ANTITRUST LAW VERSUS INTELLECTUAL PROPERTY LAW: WHERE IS THE INTERFACE?

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A paper given at a Joint Conference of the Australian and New Zealand Institute of Patent Attorneys held in Queenstown, New Zealand; March 27-30, 1988. This paper is written as at 31 December 1987. The word "interface" has a number of meanings. For purposes of this paper, the most appropriate meaning is "the point or area at which any two systems or disciplines interact" this being one of the meanings ascribed to the term by the Macquarie Dictionary. The term "antitrust" law is the American term for "competition" law. The two terms are used interchangeably in this paper. When referring in this paper generically to both section 46 of the Australian Trade Practices Act (covering "Misuse of Market Power") and section 36 of the New Zealand Commerce Act (covering "Use of a dominant position in a market") the conduct is described as being a "misuse of market power" notwithstanding the terminological inexactitude involved in such description.

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[AUTHORS NOTE: This paper was delivered prior to the Australian High Court decision in Queensland Wire v BHP *(Judgment 8 February 1989). Some of the comments in the paper require modification in light of this case. The judgment is not able to be discussed in this paper but AUTHOR'S NOTES have been added to those parts of the paper which may be most affected by it].*

I INTRODUCTORY OBSERVATIONS

In 1977 I chanced to stray into the competition/intellectual property interface when I presented a paper entitled "*Patents and Trade Practices — Competition Policies in Conflict?*" at that year's Annual Congress of the Licensing Executives' Society[1]. In the same year, I gave a lecture at Monash University under the title "*Intellectual Property and Monopolization in Australia*"[2]. In 1979, I had the honour to present a paper to the Sixtieth Annual Convention of the Institute of Patent Attorneys of Australia on the topic "*Distributorships, Franchising and Non Patent Licensing — Developments 1974-1978 under the Trade Practices Act*"[3].

1 This paper was subsequently republished in the *Australian Business Law Review* Vol.5 No.3 (Sept.1977) at pages 172 to 203.

2 This lecture was given on October 25, 1977 at the 1977 Intellectual Property (Copyright and Industrial Property) Lecture Series conducted by the Monash University Faculty of Law. The lecture was subsequently republished in *Management Forum* (University of New England) in two parts — Vol.4 No.1 (March 1978) pp.35-45; Vol.4 No.2 (June 1978) pp.104-120.

3 This paper was subsequently republished in *Management Forum* (University of New England) Vol.5 No.1 (March 1979) pp.48-64.

I was asked by your organisers to present this present paper on the basis that "It is now some time since you last spoke to our group and our members are no doubt ready to be re-educated on the law according to Pengilley"[4].

I make the above preliminary observations for a number of reasons, which are:

(a) To affirm that it is indeed "some time" (nine years) since I last spoke to your group. No-one and no topic, however, should be allowed to suffer over-exposure. I am honoured that your organisers should recall my last talk and invite me to speak again. Particularly is this so because I agree with your Conference promotional literature that Queenstown, New Zealand, which I have visited many times before, certainly has "some of the most charming scenery to be found anywhere in the world".

(b) To establish some credibility in the general area — an area which has been of considerable interest to me for quite some time.

(c) To lay the ground work for many of my conclusions. Your organisers have asked me to give you "the law according to Pengilley". This I willingly do. I do so because there is still very little Australian or New Zealand law directly in point. Although I believe that more precise conjecture is now possible than when the previous papers were written, most of one's conclusions must still be somewhat what your organisers have requested me to give — that is "the law according to Pengilley". I note from my 1977 paper, that I then observed that there were no relevant Australian Court decisions or Trade Practices Commission evaluations and "So I feel free to philosophize, and presumably can do so, without offending either the Australian judiciary or the Trade Practices Commission". There are now some cases but one is still called upon to do a good deal of philosophizing.

II Subject Matter of Paper

This is a conference of patent attorneys. It seems axiomatic therefore, that I should regard the term "Intellectual Property" as equating to "Patents" and I do so.

Having thus narrowed my subject matter, I believe that the following topics directly related to competition law and patent law are of greatest interest:

(a) (i) What is the general impact of those sections of competition law dealing with misuse of market power? (section 46 of the Australian Trade Practices Act and section 36 of the New Zealand Commerce Act).*

(ii) Does a patent holder necessarily possess market power?

(iii) How much power is needed to come within those sections dealing with misuse of market power?

(b) What are the duties of a party coming within the provisions of those sections dealing with market power? Is there, for example:

(i) a duty to deal?

(ii) a duty to pre-disclose new technology?

* As noted above, when I am referring generically to both section 46 of the Australian Trade Practices Act and section 36 of the New Zealand Commerce Act I will do so, notwithstanding the terminological inexactitude involved, by referring to the conduct involved as being a "misuse of market power".

4 Letter from Mr.Trevor N.Beadle of the Institute of Patent Attorneys of Australia to the writer dated 20 November 1987.

(c) What types of conduct are frequently alleged to be an improper exercise of patent power? Are they, or any of them, protected under the patent exemption provisions of the respective competition statutes?

III Be Aware of the Exocet We Do Not Here Discuss: The Recently Enacted Fair Trading Laws

In narrowing my topic in accordance with the foregoing comments, I am precluded from discussing what I really think will be the statute of greatest relevance in all dealings, including those of patent attorneys, in the near future. Further, it is probably one of the least known of all recent statutory enactments although it almost certainly constitutes one of the greatest changes in the law since the invention of the Chancellor's foot. I refer, of course, to Part V of the Australian Trade Practices Act (and particularly section 52 of that Act which deals with conduct in trade or commerce which is misleading or deceptive or likely to be so) and its New Zealand equivalent provisions in the Fair Trading Act (primarily section 9 of that Act). These sections affect all business and professional persons but because they have no direct impact specifically on patent law, I feel we must here pass them over. I make reference to them, however, because in Australia they are generally regarded as part of the competition law because they physically appear in the Trade Practices Act. In New Zealand law there is no such physical nexus, there being separate statutes for competition and consumer protection law.

However, I pass over the "fair trading laws" only after making the observation that they have resulted in a most dramatic reversal of the common law in relation to all dealings. The legislation applies not only to misrepresentations made to the public generally (eg. misleading advertising) but also to statements made in *inter partes* negotiations. The provisions can be used to upset all sorts of contracts and dealings previously inviolate as a matter of common law. It is essential that everyone have a basic knowledge of the effect of the provisions as they apply to virtually every contract entered into and virtually every negotiation related to such contracts.

