are often a very clear source of market power.[123] It smacks of presumptive and unequal treatment of IP rights, and comes dangerously close to committing the error of confusing legal and economic monopolies. It has therefore been criticised by academics.[124] Such critics may however be mollified by the suggestion that what is perhaps a throw-away comment by the Court should not be interpreted as suggesting its approach in all IP cases, but rather, merely standing for the innocuous proposition that IP rights can, in certain circumstances, convey structural market power.

In *ASX Operations Pty Ltd v Pont Data Australia Pty Ltd*,[125] ASX was a regulated nationwide stock exchange. ASX Operations (ASXO) was a subsidiary of ASX, which supplied Pont Data with electronic stock market data. Much of this data was not available from other sources. ASXO required contractual commitments from Pont Data that it would not on sell such information to other information wholesalers. ASXO witnesses stated that the purpose of seeking such commitments was to keep the wholesale information market to itself. At first instance, ASXO was found to have attempted to monopolise the wholesale information market, and attempted to prevent the establishment of rival stock exchanges outside of Australia that could compete with ASXO's parent company ASX. ASXO claimed it was heading off an unlawful infringement of IP rights it felt it had in the information. The Full Federal Court held that this case could not be characterised so simply as an enforcement of

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[120] *NT Power Generation Pty Ltd v Power and Water Authority* above n 79, at [85].

[121] Ian Eagles and Louise Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics* (Hart Publishing, Oxford and Portland, Oregon, 2011) at 204.

[122] *NT Power Generation Pty Ltd v Power and Water Authority*, above n 79, at [125].

[123] *NT Power Generation Pty Ltd v Power and Water Authority*, above n 79, at [125].

[124] Corones, above n 81, at 461.

[125] *ASX Operations Pty Ltd v Pont Data Australia Pty Ltd* [1990] FCA 515, (1991) ATPR 41-069, 97 ALR 515.

private rights.[126] Commentators have read into this statement an implicit acceptance that the public law regulatory regime took precedence over private rights.[127] If this interpretation is correct, it stands for the proposition, already put forward in this dissertation, that IP rights can be reasonably limited to achieve policy goals.

[126] At [79].

[127] Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics*, above n 12, at 200.

V. The Law of New Zealand

New Zealand has several mechanisms by which the State may possibly compel a firm to licence its intellectual property:

A. Compulsory Licencing Provisions

1. Patents Act 2013, ss 169 and 170

Section 169 of the Patents Act provides that 3 years after the sealing of a patent, or 4 years from the date of the patent, whichever is later, any person may apply to the court for the grant of a licence under the patent.[128] Under s 170, applications may, however, only be granted if the market for the patented invention is not being supplied, or is not being supplied on reasonable terms, in New Zealand.[129]

Thus, while a refusal to licence may be overturned by a court using s 170, the usefulness of the section is limited in several ways. First, it applies only to patents. There is no directly analogous provision for copyrights.[130] Second, it explicitly limits the ambit of the licence to situations where the market for the patented good itself is not being met, and does not cover potential secondary markets dependent on the patented good as a bottleneck facility.

While sections 169 and 170 are of little use in the majority of refusals to deal in IP, their existence does suggest that patent grants are not given in the abstract; rather, they are given on the understanding that the patentee will fill the market with the patented product for the benefit of consumers. This perhaps gives weight to the broader claim that IP rights must be tied to their theoretical justification, and if they are not, they may be curtailed.

2. Commerce Act 1986, Part 4

Part 4 of the Commerce Act 1986 "provides for the regulation of the price and quality of goods or services in markets where there is little or no competition and little or no likelihood of a substantial increase in competition."[131] However, while this Part does helpfully

[128] Patents Act 2013, s 169(1)
[129] Patents Act 2013, ss 169(2)(a) and (b).
[130] Copyright-holders may be compelled to licence their copyright if the right is contained within a licencing scheme by more than one author. See Copyright Act 1994, s 153.
[131] Commerce Act 1986, s 52.

illuminate the government's commitment to innovation,[132] and its readiness to intervene if the competitive process is being hampered by the existence of a bottleneck facility, it is unlikely that Part 4 will, or indeed, could, ever be applied to an intellectual property right. Since 1986, it has only been used on four industries: telecommunications, electricity, airports, and gas distribution. Ben Hamlin, Senior Legal Counsel at the Commerce Commission has expressed the opinion that:[133]

> Given the competition and outcome thresholds for regulation, it seems unlikely that there will be a significant number of additional industries regulated under Pt 4 any time soon, if ever.

Ultimately, the great expense involved in Part 4 regulation, as well as the fact that Part 4 seems geared towards industry-wide regulation rather than case-by-case regulation, suggest that Part 4 of the Commerce Act is ill suited to address the refusal to license situation.

B. The Commerce Act 1986 – Possible paths to liability and exculpation

Having noted the limitations of compulsory licensing provisions in ameliorating the potentially anticompetitive effects of refusals to licence, it remains to consider the substantive sections of the Commerce Act 1986. The two main sections under which a refusal to licence may be addressed are sections 27 and 36.

Section 27 prohibits contracts, arrangements, or understandings that substantially lessen competition. It is therefore a section requiring multilateral action. Section 36 is the New Zealand equivalent of the Australian section 46, mentioned above. Like that section, it prohibits the taking advantage of market of a substantial degree of market power for a proscribed purpose. Because the majority of refusals to licence will be unilateral, section 36 will be more commonly engaged than s 27. For this reason, it attracts much of the focus of this dissertation. It should be remembered however, that s 27 remains available for multilateral refusals. Examples of a multilateral refusal to deal may be situations where Firm A has a patent on a superior product, as well as an inferior substitute, and enters into an agreement with Firm B that allows Firm B to licence that inferior product, but prohibits it from licencing the superior one. Alternatively, Firm A may announce to potential rivals that it intends never to licence its product, or only to licence it at an exorbitant price. If such an

[132] S 52A of the Commerce Act 1986 expresses the purposes of Part 4 to promote the long-term benefit of consumers by ensuring that suppliers of regulated goods and services have incentives to innovate, invest, improve efficiency and share such benefits with consumers, and are limited in their ability to extract excessive profits.
[133] Sumpter, above n 2, at 353.

announcement creates a consensus that "engenders an expectation that at least one person will act or refrain from acting in the manner the consensus envisages",[134] that will be enough to satisfy the definition of arrangement or understanding in s 27. The significance of this potential multilateralism becomes greater when it becomes clear that sections 27 and 36 are governed by rather different exceptions for the exercise of IP rights. This means that a shrewd Firm A could manipulate the form of its refusal so as to avail itself of a different substantive exception. These exceptions are as follows.