So potentially devastating is this new barrage of remedies that I recently wrote an article on the subject and entitled it "*Section 52 of the Trade Practices Act — A Plaintiff's New Exocet?*"[5]. In that article I concluded that section 52 of the Australian Trade Practices Act (and by necessary corollary section 9 of the New Zealand Fair Trading Act) is indeed an Exocet.**

Since the misleading conduct provisions of our various laws do not have

** The essential features of an Exocet are that it is a weapon which has the capacity to sink enemy missile armed boats before they are near enough to launch their own attack; a weapon which is impervious to enemy electronic countermeasures; and a weapon which penetrates its target before the warhead explodes, thus causing maximum possible damage[6].

5 W.J. Pengilley: *"Section 52 of the Trade Practices Act: A Plaintiff's New Exocet?"* Australian Business Law Review Vol.15 No.4 (August 1987) pp.247-274. This article is the more memorable because it features, for the first time in any legal publication, a photograph of the Exocet and details of its performance characteristics. It should be noted that the French manufacturers of the Exocet have, in fact, utilised s.52 of the Australian Trade Practices Act with success (see *Aerospatiale Societe Nationale Industrielle* v. *Aerospatiale Helicopters Pty Ltd* (1986) A.T.P.R. para.40-100).

6 For performance characteristics of the Exocet see M.Taylor: *Missiles of the World*" (London 3rd Ed. 1980) pp.30-31; B.Gunston (ed.): *"Encyclopaedia of World Air Power"* (Sydney 1980) p.362; R.Bermen and B.Gunston: *"Rockets and Missiles of World War III"* (Sydney 1983).

direct relevance to patent law, I now pass them by with only the comments I have made. I believe, however, that no lawyer would be fulfilling the terms of his brief if he did not make reference to this matter when presenting a paper to a conference such as this. Especially is this so because the New Zealand Fair Trading Act is of comparatively recent origin (coming into operation only on 1 January 1987) and the de facto effect of the Australian legislation has been recently (late 1987) extended by "Cross Vesting" State Courts with jurisdiction in this area and by the various States passing their own Fair Trading legislation. This State legislation mirrors, and in some cases extends, the Federal legislation at the State level.

IV Basic Philosophical Approach of this Paper

1. *Personal philosophy*

One's conclusions in relation to the intellectual property/competition interface largely depend upon one's philosophical approach to the role of each set of laws. It is appropriate to state, up front, my views on this.

I believe that the framers of intellectual property legislation have seen it as being pro-competitive. The Trade Practices Act of Australia and the Commerce Act of New Zealand are both aimed at this same pro-competitive objective. The interface "problem" is not one caused by differing objectives but by the different means taken to achieve the same objective.

Intellectual property legislation aims to "protect" certain rights and to prevent others utilising such rights for a certain period. The argument is that such protection encourages innovation and, in the case of patent rights, encourages the disclosure to the public of such innovation. All this is said to have a pro-competitive dynamic effect. In the ultimate, this view is probably no better expressed than by Abraham Lincoln when he said "The patent system added the fuel of interest to the fire of genius". These words are in fact, engraved in stone over the portals of the old Patent Office in Washington D.C.

The Trade Practices Act and the Commerce Act on the other hand attempt to achieve the same pro-competitive end by breaking down restraints imposed by, or agreed to by, certain parties. Competition law works on the basis that the more innovative result is achieved by market forces freed of restriction.

Notwithstanding this similarity of objective, the practical reality of what people want to know is quite different. I have no doubt that the concern of my audience is the extent to which intellectual property laws can be exploited and the extent to which parties can be restricted without breaching the competition law. In other words, where is the interface? It is the approach of this paper to attempt to reach answers to these questions in various contexts.

I do not here engage in philosophical disputation as to the merits of intellectual property legislation. Patent laws in particular have been subject to considerable intellectual criticism[7]. But they remain. A paper at this Conference could contribute very little, if anything, to the debate as to the worth of patent

[7] Probably the most publicised Australasian criticism of the patent system is the report to T.D.Mandeville, D.M.Lamberton and E.J.Bishop of the University of Queensland published in April 1982.

This report was commissioned by the Industrial Property Advisory Committee which was established in 1978 by the Australian Government to advise on Australia's industrial laws and practices. The report concludes that there was "little room for doubt that the benefit — cost ratio (of the patent system) in Australia is negative or at very best, in balance".

laws in achieving their pro-competitive objects. I really have no great desire at all to join any of the sects doing battle for the soul of economics. I, therefore, choose to concentrate on those fields where I think I can contribute something, i.e. on the fields of actuality. I thus assume that the intellectual property laws will remain and that the legislatures of both Australia and New Zealand have enacted two sets of laws which can live together. The interpretation of each law must, therefore, acknowledge the needs of the other.

My own philosophical starting point is that intellectual property laws give no right to wholesale abuse of competition laws. Neither should the competition laws be looked upon as constituting the basis for the destruction of intellectial property laws.

I illustrate my philosophical premises by two United States sage-like sayings. In 1972, the United States Supreme Court was asked to decide on a conflict between personal liberties and property rights. In a judgment which can easily be applied to the antitrust/intellectual property debate, the court said: [8]

> The dichotomy between personal liberties and property rights is a false one. Property does not have rights. People have rights.

In a discussion of the competition/intellectual property interface, we should all carry this statement in the back of our minds. Whether we label something as a principle of "competition policy" or as "protection of property rights" we are really talking about people's rights. No pigeonholing characterisations should obscure this fundamental premise.

My approach, therefore, as to the extent to which intellectual property rights can be exploited is probably best illustrated by the 1912 *Bath Tub Trust* decision of the United States Supreme Court when it said: [9]

> Rights covered by patents are indeed very definite and extensive; but they do not give, any more than other rights, a universal licence against positive prohibition. (The Antitrust law) is a limitation of rights; rights which may be pushed to evil consequences and therefore restrained.

The reverse proposition is, of course, equally applicable. Competition law rights are also very extensive. But they do not give, any more than any other rights, the ability to invade and destroy equally important intellectual property rights specifically recognised by the legislature.

2. *Interface philosophy as legislatively expressed*

To a significant degree the above interface is mapped out by the legislature itself. Section 51(3)(a) of the Australian Trade Practices Act provides that, except in relation to section 46 (misuse of market power) or section 48 (resale price maintenance), a contravention of (the restrictive trade practices provisions of the legislation) shall not be taken to have been committed by reason of:

(i) a licence granted by the proprietor, licensee of owner of a patent . . . or by a person who has applied for a patent . . ., or
(ii) an assignment of a patent . . . or of the right to apply for a patent . . . to the extent that the condition relates to —
(iii) the invention to which the patent or application for a patent relates or

8 *Lynch* v. *Household Finance Corporation* (1972) 405 U.S. 538.
9 *Standard Sanitary Manufacturing Co.* v. *U.S.* (1912) 226 U.S. 20.

articles made by the use of that invention

(iv) . . .

(v) . . .

Section 45(1) of the New Zealand Commerce Act is expressed in many more words and is probably wider in its exemption than its Australian equivalent[10]. It states that nothing in (the restrictive trade practices provisions of the Act) except sections 36 (use of a dominant position in a market), 37 (resale price maintenance) and 38 (resale price maintenance by others) . . . applies

(a) To the entering into of a contract or arrangement or arriving at an understanding insofar as it contains a provision relating to the use, licence or assignment of rights under or existing by virtue of any . . . patent . . .; or

(b) To any act done to give effect to a provision of a contract, arrangement or understanding referred to in paragraph (a) of this subsection.

The New Zealand legislation elaborates upon the meaning of section 45(1) by an extensive statutory explanation in section 45(2). Section 45(2) provides that a provision relates to the use, licence or assignment of any rights under or existing by virtue of any patent if

— it controls the nature, territory, or period of the exercise of those rights or the type, quality or quantity of goods to which those rights relate; or

— it imposes restrictions for the purposes of protecting the interest of the owner, seller or licensor in a technically satisfactory exploitation of those rights; or

— it consists of an obligation on the part of the licensee of a party to the contract to exchange experience, or to grant licences for improvements in, or applied use of, an invention . . . insofar as the obligation is identical to an obligation of another party who is an owner or seller or licensor of those rights; or

— it consists of an obligation affecting competition in a market outside New Zealand which obligation does not remain in force beyond the expiration of those rights.

Leaving aside the provisions of the respective pieces of legislation in other than national markets (with which topic it is not intended to deal in this paper), the legislation of each country

— gives certain exemptions from competition law in respect of patents and activities related to them

— does not extend the competition exemption to resale price maintenance activities

— does not extend the competition exemption to the misuse of market power in Australia (Trade Practices Act section 46) or the use of a dominant

[10] I may not be correct in this generalisation. In a paper given in March 1987, Professor Ian Eagles of the University of Auckland commented:

> Whether subsection (2) is intended to expand or contract the protection by subsection (1) is far from clear. The uncertainty is compounded by a terminology which confuses effect and intention and what can only be described as bizarre form of punctuation.

I. Eagles: *"The Intellectual Property and the Commerce Act 1986"* — A Paper given to a Trade Practices Workshop conducted by the Centre for Commercial Law and Applied Legal Research and held at Auckland 20-22 March 1987 (at p.26).

position in a market in New Zealand (Commerce Act section 36). Section 36(2) of the New Zealand Act provides, however, that a party does not use a dominant position in a market for an improper purpose by reason only that such person enforces or seeks to enforce a right under any patent. The Australian Act is silent on this aspect though one might well think that the enforcement of a statutory right given in respect of intellectual property could hardly, of itself, be a misuse of market power.

The exempting provisions in the legislation of each country are not at all identical. Different results may well eventuate in each country from the same set of facts. For example, it may be argued in Australia that an agreement to restrict the number of articles to be produced (a quota restriction) is anticompetitive because pegged production levels render most price competition futile. It can similarly be argued that such a restriction is not exempted in Australia because it does not relate "to the invention . . . or articles made by use of the invention" (Trade Practices Act section 51(3)(a)(iii) — see above). Such an argument would appear to be difficult to run in New Zealand in the context of an alleged anticompetitive agreement because section 45(2)(a) of the Commerce Act specifically exempts agreements containing restrictions on the quantity of goods to which the patent relates.

It is obvious, however, that the chief problem in the intellectual property/competition interface arises in relation to misuses of market power — see section 46 of the Australian Trade Practices Act and section 36 of the New Zealand Commerce Act. This paper thus deals initially with this question. Other specific legislative provisions are also covered. These other provisions are also quite fundamental to a discussion of what a patent holder can and cannot do under competition law. Such provisions are not uniform between Australia and New Zealand — especially in relation to exclusive dealing where Australia has an extensive statutory code which New Zealand does not.

3. *Different results follow because the substantive Australian and New Zealand legislative provisions are quite different*

It is appropriate to note that different results may come about in each country not only because the patent exemption provisions of each are different (see above) but also because the substantive misuse of market power provisions are themselves quite different. Further there are differences in other aspects of the two pieces of legislation. As stated, Australia has an extensive statutory code covering exclusive dealing which is not duplicated in New Zealand. One effect of this is that "third line forcing" (dealt with later) is illegal *per se****** in Australia but not in New Zealand. Such different results can be highly important to patent holders. There is thus no necessary uniformity of result, as a matter of law entirely independent of any patent exemption question, between a result reached under the Australian legislation and a result reached under the New Zealand legislation.

The different legislative approaches as to the extent to which the exercise of market power should be permitted, the extent to which patents should

*** The term *per se* is one used in competition law to indicate an offence which is illegal if the relevant facts are proven. The plaintiff does not have to prove, in addition to the facts, that an anti-competitive result follows. Some commentators prefer to regard a *per se* offence as illegal because it is *deemed* anticompetitive. This is the rationale reached by judicial interpretation in the United States. In Australia and New Zealand such a rationale applies to the legislative treatment of some *per se* offences — notably price fixing.

be protected and the different approaches taken to other conduct are obviously illustrative of differences in philosophical approach to the same factual situation. Necessarily these differences of philosophical approach find their way into court cases and learned literature. In this general field, one cannot thus afford to be too dogmatic until blessed by a decision of an ultimate court of appeal. Neither Australia nor New Zealand is presently so blessed.

V WHAT IS THE GENERAL IMPACT OF THOSE SECTIONS OF COMPETITION LAW DEALING WITH MISUSE OF MARKET POWER (SECTION 46 OF THE AUSTRALIAN TRADE PRACTICES ACT AND SECTION 36 OF THE NEW ZEALAND COMMERCE ACT)?

1. *Overall Policy Differences between Australian and New Zealand Legislation*

As already stated, the Australian section 46 and the New Zealand section 36 are far from the same. The New Zealand legislation resembles the Australian legislation prior to its amendment in 1986. One of the avowed purposes of the Australian 1986 amendments was to make the section "more effective" because, as drafted pre-1986 it "proved of quite limited effectiveness"[11]. New Zealand did not follow the enthusiasm of the Australian legislators in this regard.