1. *Section 36(3)*

Section 36(3) of the Commerce Act 1986 has been called a statutory "oddity",[135] and lacks an analogue in the Australian Act. Its exact operation and intent remain slightly uncertain, having only been directly litigated by an IP-holder once. The section states:[136]

> For the purposes of [section 36], a person does not take advantage of a substantial degree of power in a market by reason only that the person seeks to enforce a statutory intellectual property right, within the meaning of section 45(2) in New Zealand.

Section 45(2) in turn defines a statutory intellectual property right as "a right, privilege, or entitlement that is conferred, or acknowledged as valid, by or under" the Patents Act 1953 (now the Patents Act 2013), the Designs Act 1953, the Trade Marks Act 2002, the Copyright Act 1994, the Plant Variety Rights Act 1987, and the Layout Designs Act 1994.[137]

The first, and most obvious, question is whether s 36(3) can apply to refusals to licence at all. The crucial point will be whether a mere refusal to deal can be considered an 'enforcement' of an IP right. Sumpter disposes of this issue in a rather terse 21 words, stating: "In any event, s 36(3) only deals with the enforcement of IPRs; it does not apply directly to refusals to licence".[138] Sumpter therefore seems persuaded that the word "enforce" in s 36(3) can only suggest positive action rather than passive refusal. As commentators have noted, the "hair-splitting and literal construction" of s 36(3) that would distinguish between refusals and positive enforcement "does not sit well with modern notions of purposive interpretation."[139] Calhoun and Brown contend that the correct interpretation of "enforce" in s 36 is

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[134] *Giltrap City Ltd v Commerce Commission* [2004] 1 NZLR 608 at [17].
[135] Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics*, above n 12, at 205.
[136] Commerce Act 1986, s 36(3).
[137] Commerce Act 1986, s 45(2).
[138] Sumpter, above n 2, at 330.
[139] Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics*, above n 12, at 207.

'maintaining', 'upholding' or 'compelling the observance of'.[140] Under these definitions, especially 'maintaining' and 'upholding', certain forms of refusal to licence may conceivably fall under the ambit of the section. The facts of *Broderbund Software* may be suggested as an example.[141] Broderbund took legal action to prevent parallel importation of computer software over which it held a copyright licence. In a cross-claim, the cross-respondents argued that this action was an infringement of s 46 of the Trade Practices Act 1974, and was a constructive refusal to licence. The actions of Broderbund were, in the context of s 36(3), an enforcement of an IP right.[142]

However, while *Broderbund's* refusal to deal may sensibly be seen as an active enforcement, it is certainly not the typical form that refusals to licence take. The vast majority of passive refusals are unlikely to fit so neatly into the proactive language of s 36(3). It seems curious that Broderbund could avail itself of this section by actively enforcing its copyright only because the parallel importer had not sought importation permission of Broderbund first. Had it sought such permission, and Broderbund had refused, Broderbund would not then fall into s 36(3), despite relying on the same legal right to deny the importer in each case. However, while it is economically inconsistent and conceptually incoherent, s 36(3) seems only to apply to those refusals to licence that take a more active form of enforcement.

Assuming that s 36(3) may, in theory, apply to at least a small portion of refusals to licence IP, the next issue pertains to the exact operation of the section. On its face, section 36(3) could be read as suggesting that any enforcement of an IP right, within the scope of that right as prescribed by s 45(2), is immune to competition scrutiny. This would be a clear importation of a scope of the grant principle, the corollary of which would be to immunise actions within the grant and make the leveraging of power to a market outside that grant the *sine qua non* of regulatory intervention.

Another, more intellectually attractive, interpretation of s 36(3) is possible however. It is argued that the words "by reason *only* that the person seeks to enforce a statutory intellectual property right" merely point out that enforcement of an IP right is usually a perfectly valid business action, and that in order for a firm to run afoul of s 36(3), some extra element of

[140] D Calhoun and B Brown "New Zealand: Interface Between Misuse of a Dominant Position and the Exercise of Intellectual Property Rights" (1990) 12 E I P R. 437 at 438.
[141] *Broderbund Software Inc v Computermate Products (Aust) Pty Ltd*, above n 9.
[142] In 1991, when the case was before the Court, the importation of a copyrighted article without a licence from the owner for the purpose of sale or trade was a breach of copyright. See Copyright Act 1968 (Cth), s 37. This prohibition no longer exists.

intent or anticompetitive effect would need to be shown. This has been conceptualised as an evidential burden,[143] and is preferable to a scope of the grant presumption in that it does not preclude investigation into the economic justifications of the refusal itself, or immunise actions falling within the boundaries of the IP right. While the issue has not been directly litigated, tentative support for this interpretation may be advanced. In *Geotherm Energy*,[144] the court attempted to delineate between the legitimate exercise of legal rights and illegitimate breaches of s 36. The court stated that:[145]

> Even a monopoly must be entitled to make a case to the appropriate licensing or other authority for the preservation of its monopoly. The submission of reasonable arguments to that end and the taking of reasonable steps to prepare the case could not in themselves amount to a use of a dominant position in a market. *Something more* would have to be shown …

In *Telecom v Clear*,[146] Telecom had threatened legal action for infringement by Clear of their copyright in the toll charts published in local telephone directories. It was argued by Clear that Telecom's threat of legal action was a misuse of market power under s 36. Smellie J considered that Telecom's liability for such an act "is expressly excluded by [s 36(3)] from conduct proscribed in [s 36(2)] in that the pursuit of copyright (or other intellectual property rights) is recognised as appropriate."[147] Smellie J then went on to apply the "something more" test described in *Geotherm*. He did not, however, clarify whether s 36(3) should be interpreted in light of this test.