It is appropriate, therefore to note the chief differences between the Australian and New Zealand legislation. These differences are set out in Table I below:

TABLE I

DIFFERENCES BETWEEN AUSTRALIAN LEGISLATION (section 46 Trade Practices Act) AND NEW ZEALAND LEGISLATION (section 36 Commerce Act)

Australia	**New Zealand**
Trade Practices Act s.46	Commerce Act s.36
1. Title to Section is *"Misuse of Market Power"*	1. Title to Section is *"Use of a dominant position in a market"*
2. Applies if a corporation has *"a substantial degree of power in a market"*	2. Applies if a person has *"a dominant position in a market"*
3. Prohibits *taking advantage* of power for the purpose of effecting specified improper ends. [The relevant purpose may be one of several purposes so long as the improper purpose is a substantial purpose — s.4F]	3. Prohibits *using* a dominant position for the purpose of effecting certain improper ends. [The relevant purpose may be one of several purposes so long as the improper purpose is a substantial purpose — s.2(5)(b)]

11 See Hon.Lionel Bowen, Attorney-General of Australia — *Trade Practices Amendment Bill 1985 Second Reading Speech* (Parliamentary Debates (H.of R.) 9 October, 1985 p.1724).

4. The improper ends referred to in 3 above are: — eliminating or substantially damaging a competitor in any market — preventing the entry of a person into any market; or — deterring or preventing a person from engaging in competitive conduct in any market	4. The improper ends referred to in 3 above are: — eliminating any person from any market — restricting the entry of any person into any market; or — preventing or deterring any person from engaging in competitive conduct in any market
5. The only exemption of patents from the competition provisions of the Act is the general exemption conferred in s.51(3)(a) [see Part IV earlier]. This provides no patent exemption from s.46 re misuse of market power.	5. The exemption for patents in s.45 [see Part IV earlier] does not exempt from abuse of a dominant position. However, s.36 has its own specific exempting subsection re patents. This states that a person does not use a dominant position in a market for an improper purpose "by reason only that the person enforces or seeks to enforce any right under or existing by virtue of any . . . patent".

2. *The importance of "The Market" in relation to Misuse of Market Power*
(a) What is "the market"?

Both the Australian and New Zealand legislation operate in relation to "a market". When we talk about a monopoly or its various derivatives such as "market dominance" or "market power" we should be quite clear to speak in economic terms and not in pleasingly semantic, but often highly inaccurate, epithets.

The concept of market definition has occupied numerous court cases but it is fair to say that the Australasian *cause celebre* is the Determination of the Australian Trade Practices Tribunal in *Queensland Co-Operative Milling Association ["QCMA"]*[12]. This precedent decision, since widely followed in both Australia and New Zealand, still merits citation in full as to the market issue. On this aspect, the Tribunal stated:

> Before giving our reasons we should explain our understanding of the market concept, and of the relationship between "markets" and "sub-markets". We take the concept of a market to be basically a very simple idea. A market is the area of close competition between firms or, putting it a little differently, the field of rivalry between them. (If there is no close competition there is of course a monopolistic market). Within the bounds of a market there is substitution — substitution between one product and another, and between one source of supply and another, in response to changing prices. So a market is the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive. Let us suppose that the price of one supplier goes up. Then on the demand side buyers may switch their patronage from this firm's product to another, or from this geographic source of supply to another. As well,

12 Re *Queensland Co-Operative Milling Association* ("Q.C.M.A.") (1976) A.T.P.R. para.40-012 (Australian Trade Practices Tribunal). This decision has been frequently followed in Australia (see, for example, the recent decision in *Mark Lyons Pty Limited* v. *Bursill Sportsgear Pty Limited* (1987) A.T.P.R. para.40-809 where the citation in the text set out in full and followed). It has also been followed by the New Zealand High Court — see *Air New Zealand* v. *The Commerce Commission* (1985) 2 N.Z.L.R. 383, 345.

on the supply side, sellers can adjust their production plans, substituting one product for another in their output mix, or substituting one geographic source of supply for another. Whether such substitution is feasible or likely depends ultimately on customer attitudes, technology, distance, and cost and price incentives.

It is the possibilities of such substitution which set the limits upon a firm's ability to "give less and charge more". Accordingly, in determining the outer boundaries of the market we ask a quite simple but fundamental question: If the firm were to "give less and charge more" would there be, to put the matter colloquially, much of a reaction? And if so, from whom? In the language of economics the question is this: From which products and which activities could we expect a relatively high demand or supply response to price change i.e. a relatively high cross-elasticity of demand or cross-elasticity of supply?

It is thus immediately obvious that a monopoly of a particular product — or even a monopoly of a particular process — may confer no market power at all. If I have a patent on a bottle making process, for example, it is of little use (assuming it to be the case) if processors will turn to cans or cartons should I seek to exploit my so called "monopoly" by increasing royalties beyond those which the processors might reasonably be prepared to pay.

There are some early Australian decisions[13] which have tended to say that markets can be defined in very narrow terms. In *Ira Berk*[14], for example, the relevant market was found to be Datsun cars in the Gold Coast area. However, decisions of this nature can no longer be regarded as either persuasive or logical. In *Mark Lyons* v.*Bursill*[15], one of the latest Australian authorities in relation to section 46, Mr.Justice Wilcox in reviewing *Ira Berk*, stated as follows:

> . . . there will always be a question of fact whether the relevant market is confined to a single product or brand of products. The test is substitutability. There may be cases where a particular product, or brand of products, is so distinctive that no other product or brand is seen by consumers as a possible substitute. In such a case the "market" is constituted by the trade in that product or brand of products. Perhaps more frequently other products or brands present realistic alternatives; in which case they also will be within the relevant market.

It is thus of fundamental importance that everybody, whether of the so called "pro-competition" camp or "pro-patent" camp stops talking about patents conferring "a monopoly". This is a classic case of one word being used to mean both chalk and cheese. A monopoly over the process of manufacture of a product says nothing whatsoever about the state of the market in which that product, or the process which leads to its production, competes.

True it is that basic process patents can confer substantial market monopoly. But this conclusion by no means follows axiomatically, as is often so readily assumed.

(b) "The Market" and Semantics

A significant problem in assessing patents in a market context is that of semantics. Until we solve this problem, many of the misconceptions by which a patent "monopoly" and a market "monopoly" are equated will continue. It is words, not logic or economic equations, which make people act. Words motivate political and social attitudes and (dare one say it?) even the attitudes of economists. The cool insights of cerebral man are, of course, indispensable

13 Notably *Top Performance Motors Pty Limited* v. *Ira Berk (Queensland) Pty Ltd* (1975) A.T.P.R. para.40-004.

14 n.13 above.

15 *Mark Lyons* v. *Bursill* n.12 above.

to the advancement of mankind but they do not create revolutions, even intellectual ones. It is words which motivate! So let us fix up the terminology and maybe the other confusions will also be solved as a result.

I strongly urge a concerted effort by Patent Attorneys to bring Dr. Neville Norman's term "monokat" into general use as a word to describe accurately the position of a patent holder[16]. Norman argues that the word "monopoly" (which comes from two Greek words meaning sole seller) can be applied only in the context of an economic market, complete with the economic criteria involving substitutable products. Patent holders, he argues, are more aptly described by the word "monokat" — a coined word of his own which has, in my view, high semantic appeal. Norman says that the word "monokat" can be used to describe a person having certain property rights at law that give trading advantages but which do not guarantee, and in fact seldom actually confer, market monopoly power.

I say no more on the question of market. Suffice it to reiterate that a patent may well give no market power. A market analysis has to be conducted. It may be (and is generally likely to be) that, as a result of this analysis, the patent holder comes nowhere near the relevant position of market power which brings into effect the provisions of competition law impinging upon his freedom of action. I hasten to add that probably lawyers are the hardest people to convince on this quite fundamental issue — and this is so even though the case law clearly supports the point of view I have set out.

3. *How much market power is needed before a patent holder comes within the sections of the respective Competition Statutes?*

(a) General comments and conclusions in relation to the New Zealand Commerce Act — section 36

There are a number of United States cases which state that a fifty percent market share is necessary before section 2 of the United States Sherman Act (dealing with monopolization) will be triggered. This seems to be the minimum threshold which United States courts will take as giving the power to control prices and exclude entry. A twenty to thirty percent market share has generally been held to be inadequate market power for section 2 monopolization purposes[17]. This rough guideline would also appear to accord with the percentage share needed to "dominate" a market, as determined in the *Ansett—Avis* decision in the Federal Court of Australia[18]. It is perhaps of further relevance to note that the Australian Trade Practices Commission's Merger

16 See N.Norman: *"Economics of Patents"* — "Les Nouvelles" (Journal of the Licensing Executives Society) Vol.XVIII No.3 — Sept. 1983 p.193.

17 See W.J.Pengilley — *"Lowering the Monopoly Power Threshold: An evaluation of the Australian Monopolization Amendments and their likely results"* Sydney Law Review Vol.11 no.2 (March 1987) pp.196-229. Specific authority for the propositions put in the text is to be found at pp.199-200 and cases cited at footnotes 7 to 11. As in all things in the trade practices world, the 50% market share rule is not without its exceptions. The United States Second Circuit has said that a party may have monopoly power with less than a 50% market share (*Haydn Publishing Co.* v. *Cox Broadcasting Co.* 730 F. 2d at 69 n.7). In one recent case, a 25% share was held adequate where the conduct involved was "wilful" (*Energex Lighting* v. *N.A.P.L.C.* 1987 — 1 Trade Cases para.67481) but this seems to be somewhat contrary to general authority.

18 *Trade Practices Commission* v. *Ansett Transport Industries (Operations) Pty Ltd* (1978) A.T.P.R. para.40-071. In this case a 43-46 per cent market share was held not to constitute market dominance. Note, however, that this conclusion must be read in conjunction with behavioural evidence given in the case which would also negative a conclusion as to dominance.

Guidelines (the Australian merger section having a "dominance" test of illegality) states that dominance will basically be considered to exist only where an entity has forty-five per cent or more of the market and exceeds the market share of its nearest competitor by fifteen per cent or more[19].

The conclusion, therefore, is that section 36 of the New Zealand Commerce Act, which requires a dominant position in order to trigger its operation, probably is not infringed unless a forty-five to fifty per cent market share is held.

(b) Comments in relation to the Australian Trade Practices Act — section 46

The situation in Australia is more difficult. Prior to 1 June 1986, a dominant position was required and so the forty-five to fifty per cent market share analysis set out above was applicable. However, a conscious decision was made to amend the Act with effect from 1 June 1986 and to lower the threshold of market power necessary to activate section 46. The stated intent of this lowering of the threshold was

— to make the section of greater utility as the prior high threshold had limited its effectiveness; and
— to provide that the section should apply to oligopolies in the market and, in some cases, to firms in even less concentrated markets[20].

As a result of this governmental decision, all that is now required in Australia to trigger section 46 is a "substantial degree of power in a market". According to the Parliamentary Papers relating to the 1986 amendments[21], "substantial" is intended to signify "large or weighty" or "considerable, solid or big" but is not intended to require the high degree of market power connoted by dominance or by having the power to "determine" the prices of a substantial part of the goods in a market.

Only one case in Australia to date has considered in detail the effect of the post-1986 lowered threshold. This is *Lyons* v. *Bursill*[22], decided in August 1987. In that case, Mr.Justice Wilcox cited prior Federal Court authority to the effect that the word "substantial" has been said to be not only not susceptible of ambiguity but is, indeed, "a word calculated to conceal a lack of precision"[23]. His Honour noted the legislative policy change in 1986. He was thus prepared to find a thirty per cent share of the Australian ski boot market was enough to bring Bursill Sportsgear within the ambit of section 46.

No doubt the *Mark Lyons* v. *Bursill Case* is an example of the effect of the 1986 reduced threshold. It should not be taken as axiomatic, however, that a thirty per cent share will trigger the operation of section 46 of the Australian Act. Of critical importance to his Honour's evaluation of the case was the particular position of Bursill in the Australian ski boot market. The Nordica boot supplied by it was widely regarded as the market leader in

19 See *Australian Trade Practices Commission Merger Guidelines* — Reported at Vol.2 Australian Trade Practices Reporter p.60, 651. The statement in the text is generality only and for more specificity the Guideline itself, comprising some 19 pages of the A.T.P.R., should be read.

20 See Parliamentary *Second Reading Speech* (n.11) and *Parliamentary Explanatory Memorandum to Trade Practices Amendment Bill 1985.*

21 n.20.

22 n.12.

23 Deane J. in *Tillmans Butcheries Pty Limited* v. *The Australian Meat Industry Employees Union* (1979) A.T.P.R. para.40-1138. For other authorities on the meaning of "substantial" see *Mark Lyons* v. *Bursill* (n.12) at p.48799.

terms of innovative ideas. Further, evidence was given and accepted that ninety per cent of Australian retailers found it necessary to stock the Nordica boot. These facts may well not apply in all cases where there is a thirty per cent, or even greater market share.