It has been suggested that s 36(3) was introduced to protect from litigation those owners of IP who take legitimate steps to protect their rights, and that at the time of drafting, the legislators could not have anticipated that the *Geotherm* case would cogently address the issue of legitimate enforcement of legal rights.[148] This dissertation supports the evidential burden that *Geotherm* seems to import, and contends that s 36(3) should be interpreted in light of that test.

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[143] Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics*, above n 12, at 205.
[144] *Electricity Corp Ltd v Geotherm Energy Ltd* [1992] 2 NZLR 641 (CA).
[145] At 655 (emphasis added).
[146] *Telecom Corp of NZ Ltd v Clear Communications Ltd* [1992] 3 NZLR 247; (1992) 4 TCLR 568.
[147] At 576.
[148] Brookers Online, Statutes of New Zealand, CA36.24(2).

2. *Section 45*

While s 36(3) provides an exemption to certain uses of intellectual property rights within s 36, s 45 has a similar (but by no means identical) function within the other Part 2 prohibitions. It does not apply to s 36.

Section 45 can be seen to be an encapsulation of the scope of the grant principle that this dissertation has already criticised. The section protects arrangements that authorise the doing of anything prohibited by a relevant IP statute. As long as the provision in question sits within this scope, one cannot look into the effect on the market that such a provision may have. Nor can one investigate the purpose behind the provision. It is the objective nature of the clause, rather than the intent, which is relevant.[149]

It seems instantly clear from a reading of the section that it is intended only to catch multilateral active conduct. The words ‘contract, arrangement or understanding’ clearly impute multilaterality, while the requirement of action is created by the words ‘entering into’, ‘arriving at’, and ‘any act done to give effect to’. Thus, a refusal to licence that is passive or unilateral will not fall within s 45.

Practically, the distinction between action and inaction, multilateralism and unilateralism may be generally inoffensive. As Sumpter notes, the complete absence of case law on s 45 may be driven by the general belief that an IP licence is unlikely to adversely affect competition unless, for example, the licenced product has become a bottleneck facility, and in the vast majority of those cases, the defendant will have market power so as not to attract the operation of s 45.[150] To exclude unilateral or passive conduct may not therefore be to exclude many refusals to licence from the operation of s 45, as they would either be caught by s 36 and thus not by s 45, or would lack the market power to raise anticompetitive concerns in the first place.

Conceptually, however, the distinction is more difficult to accept. In creating ss 45 in its current form, legislators have prioritised the form and appearance of firm behaviour over the economic substance and effect of that behaviour. Section 45 features what Ian Eagles calls the “*Port Nelson* effect”,[151] but without the focus on purpose that was so central in *Port*

[149] Ian Eagles “Regulating the Interface Between Competition Law and Intellectual Property in New Zealand” (2007) 13 NZBLQ 95 at 106.
[150] Sumpter, above n 2, at 323.
[151] In *Port Nelson Ltd v Commerce Commission* above n 83, at 13, the court held that it is the provision, not the ‘contract, arrangement or understanding’, that must be analysed. The Court was

Nelson.[152] The objective nature of the clause is significant, not the intent of the party inserting it. Some academics have suggested that these characteristics may enable "gaming" of the competition law regime,[153] as firms take advantage of the distinctions between s 45 and s 36(3). If intent is irrelevant, and the form of the provision is everything, firms have a vested interest in structuring their dealings in a way that shoehorns their behaviour into a substantive exception, despite the effect of such behaviour remaining the same. This is especially possible in the context of constructive refusals to licence, which may be multilateral if for example the licensor agrees to licence the IP at unfair or discriminatory prices, or if the licensor only makes an inferior version of the IP available to the licensee. Such a refusal could prima facie fall under both the provisions for unilateral conduct (s 36) and multilateral conduct (s 27), and yet immunisation from liability may differ between sections due to the different wording of ss 45 and 36(3). The distinction between action and inaction may also make such constructive refusals to deal more likely, as firms seek to avail themselves of the protection that s 45 confers on active conduct.

Both sections 36(3) and 45 prioritise the form of firm behaviour over the function. Both distinguish between action and inaction in a way that seems intellectually untenable. The differences that exist between the sections may be due to a genuine desire to address the practical differences between conduct involving market power and conduct without such power, but the result is to facilitate gaming of the competition law regime. If both sections were to disappear, "the sky would not fall on intellectual property owners."[154] Rather, competition law would simply be slightly freer of unnecessary distractions and impediments to its overall goal of holding intellectual property to the same standard as that of all other property rights.

C. The substantive provision – s 36

The key provision in New Zealand's Commerce Act 1986 that prohibits the unilateral exercise of market power, and which is therefore most directly relevant to the issue of refusals to deal, is section 36. The relevant wording is as follows:

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speaking of s 27, but Eagles contends that the use of identical language in s 45 imports the same analysis.

[152] Eagles "Regulating the Interface Between Competition Law and Intellectual Property in New Zealand", above n 149, at 106.

[153] At 106.

[154] At 111.

36. Taking advantage of market power –

(2) A person that has a substantial degree of power in a market must not take advantage of that power for the purpose of –

(a) restricting the entry of a person into that or any other market; or

(b) preventing or deterring a person from engaging in competitive conduct in that or any other market; or

(c) eliminating a person from that or any other market.

From a glance at s 36, the basic elements can quickly be made out. It must be shown that:

a) The defendant has a substantial degree of market power; and
b) The defendant has taken, or is taking, advantage of that power; and
c) The taking advantage of market power was done for one (or more) of three proscribed purposes.