It remains but to be noted that markets, whilst generally broadly defined — and becoming even more so because of increasing consumer mobility — can nonetheless, in appropriate cases, be quite local. They can be local because of a number of factors, the chief one usually being the high cost of transportation of the product involved relevant to its value. United States Courts have held that predatory conduct classically occurs in local markets[24]. Both the Federal Court of Australia[25] and the Australian Trade Practices Commission[26] have found local markets to be the applicable relevant markets in various decisions.

Patent market power is more likely to occur in a broad geographic market than in a local one. However, the possibility of misuse of power in quite confined local markets must not be overlooked.

4. *A summary of the observations in Part V of this paper*

From what has been said in this part, the following conclusions follow:

(a) The New Zealand and Australian statutes are different. The New Zealand

24 *Moore* v. *Meads Fine Bread Co.* 1954 Trade Cases para.67906 (U.S. Sup.Ct.); 348 U.S. 115 (1954); *Maryland Baking Co.* v. *F.T.C.* 1957 Trade Cases para.68681 (4 C.C.A.); *Atlas Building Products Co.* v. *Diamond Block & Gravel Co.* 1959 Trade Cases para.69448 (10 C.C.A.); *E.B.Muller & Co.* v. *F.T.C.* 1944 Trade Cases para.57231; *Hardwick* v. *Nu Way Oil Co.* 1978-1 Trade Cases para.61909. (Subsidising price cutting in one service station from profits in another described as "a classic claim of discriminatory price cutting"). In *O'Hommel* v. *Ferro Corp.* 1981-2 Trade Cases para.64264 geographic price discrimination was said to be "the main evil" at which price discrimination was aimed. These cases occurred in a price discrimination context. There is no price discrimination law in New Zealand although there is in Australia (s.49 of the Trade Practices Act). This does not mean that the conduct in the cases or the market definition is irrelevant to New Zealand, however. It can be argued that price discrimination is merely one more form of misuse of market power and the *Blunt Committee* (Small Business Consultative Committee Report (1979) at paras.9.24 and 10.110 to 10.111) so argued.

In the United States it has been held that price discrimination law and monopolization under s.2 of the Sherman Act "are directed at the same economic evil and have the same substantive content". (*D.E.Rogers Associates* v. *Gardner-Denver Co.* 1983-2 Trade Cases para.65668 (6 C.C.A.)). For a case involving a "bottleneck monopoly" (see Part X and text relating relevant to n.80) see *Hecht* v. *Pro Football League* (1977) 570 F.R. 2nd 982 — relevant facility was the stadium in Washington D.C.

25 *Cool & Sons Pty Ltd* v. *O'Brien Glass Industries* 1081 A.T.P.R. paras.40-220, 40-260; *O'Brien Glass Industries Ltd* v. *Cool & Sons Pty Ltd* 1983 A.T.P.R. para.40-376 — market was Wagga Wagga and an area of 50 miles from this city; *Ira Berk* (n.13) — geographic market was the Gold Coast.

26 E.g. *Bass Bakery* 1974-5 A.T.P.R. (Com.) 8805 — "the area around Smithtown"; *S.E.Dickens Pty Ltd* 1974-5 A.T.P.R. (Com.) 8845 — "Traralgon"; *Dickens Pty Ltd* 1974-5 A.T.P.R. (Com.) 8845 — "Warragul"; *Pioneer Concrete Services* 1974-5 A.T.P.R. (Com.) 8830 — "Wagga market for sand and aggregate"; *Mayne Nickless Ltd* 1974-5 A.T.P.R. (Com.) 8847 — "road transport between Melbourne and the Latrobe Valley"; *Allen Taylor* 1976-7 A.T.P.R. (Com.) 16123 — "North Coast log market"; *Austral Bakeries* 1976-7 A.T.P.R. (Com.) 16104 — "Bread market within 30 miles of Geelong"; *Darwin Cinemas* 1976-7 A.T.P.R. (Com.) 16127 — "Darwin"; *Derby Meat Processing* 1976-7 A.T.P.R. (Com.) 16101 — *inter alia* "West Kimberleys"; *Ensign Holdings* 1976-7 A.T.P.R. (Com.) 16164 — "Albury and a radius of about 150 km"; *Ensign Holdings* 1976-7 A.T.P.R. (Com.) 16170 — "primarily the Albury market"; *Farley & Lewers* 1975-6 A.T.P.R. (Com.) 16110 — "Gold Coast area"; *S.E.Dickens* 1975-6 A.T.P.R. (Com.) 16138 — "Geelong and possibly only its inner suburbs"; *Pioneer Concrete (N.S.W.) Pty Ltd* 1975-6 A.T.P.R. (Com.) 16164 — "Moree"; 1975-6 A.T.P.R. (Com.) 16165 — "Young".

statute is akin to that in Australia prior to the 1986 Amendments. In 1986, Australia lowered its misuse of power threshold. The legal effect of the same factual circumstances will not necessarily be the same in both Australia and New Zealand.

(b) A patent holder does not necessarily have market power by virtue of his patent. The term "monopoly" is badly used in this discussion because it has a variety of meanings. This writer suggests a concerted effort to bring Dr.Norman's coined Greek word "monokat" into vogue.

(c) A forty-five to fifty per cent share is probably required to activate section 36 in New Zealand. In at least one Australian case, a thirty per cent share was enough. This is because of the lower Australian threshold. It should also be remembered that markets may be local because of the operation of such factors as transport constraints though any abuse of market power by virtue of a patent holding is likely to be in a more broadly defined geographic market than the local one.

VI WHAT ARE THE DUTIES OF A PARTY COMING WITHIN THE RELEVANT SECTIONS DEALING WITH MARKET POWER?

Traditional discussions of the concept of misuse of market power or of the use of a dominant market position tend to begin with an analysis of how the party having the relevant market power has to be kind to competitors. I would like to reverse this approach and, instead, map out those areas in which a party with market power may act in accordance with his own decision, and thus, quite frequently, with total disregard for the desires of competitors. It is just as important to know what does not infringe the legislation as to know that does. Because of a concentration in most commentaries on what does infringe the legislation, a quite extreme view exists in the minds of many as to the extent to which a person having market power is prevented from acting in accordance with his own decisions as to what is in his own best interests.

I reiterate what is said in Part V of this paper. Section 46 of the Australian Act and section 36 of the New Zealand Act only apply if the relevant market power *in an economic sense* is possessed. The mere fact of holding a patent does not of itself bring about this result.