1. *Substantial degree of market power*

This is the threshold test, required to be satisfied before the firm falls under the ambit of s 36. Before the degree of market power the defendant wields can be ascertained, it must first be asked: in exactly which market does the defendant possess power? In *Queensland Wire* it was suggested that this process will involve "value judgments".[155] There are however established methodologies enshrined in both the Commerce Act 1986 (NZ) and the case law. First, substitutability is the key consideration.[156] Under this concept, market power is bounded by the availability of close (actual or potential) substitutes for the product in question. The question, as expressed by *QCMA,* is: "if the firm were to 'give less and charge more' would there be, to put the matter colloquially, much of a reaction?"[157]

There are several dimensions to a market: product, space, function and time.[158]

In the intellectual property context, IP rights have the potential to be a 'red herring'.[159] Sumpter argues that "British IP case law (adopted in New Zealand) tends to be replete with

[155] *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd*, above n 108, per Deane J.
[156] Commerce Act 1986, s 3(1A).
[157] *Re Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,247; (1976) 25 FLR 169 at 190; 8 ALR 481 at 517.
[158] Maureen Brunt ""Market Definition" Issues in Australian and New Zealand Trade Practices Litigation" in R Adhar (ed), *Competition Law and Policy in New Zealand* (Lawbook Co, 1991) Ch 8, p 122.

concerns about monopoly",[160] especially as regards trade marks. In *GE Trade Mark*, for example, Lord Diplock noted:[161]

> The right of property in a trade mark has special characteristics. One, which it shared with patents and with copyrights was that it was a monopoly; that is to say it was a right to restrain other people from using the mark.

In the US context, the same can intermittently be said of both copyright and patent law.[162] The danger of excessive fixation on the statutory monopoly granted by IP law is that a court will begin to equate that legal monopoly with economic market power. The presumption that IP always confers market power existed in the US for much of the 20th century, and was formally adopted in *US v Loew,*[163] in which the Court held that "the requisite economic power is presumed when the tying product is patented or copyrighted", citing *International Salt Co. v. United States*[164] and *United States v. Paramount Pictures, Inc.*[165]As late as 1984, this presumption was upheld by the Supreme Court.[166]

So eagerly, however, did the US courts embrace the idea, once it had taken root, that intellectual property rights did not in fact create economic monopolies, that the scales began to shift too far in the opposite direction. As Ian Eagles and Louise Longdin note:[167]

> It was only a short step, however, from treating what happened *outside* the right as presumptively anti-competitive (or worse deeming it to be such) to regarding what happened *within* the parameters of a particular intellectual property right as actually or presumptively immune from antitrust attack… As we shall see, that step was increasingly taken.

This was, it will be recalled, the step taken in *CSU v Xerox.*

The truth, however, is that IP monopolies and market monopolies are rarely coterminous. As noted by Susy Frankel, one need only consider the numerous patents granted for bottle openers, paper clips and so on, to realise that patents are not economic monopolies.[168] In the

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[159] Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics*, above n 12, at 10.
[160] Sumpter, above n 2, at 321.
[161] *GE Trade Mark* [1973] RPC 297 (HL) at 325.
[162] Sumpter, above n 2, at 321.
[163] *United States v. Loew's Inc*, 371 U.S. 38 (1962) at 370.
[164] *International Salt Co. v. United States* 332 U. S. 392
[165] *United States v. Paramount Pictures, Inc* 334 U. S. 131.
[166] *Jefferson Parish Hosp. Dist. v Hyde* 466 U.S. 2 (1984) at 15-16.
[167] Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics*, above n 12, at 126.
[168] Susy Frankel *Intellectual Property in New Zealand* (2nd ed, LexisNexis, Wellington 2011) at 165.

copyright sphere, there is even less overlap between economic monopolies and the statutory grant, because copyright protects expression, rather than the idea itself.[169] Indeed, modern US case law has become more cognizant of the distinction between legal and economic monopolies. Since 1984, and against precedent, several lower courts began to eschew the presumption of market power in favour of a rule of reason economic analysis.[170] In 1995, the presumption was abandoned by regulators.[171]

This is not to say, of course, that intellectual property is incapable of ever maintaining an economic monopoly. If the product is sufficiently unique or idiosyncratic to occupy its own market, being not reasonably substitutable with other products, an IP right may preserve a monopoly over that product. For example, if a distinctive aroma chemical in a perfume or cologne formulation is protected by a patent, competitors are essentially foreclosed from reproducing it. Because cologne can be an idiosyncratic consumer choice, it may not be realistic to assert that a cologne, such as Davidoff's *Cool Water*,[172] is substitutable with other perfumes. *Cool Water* would thus occupy its own market, and legal and economic monopolies would overlap.

The lesson that New Zealand can learn from the overseas experience is that it is essential to dispel the misconceptions surrounding the notion of intellectual property as always conferring market power. To approach the market power question with the preconception that intellectual property will always confer economic monopoly, or conversely that intellectual property is never harmful as long as its exercise is restricted to the scope of its statutory grant,[173] is to falter at the first hurdle, and to impede a meaningful empirical assessment of the actual effect on competition that the proposed regulatory/judicial intervention would have.

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[169] At 166.

[170] *Nobel Scientific Indus. Inc v Beckman Instruments Inc* 670 F Supp 1313, 1328,29 (D Md 1986), *aff'd* 831 F 2d 537 (4th Cir 1987).

[171] *Antitrust Guidelines for the Licencing of Intellectual Property* (6 April 1995), issued by the US Department of Justice and the Federal Trade Commission.

[172] Cool Water contains an aroma molecule (known as an oderant), called Dynascone. While perfumes themselves cannot be patented, oderants (provided they are new) can. The result is that while perfumes can be easily analysed and broken down into constituent molecules by the potential competitor in order to copy, any oderants that are patented will not be able to be used by that potential copier until the expiration of the patent grant. For the duration of the grant of the patent over Dynascone therefore, Davidoff held the monopoly over perfumes with the particular scent element contributed by Dynascone. This foreclosed any copying of the fragrance.

[173] An approach which may possibly be discerned in s 45 Commerce Act 1986, as this dissertation has already discussed.

As seen above, the nature of the investigation into market power in New Zealand is based on relatively sophisticated empirical methodology, including the primacy of the principle of substitutability, and this spirit of empiricism must be carried across into the IP sphere unmolested by irrelevant and illogical presumptions.

2. *Taking advantage of market power*

Once it is proved that the firm had a substantial degree of power, and the relevant market has been defined, it must be shown that it took advantage of that power.

In 2010 the Supreme Court ruled that the sole test for determining whether a firm has taken advantage of its market power is the counterfactual test, or, as it was renamed in that case, the 'comparative exercise'.[174] Cento Veljanovski defines a counterfactual as "a "what if" statement indicating what would be the case if its antecedent were true."[175] Its philosophical lineage can be traced as far back as circa 90 AD, to Livy's *Ad Urbe Condita* (Book 9), in which the historian mused 'What would have happened to Rome had Alexander the Great invaded?'[176]

Essentially, the counterfactual is a test for causation,[177] and compares an actual state of affairs (the *factual* scenario), with a hypothesised one (the *counterfactual*). The precise operation of the current formulation of the counterfactual test will be discussed shortly.

For the purposes of section 36 of the Commerce Act 1986, the counterfactual has been consistently implemented by New Zealand judges since the Privy Council held it to be the sole test for s 36 proceedings in *Telecom v Clear Communications*.[178] Though not referred to by statute,[179] the test nevertheless has been argued to possess "quasi legislative status" in New Zealand.[180]

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174 *Commerce Commission v Telecom Corporation of New Zealand Limited* ('0867') [2010] NZSC 111 at [32].
175 Cento Veljanovski "Market Power and Counterfactuals in New Zealand Competition Law" 9(1) Journal of Competition Law and Economics 171 at 172.
176 Titus Livius *Ad Urbe Condita* (90 AD).
177 Veljanovski, above n 175, at 173.
178 *Telecom Corp of New Zealand Ltd v Clear Communications Ltd*, above n 84, at NZBLC 103,565; NZLR 402-403.
179 While section 36 does not refer to the counterfactual test, it is noted by the Commerce Commission's official guidelines to be the appropriate test for mergers and acquisitions. See New Zealand Commerce Commission, Mergers and Acquisitions Guidelines 2.4 (January 2004).
180 Peter Heerey "Shootout at the Real Chance Café: Aiming at s50" (2011) 39 Aust Bus L Rev 457.

Since the introduction of the counterfactual in *Telecom v Clear Communications*, private s 36 enforcement, as well as successful prosecutions by the Commerce Commission, have markedly declined.[181]

3. The Current Counterfactual – the Telecom Case

As alluded to earlier, the counterfactual in New Zealand was upheld in the *Telecom (0867)* case, and renamed the "comparative exercise". This dissertation will treat both terms as synonymous. In the *0867* case, Telecom had introduced a telecommunications network for Internet Service Providers (ISPs) known as '0867'. Three years previously, Clear Communications and Telecom had reached an agreement whereby when customers of one provider called the network of the other provider, the originating network paid a charge to the other network. This agreement was initially favourable to Telecom, but as dial-up internet became more common, Telecom customers began making more long calls to ISPs, many of which were on Clear's network. Clear took advantage of this by attracting ISPs with low fees. In the face of this unfavourable change, Telecom introduced an 0867 network service to attract ISPs from Clear's network to Telecom, by imposing no charge for customer using the 0867 prefix, but two cents per minute beyond 10 hours of internet use per month if their ISP was Clear's rather than Telecom's.

The Court's exact expression of the counterfactual is as follows:[182]

> The essential point is that if the dominant firm would, as a matter of commercial judgement, have acted in the same way in a hypothetically competitive market, it cannot logically be said that its dominance has given it the advantage that is implied in the concepts of using or taking advantage of dominance or a substantial degree of market power. Conversely, if the dominant firm would not have acted in the same way in a hypothetically competitive market, it can logically be said that its dominance did give it the necessary advantage. This is because it can reasonably be concluded that it was dominance or substantial degree of market power that caused, enabled or facilitated its acting as it did in the actual market.

The Supreme Court went on to describe more closely the mechanics of the counterfactual in practice:[183]

> It is also important to point out that for the comparative exercise to be effective in identifying when a dominant firm takes advantage of its dominance, the hypothetically competitive market

[181] Sumpter, above n 2, at 259.
[182] *Commerce Commission v Telecom Corporation of New Zealand Limited* ('0867'), above n 174, at [31].
[183] At [35].

> must genuinely deny that firm all aspects of its dominance. The constraints acting upon the firm in the hypothetical market must neutralise the dominance in the actual market. The hypothetical market should, however, replicate the actual market, save for eliminating the dominance of the alleged contravener. The means of achieving that elimination is to posit in the hypothetical market as well as the alleged contravener (company X) at least one other firm (company Y) in effective competition with company X.

As regards refusals to deal in IP, the *Telecom* case is notable for several reasons:

(a) The inclusion of "material facilitation"

At several points in the *Telecom* decision, the Court refers to the concept of "material facilitation", as it does in the above quotation. This has led some to contend that the counterfactual has been broadened to catch conduct of the kind envisaged by *Melway.*[184] Other academics have however, argued that the references to material facilitation simply represent an internal inconsistency within the decision.[185] It is not within the purview of this dissertation to expand upon the arguments for and against the inclusion of material facilitation, largely because such arguments do not illuminate the issue of refusals to licence. This dissertation contents itself with asking whether the inclusion of material facilitation would be a desirable development within the law of NZ as it relates to IP. Even this more modest inquiry poses difficulties, as it is to an extent dependent upon the precise formulation of the test that is found to be operative in NZ. For the purposes of this discussion, it will be assumed that if material facilitation continues to be applied in NZ, it will be along the lines of the Court's approach in *Zespri*.[186] While in Australia courts have occasionally required different evidence,[187] or felt obliged to select one test to the exclusion of the other,[188] the

[184] John Land and Sam Hiebendaal "Misuse of Market Power – Section 36: How the Telecom 0867 Case Has Clarified the Law" (2011) Kensington Swan, Bright*Star's 11th Annual Competition Law and Regulatory Review at 6.19.