1. *United States Holdings*

I start the analysis of the liberties available to a party possessing market power with a discussion of relevant principles which can be gathered from United States decisions.

There have been a number of United States cases in which monopolization has been alleged but not found by the courts. Courts have utilised a type of "rule of reason" to allow legitimate conduct and thus allow a defendant to invoke "business justification" for what he has done,

Some of the more relevant principles which have been established in this area are as follows:

(a) A party does not have to pre-disclose technology to a competitor. This appears to have been definitively decided in the *Berkey-Kodak Case*[27] in which the Second Circuit Court of Appeals said:

[27] *Berkey Photo* v. *Eastman Kodak* 1979-1 Trade Cases para.62718 (2nd Cir.); see also *Foremost Pro Colour* v. *Eastman Kodak 1983* — 1 Trade Cases para.65239 (9th Cir.).

> Withholding from others advance knowledge of one's new products . . . ordinarily constitutes valid competitive conduct. Because . . . a monopolist is permitted, and indeed encouraged . . . to compete aggressively on the merits, any success that it may achieve through the process of invention and innovation is clearly tolerated by the antitrust laws.

(b) Similarly a monopolist has the right to redesign its equipment and has no duty to help peripheral equipment manufacturers survive or expand[28].

(c) Price reductions to meet competition do not of themselves constitute predatory pricing and are entirely proper. Direct evidence of intent to vanquish a rival in an honest competitive struggle does not show an antitrust violation in the absence of predation[29]. Indeed, non-predatory price reductions do not violate the Sherman Act because this "is, in fact, the result which the antitrust laws were designed to accomplish"[30].

(d) The act of refusing credit is not monopolization conduct if it constitutes an act of ordinary commercial conduct based on *bona fide* business jugdment[31].

(e) Section 2 of the Sherman Act does not forbid a monopolist setting profit maximising prices. Such conduct does not violate the antitrust laws but rather is "the normal rational response of a business . . . seeking to maximise profits sales or revenues". Setting a high price is not in itself anticompetitive[32].

(f) "Acts which are ordinary business practices typical of those used in a competitive market do not constitute anticompetitive conduct violative of Section 2. The exercise of business judgment cannot be found to be anticompetitive. To be labelled anticompetitive the conduct must be such that its anticipated benefits are dependent upon its tendency to eliminate competition and thereby enhance the firm's long term ability to reap the benefits of monopoly power"[33].

(g) Section 2 does not give "purchasers the exclusive right to dictate the terms on which they will deal . . . nor does it require a monopolist to accede to every demand of its competitors or customers"[34].

(h) Generally speaking, a party has the right to determine those with whom it will deal so long as such decision is made unilaterally. It is not a breach of the law that a refused entity is adversely affected where the refusal is for business reasons sufficient to the supplier[35]. In some cases, however, a monopolist which has control of a facility essential for a competitor to enter the market may be under a duty to make the facility essential for a competitor to enter the market may be under a duty to make the

28 *Cal Computer Products* v. *Intern. Business Machines 1979* 1 Trade Cases para.62713 (9th Cir.); *Transmedia Computer Co.* v. *I.B.M.* 1982-3 Trade Cases para.65218 (9th Cir.).

29 *William Inglis & Sons Baking Co.* v. *I.T.T. Continental Baking Co.* 1981-2 Trade Cases para.64229 (9th Cir.); *Airweld Inc.* v. *Airco Inc.* 1984-2 Trade Cases para.66197 (9th Cir.); *Trace X Chemical* (n.31).

30 *Berry Wright Corp.* v. *Pacific Scientific Corp.* 1982-83 Trade Cases para.65189 (D.C.Mass.).

31 *Trace X Chemicals* v. *Canadian Industries* 1984-2 Trade Cases para.66089 (8th Cir.). "The exercise of business judgment cannot be found to be anticompetitive . . . we conclude . . . that C.I.L.'s refusals to extend credit . . . were not invalid uses of monopoly power, but were, under the circumstances, ordinary business practices". The court also held that the credit evaluation was done in good faith.

32 *Trace X Chemicals* (supra n.31) at 66076 and cases there cited. See also discussion in *Berkey Photo* v. *Eastman Kodak* (supra n.27) at 78020.

33 *Trace X Chemicals* (n.31) and cases there were cited (at 66075).

34 *Trace X Chemicals* (n.31) and cases there were cited (at 66076).

35 *Interface Group* v. *Gordon Publications Inc.* 1983 1 Trade Cases para.65466 (D.C.Mass.).

facility available (see Part X 3(h) hereunder). The "essential facilities" argument is applicable only in limited circumstances. The general United States law still remains that refusals to deal, without more, do not violate the Sherman Act. "It is the right of one engaged in private business to deal or discontinue dealing, with anyone, for any reason, unless the dealer combines with others in a concerted effort to hinder free trade"[36].

(i) Just as a party has a discretion as to those parties with which he will deal, a patent holder has a similar discretion in relation to patent licensing. In the 1981 *Westinghouse-Mitsubishi* litigation[37] the United States government alleged, amongst other things, that Westinghouse licensed certain overseas patents to Mitsubishi thus making it a potential United States competitor. Westinghouse, however, refused to license its United States patents to Mitsubishi thus preventing Mitsubishi entering the United States market. The Ninth Circuit Court of Appeals held that no court has determined that a patentee must grant further licences to potential competitors merely because he has granted licenses to some. Further no court has determined that the antitrust laws require a patent holder to forfeit the exclusionary power inherent in his patent. To determine otherwise, thought the court, would be to undermine the whole patent system. In yet another *Kodak Case*[38] a New York District Court held in 1981 that "Kodak's unilateral refusal to license internally developed patents may not trigger liability under the antitrust laws"[39]. These holdings appear clearly to state the United States law on the interface between patent licensing obligations and antitrust law.

(j) Just as important as the holdings of United States courts as encapsulated above are some of the broad principles stated in a number of United States antitrust cases. Thus various decisions have spelt out that antitrust laws are for the protection of "competition" not "competitors"[40], that "the successful competitor, having been urged to compete, must not be turned on when he wins"[41], that the antitrust laws were never meant to be a panacea for all wrongs[42] and neither are they a panacea for all business affronts which seem to fit nowhere else[43]. Courts have warned that the antitrust laws do not grant the government a roving commission to reform the economy at will[44] and that the courts have long resisted the temptation to use the antitrust law "to create a federal common law of unfair competition"[45].

36 *Interface Group* (supra n.35) and cases there cited.