[185] Scott, above n 116, at 279. In Melway, the High Court's refused to apply the material facilitation test, which had originated from a submission of the ACCC and had been introduced for the first time on appeal, because there had been no arguments or findings of fact with such a test in mind. Paul G. Scott contends that this implies that "liability for material facilitation required different and further evidence", suggesting that material facilitation cannot simply be determined as an alternate possibility in the standard counterfactual test. It must be a stand-alone test, as it makes different evidential demands of the court. The possibility of the Supreme Court's importation of material facilitation as a stand-alone test was, however, foreclosed by the emphatic rejection by the Court of the specific importation of the Melway test into NZ law. The Court considered that test to simply be a variant on the basic comparative exercise, and therefore not a departure from the counterfactual expressed in Queensland Wire.

[186] *Turners & Growers Ltd v Zespri Group Ltd* [2011] 13 TCLR 286 (HC).

[187] *Melway Publishing Pty Limited v Robert Hicks Limited ('Melway')*, above n 111.

limited jurisprudence available in NZ suggests a more holistic approach. Thus, in *Zespri*, the Court applied the counterfactual test, and then applied the 'material facilitation' test as a "cross check".[189] The material facilitation test is "just another way of thinking about the problem".[190]

The broadening of the counterfactual to include situations in which conduct was materially facilitated by market power may possibly result in more successful prosecutions by the Commerce Commission insofar as it represents a broadening of the situations that may result in liability. This is just as true of refusals to licence. However, while the dearth of successful prosecutions of alleged s 36 breaches in NZ may lead one to consider this increased inclusivity a leap forward, there is not necessarily an economic basis for such a contention. As evident from *Safeway*, the material facilitation test is just as focused on the purpose on the conduct, rather than the effect, and therefore the success or failure of a prosecution need not necessarily be tied to the economic harm to the market of the defendant's conduct. This is exacerbated by the following issue: the Court's rather flippant attitude to economic analysis.

(b) The Supreme Court's eschewal of economic analysis

As regards the input of economic analysis into section 36 cases, the court in *the 0867* case held:[191]

> Economic analysis may be helpful in construing the hypothetically competitive market and to point to those factors which would influence the firm in the market. But it must always be remembered that the 'use' question is a practical one, concerned with what the firm in question would or would not have done in the hypothetically competitive market. As the question is one of rational commercial judgment, the test should be what the otherwise dominant firm would, rather than could, do in the hypothetical market.

The distinct lack of enthusiasm shown by the Supreme Court for economic analysis has been argued to sit at odds with its exclusive preference for the counterfactual test.[192] Without

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188 *Australian Competition and Consumer Commission v Australian Safeway Stores Pty Ltd*, above n 113, used the 'materially facilitated' test; *NT Power Generation Pty Ltd v Power and Water Authority*, above n 79, used the standard counterfactual, etc.

189 *Turners & Growers Ltd v Zespri Group Ltd*, above n 186, at [344].

190 Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics*, above n 12, at 186.

191 *Commerce Commission v Telecom Corporation of New Zealand Limited* ('0867'), above n 174, at [35].

192 Eagles and Longdin *Refusals to Licence Intellectual Property: Testing the Limits of Law and Economics*, above n 12, at 192.

economic analysis, the counterfactual is effectively reduced to a "judicial stab in the dark"[193] as to the dominant firm's probable response. This approach is inconsistent with Australian authorities such as *Melway,* in which the court held that the question of how a firm would act without market power would involve economic analysis, and that such an approach was consistent with the purposes of s 46 Trade Practices Act. This is especially true given the *Melway* court's contention that absence of a substantial degree of market power (the counterfactual scenario) does not assume the presence of a neoclassical model of perfect competition, but simply the existence of enough competition to remove the substantial market power of the defendant.[194] One cannot therefore turn to the theoretical economics of perfect competition to determine whether the defendant would act in a certain way. Case-by-case economics is required. The Supreme Court in the *0867* case demonstrably agreed with the *Melway* court's suggestion that the counterfactual does not posit perfect competition, in its proposition that an asymmetric duopoly is sufficient to remove the defendant's market power.[195] It seems not, however, to agree that this fact necessitates a closer affinity for empiricism.

In *Melway*, empirical analysis was not needed, because the defendant had engaged in the same conduct before attaining market power as it did after. However, in the majority of cases where such helpful indications are not given, it will be necessary to construe a hypothetical scenario in order to consider how a firm would act. This dissertation contends that the *Melway* court is correct insofar as it asserts that in the majority of cases economic analysis will be necessary in order to elevate the counterfactual above mere judicial speculation.

This is especially true of cases involving IP. As this dissertation has attempted to show, intellectual property rights occupy an often nebulous position in both economics and the law. The extent to which they incentivise innovation is highly contested. Their ideological justifications are often confused, and their intangibility has facilitated unchecked expansion of their scope and duration,[196] which is arguably becoming increasingly disproportionate and

[193] At 192.
[194] *Melway Publishing Pty Limited v Robert Hicks Limited ('Melway')*, above n 111, at [52].
[195] *Commerce Commission v Telecom Corporation of New Zealand Limited* ('0867'), above n 174, at [35].
[196] Gold argues that the intangibility of IP rights make their legal boundaries inherently fuzzy. He contrast them to physical property, claiming that unlike a table, there is no objective means of delineating the boundaries of a knowledge asset. See Gold, above n 26, at 396.

superfluous to their purpose.[197] Mere presumptions and a retreat to "commercial judgment" cannot be the right answer within a doctrine that lies so deeply within the penumbra of economic uncertainty, and varies so much between cases. Nor does the fact that IP's benefits and detriments are difficult to pin down *in the abstract* mean that empirical economic analysis cannot, and should not, be attempted *case by case*. IP represents an area in which the answer to economic questions of benefit or detriment are very frequently 'it depends'. There cannot therefore be any substitute for empirical analysis.

(c) The difficulties in construing the counterfactual

While this criticism is not specific to the *Telecom* counterfactual, it is nonetheless a significant weakness that must be addressed. Construing the counterfactual is a notoriously difficult exercise.[198] It is often unclear how the counterfactual market should be structured, and exactly where the defendant's market power truly lay.

Such problems can become even more acute when IP is in issue. Consider for example, the case of *Community v International Business Machines.*[199] IBM had produced a computer, the internal specifications of which were protected by design patents. Firms sought to produce peripherals for the computers such as hard drives and printers, and therefore required the design specifications in order to make such peripherals compatible. IBM wished to preserve the peripherals market for itself, in order to recoup R&D expenditure, and refused to release such specifications, relying on its intellectual property rights. In return for the Commission of European Communities refraining from taking legal action, IBM agreed to release such designs.

It is useful to apply NZ law to the same facts. Assuming IBM has a substantial degree of market power, how does one construe the counterfactual? If one assumes the existence of an asymmetric duopoly, the result is IBM, with a design patent over a computer, and a rival X, offering a broadly substitutable computer. This effectively removes IBM's market power in the computer market. It does not however affect the downstream peripherals market. IBM would retain its design patent, and would therefore retain a monopoly over a peripherals

[197] Scassa argues that this expansion is achieved in two ways: First, in the increasing overlap between patent and trade-marks, and between copyright and trade-marks; Second in the increasingly successful exploitation of weak or uncertain IP rights. See Teresa Scassa "Extension of Intellectual Property Rights" in Marcel Boyer, Michael Trebilcock and David Vaver (eds) *Competition Policy and Intellectual Property* (Irwin Law Inc, Toronto, 2009) 17 at 18.
[198] Veljanovski, above n 175, at 188.
[199] *Community v International Business Machines*, above n 4.

market that is potentially hugely profitable, given there are only two firms in the hypothetical market. As a matter of "commercial judgment" therefore, it could not rationally be proposed that IBM would not have refused to licence its IP, or that its refusal was facilitated by market power. Certainly the refusal was facilitated by its IP monopoly, but as this dissertation has already discussed, that monopoly is not synonymous with market power. IBM's conduct would be excluded from the ambit of s 36, despite its having leveraged a monopoly over the market for IBM peripherals, and despite there having been absolutely no economic enquiry into whether IBM's refusal was at all related to incentives to innovate.[200]

It may also be the case that a court poses the counterfactual by hypothetically removing IBM's design rights themselves. This would not be as perspicacious a decision, given the often tenuous link between IP rights and market power. Statements such as that made by the Court in *NT Power* however, that IP rights very often confer market power,[201] may suggest that such a construal is not impossible. If this hypothetical was posed however, the 'problem' is defined away. If IBM possesses no design patents to protect its computers from copying, no competitors in the peripherals market would need to request the release of such information at all.

A different result may potentially be reached if one was to assume that peripherals technology is sufficiently cross-substitutable that peripherals designed for IBM's hypothetical rival could also be used on IBM computers. If this was the case, there would be little incentive for IBM to refuse to licence its IP, as such a refusal would not preserve the secondary market, and s 36 may well be breached. This counterfactual requires hypotheses regarding not only the state of the primary market, but also the secondary market. Even if one contended that the certainty of such hypotheticals could be increased through expert testimony regarding the possibility or likelihood of cross-substitutable peripherals (analysis which even a court concerned with "commercial judgment" would surely welcome),[202] such testimony will by no means always be forthcoming. In the case of IBM, it had produced a new kind of machine, distinguishable from the minicomputers that dominated the 1970s. In the face of such new technology, it may not be possible to predict with any certainty the

[200] Jeremy Thorpe argues that an outcome roughly equivalent to the one hypothesised above for the NZ context, would be reached in Australia. See Jeremy Thorpe "In Defence of Intellectual Property Tie-Ins" 8 Corp & Bus L J 81 1995 at 88.
[201] *NT Power Generation Pty Ltd v Power and Water Authority*, above n 79, at [125].
[202] The Court in *Telecom* noted that economic analysis would be useful in construing the hypothetical market. See *Commerce Commission v Telecom Corporation of New Zealand Limited* ('0867'), above n 174, at [35].

degree to which hypothetical peripherals to hypothetical competing computers are able to be cross-substituted with existing products.

Therefore, while of course the difficulties in construing the counterfactual are by no means exclusive to IP rights, the innovative and progressive nature of IP is such that hypotheticals become even more difficult. When one adds to this the fact that IP rights, like technological ties, have the potential to create isolated secondary markets with monopolistic traits, and the fact that exploiting these markets will almost always represent sound “commercial judgment”, a simple ‘what-would-the-company-have-done?’ counterfactual is likely to be woefully under-inclusive of anticompetitive conduct. The lack of empirical analysis further means that one cannot always be consoled by the promise of dynamic benefits to offset static losses.

(d) What should be done?

In the face of the Supreme Court’s confirmation of the counterfactual test in *Telecom*, it is likely that statutory intervention is required in order to dislodge the current test.

There have been suggestions of statutory recognition of the *Melway* test, or at least clear judicial recognition of the test, in keeping with Australian law.[203] This dissertation would support such a clarification of the somewhat unclear expression of material facilitation found in *Telecom*. However, while the *Melway* test may be a valuable means of broadening the conduct caught by s 36, it arguably does not address the fundamental issue with the counterfactual test: that it is not sufficiently focused on the *effect* of a firm’s conduct.

In 1999, the Commerce (Control of Dominant Position) Amendment Bill was introduced to Parliament. The Bill would have introduced an ‘effects test’ for anticompetitive conduct to run in parallel with the current purpose test. The Bill was narrowly defeated by the opposing National Government. The greatest criticism of the test was its potential breadth. As this dissertation has suggested, much conduct that results in static losses (including the bestowal of IP rights) can yield dynamic efficiencies that more than offset short-term losses. By focusing solely on anticompetitive conduct therefore, the test runs the risk of discouraging vigorous competition.

[203] Rex Adhar “The Unfulfilled Promise of NZ’s Monopolisation Law” (2009) 16 Competition and Consumer Law Journal at 305.

This dissertation would suggest that such a weakness could be addressed by the adoption of a test akin to that found in *Microsoft*.[204] In that case, Microsoft was accused of abusing its monopoly position by engaging in certain anticompetitive behaviours, notably the bundling of Internet Explorer (a market in which Microsoft did not have a monopoly) with Microsoft Windows (a market in which Microsoft did). The U.S. Court of Appeals for the D.C. Circuit clearly outlined the elements for liability under the monopolisation section of the Sherman Act.[205] The test is as follows:[206]

1. The plaintiff must show that the defendant's conduct had anticompetitive effect, of the kind envisaged by the Sherman Act. This is damage to the competitive process itself, rather than to individual competitors.
2. If the plaintiff satisfies the court as to anticompetitive effect, the burden of proof shifts to the defendant to put a "procompetitive justification" for its conduct. The burden shifts back to the plaintiff to rebut the claim of procompetitive justification.
3. If the justification is unrebutted, the plaintiff must show that the anticompetitive effect complained of outweighs the procompetitive benefits. The court is responsible for balancing the claims, and is to focus on the effect of the conduct, rather than the intent.

The *Microsoft* test therefore focuses on effect, while leaving open the possibility of procompetitive justifications being brought. Dynamic efficiency need not suffer to the extent that it would have under the Commerce (Control of Dominant Position) Amendment Bill.

In the context of intellectual property, the test is an appealing one. It facilitates an economic inquiry into the extent to which a refusal to deal in IP is linked to efficiency, in a way that both the *Telecom* and *Melway* tests fail to do. Under the *Microsoft* test, it could easily be seen that in the above thought-exercise involving IBM, the fact that IBM would have refused to licence its IP would not absolve it of liability. It must show that such a refusal has procompetitive justifications, for example that it was necessary to incentivise innovation in the market.

It may be argued that this test would unfairly require IP-holders to re-justify the property rights that have been given to them by parliament. It would force them to proffer

[204] *United States v Microsoft Corp* 253 F 3d 34 (DC Cir, 2001).
[205] Sherman Antitrust Act 15 USC § 2.
[206] *United States v Microsoft Corp*, above n 204, at 58-59.

justifications for the exercise of a right that parliament has already said they could exercise. This argument may be met in several ways:

First, as has been argued in preceding chapters, IP rights should be, as far as possible, connected to their reasons for existing. That is to say, they should be given only as much deference as is required to incentivise innovation.

Second, the test need not be read as being overly intrusive into the statutorily-bestowed right possessed by the IP-holder. As has been argued in other jurisdictions, the mere exercise of an IP right is unlikely to be anticompetitive unless 'something more' is present, such as leveraging. Harm must be to the competitive process, not merely to a competitor. It will be recalled that this dissertation has already contended that some further evidence of anticompetitiveness or extension of market power is already required in New Zealand by s 36(3).

While other academics have expressed support for the evolution of this test, or at least one quite similar to it,[207] in the courts, this dissertation would contend that the *Telecom* case has made any judicial evolution of the counterfactual test unlikely in the short or medium term. It is no longer reasonable to hope that New Zealand courts will take a markedly different approach to that laid down by the Privy Council in *Telecom v Clear*. If the proposed test is to come into existence therefore, it is Parliament that must give it life.

[207] See, for example, Adhar "The Unfulfilled Promise of NZ's Monopolisation Law", above n 203, at 302.

VI. Conclusions and Recommendations

Cognizant of the fact that refusals to licence comprise a miniscule part of potentially anticompetitive behaviour, it is prudent to display a degree of caution in making recommendations for legislative change. To advocate the abolition or amendment of the law, one must surely consider that law, and its purported effects, in a holistic manner that is beyond the scope of this work. This limitation having been acknowledged however, certain concluding observations may be made:

1. Intellectual property is possessed of certain characteristics that make it particularly resistant to meaningful *a priori* delineation of the scope of the right. Rights are fuzzy, intangible, and ever expanding. Further, IP's often uneconomic pedigree has led to a system that aspires to certain economic goals, while lacking the nuance of form required to achieve them. Competition law therefore provides a valuable means of redressing this balance *ex post*.
2. Courts should not obstruct the ability of competition law to cut across IP rights by adopting Lockean conceptions of property when delineating the boundaries of IP rights. It should be remembered that the underlying justification for IP rights is the incentivising of innovation. This is (at least aspirationally) a pragmatic, economics-based policy decision, and IP rights can therefore be tempered or limited as is economically required.
3. The counterfactual test as expressed in the *Telecom (0867)* case, while arguably broadening the ambit of the test, has not addressed the fundamental weakness of the counterfactual test: its focus on purpose rather than effect. This weakness is exacerbated by an eschewal of economic analysis, and is brought into stark relief by the issue of refusals to licence, which issue is so fundamentally based in economics. The adoption of an approach akin to the *Microsoft* test would be welcomed.
4. Unhelpful concepts such as essential facilities should continue to be resisted in NZ in favour of an approach in line with *Commerce Commission v Telecom Corp*, which would find an obligation to supply in those cases where the counterfactual is breached. The economic logic of this approach is contingent however upon the economic logic of the counterfactual being similarly improved through adoption of the *Microsoft* test.
5. Sections 36(3) and 45 of the Commerce Act 1986 contribute little to resolution of the refusals to licence question, and provide certain unwelcome obstructions by

prioritising form over effect. If they were removed, IP would continue to be subject to competition law scrutiny, but without such distracting presumptions.

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