37 *Westinghouse Electric Corporation & Mitsubishi Electrical Corporation* v. *U.S. 1981 Antitrust & Trade Regulation Reporter* No.1024 p.G1 (9th Cir.). I do not deal in the paper with a deliberate policy to acquire patents with the purpose of non-utilisation. For an excellent article on some specific examples of this practice see R.Dunford *"Is the Development of Technology helped or hindered by patent law — Can Antitrust Laws provide the Solution"* (1986) 6 U.N.S.W.L.J. 117.

38 *G.A.F. Corp.* v. *Eastman Kodak* 1981-2 Trade Cases para.64205 (D.C. N.Y.).

39 n.38 at 73767 following prior cases there cited. Note qualification to this statement expressed in n.37.

40 *Brunswick Corp.* v. *Pueblo Bowl O.Mat.Inc.* 429, U.S. 477, 488 (1977).

41 *U.S.* v. *Aluminium Co. of America* 148 F.2d.416.

42 *Parmalee Transport Co.* v. *Keeshim* 1961 Trade Cases para.70061 (7th Cir.).

43 *Scranton Construction Co.* v. *Litton Industries Corp.* 1974 1 Trade Cases para.75087 (5th Cir.).

44 *Westinghouse & Mitshubishi* v. *U.S.* (supra n.37).

45 *Interface Group* (supra n.35) at 70681.

In *Berkey* v. *Eastman Kodak* (1979)[46] the observation was made that

> The purpose of the Sherman Act is not to maintain friendly business relations among firms in the same industry nor was it designed to keep these forms happy and gleeful.

In short, competition and monopolization laws are not, in any general sense, about morality, fairness or the furthering of better business relationships.

2. *Australian Interpretation*

Such cases as have been decided in Australia appear to be consistent with the above principles of United States holdings.

(a) Mark Lyons v. Bursill

In *Mark Lyons* v. *Bursill*[47], Mr. Justice Wilcox specifically affirmed that, even a person within the market power parameters of section 46 of the Australian Act, had no obligation to deal with a distributor who was dishonest, unreliable or impecunious[48].

(b) Queensland Wire v. B.H.P.

The point was even more dramatically put in *Queensland Wire* v. *B.H.P.*[49]. In this case B.H.P., with the admitted quantum of market power to activate section 46 of the Australian Act and with the admitted purpose of achieving a prohibited result by its conduct, was held not to infringe the Australian Act because it did not "take advantage" of its market power. B.H.P. refused to supply product to a competitor. The competitor's purpose in seeking the product was to sell it in competition with B.H.P.

Mr.Justice Pincus reached the conclusion that to "take advantage" of market power, a person had to act in some commercially reprehensible manner. There must, in other words, be a "misuse" of market power — a conclusion his Honour reached with the assistance of the reasoning of the 1976 *Swanson Committee Report* to this effect. His Honour reached his conclusion by analysing the Australian cases but he noted that his view was also consistent with United States and European decisions. He noted that he was referred to no authority either in the United States or Europe to the effect that a vendor may be forced, pursuant to a misuse of market power analysis, to accept a new customer except where there was a history of trading enabling one to conclude that the would-be customer was being discriminated against. His Honour believed that this gap in the authorities tends to show that refusal of a new customer is not, in general, to be regarded as a misuse of market power. He concluded that there simply was nothing commercially reprehensible about selling a product oneself rather than selling it to someone else to re-sell.

Of importance in the reasoning of Mr.Justice Pincus in *Queensland*

46 *Berkey* v. *Eastman Kodak* supra n.27.

47 N.12 above.

48 This was alleged by Bursill by way of defence. However, it was found by Wilcox J., on reasoning which seems unassailable, that this was not the true reason for the withdrawal of supply.

49 *Queensland Wire Industries Pty Ltd* v. *The Broken Hill Proprietary Company* (1987) A.T.P.R. para.40-810. The interpretation of taking advantage of market power was also considered by the Full Federal Court of Australia in *Williams* v. *Papersave Pty Ltd* (1987) A.T.P.R. para.40-818. The point was most appropriately put by Mr.Justice Fox when he stated that "a corporation which has market power does not take advantage of it whenever it is placed in juxtaposition with a competitor, and acts adversely to it."

Wire Industries were a number of pragmatic observations as to what would follow if an order were made that B.H.P. had to deal with Queensland Wire Industries. If an order were made, the supply price would also have to be specified. What would be the position if others wanted supply? What was to happen in the event of shortage? Would the court have to supervise a rationing scheme? All of these pragmatic facts convinced his Honour that there should be no obligation imposed upon even a monopoly supplier to deal in circumstances such as those in the case.

[AUTHOR'S NOTE: The High Court of Australia, on 8 February 1989, overruled the logic of Mr. Justice Pincus. The High Court decision is, of course, one reached much later than the date upon which this paper is written (31 December 1987) and the High Court decision cannot here be discussed in detail].

3. *New Zealand Interpretation*

Section 36 of the New Zealand Act is far more neutral than its Australian counterpart. It does not use the term "misuse" in its title. It does not have any reference to "taking advantage" of a market position. The market power merely has to be "used".

Notwithstanding these facts, I believe the New Zealand Act will, and should, receive an interpretation akin to that reached in Australia i.e. that "using" dominance means "misusing" it in a commercially reprehensible fashion. No other interpretation is consistent with United States, European or Australian authority. Indeed, for the reasons stated by Mr.Justice Pincus in *Queensland Wire Industries* only this interpretation leads to a workable result.

[AUTHOR'S NOTE: As regards this comment, the Australian High Court decision in *Queensland Wire* v *BHP* (8.2.89) must be now taken into account].

4. *Conclusions*

True it is that the respective sections dealing with unilateral actions of a party in a position of market power are vague. In *Queensland Wire Industries* Mr.Justice Pincus commented on this as probably being the reason why so few litigants had sought to utilise section 46 of the Australian Act. The criticism is perhaps valid but vagueness of wording of sections dealing with misuse of power is inevitable. This is because of the impossibility of drafting a general conduct section with case specific precision.

However, two clear results follow from the cases to date:

(a) There is a good deal of latitude given, even to parties possessing market power, to deal in a manner which has clear business justification; and
(b) The prohibitions on misuse of power are not infringed, in this writer's belief, either in Australia or New Zealand unless some commercially reprehensible conduct is involved.

The future debate will, of course, be on the vague issues of what can be done with "business justification" as distinct from what is "commercially reprehensible". Obviously opinions in this regard will vary between judges at any one time and they will also change over time. An appropriate number of judgments will, no doubt, help to clarify much of the present vagueness in due course.

[AUTHOR'S NOTE: The Australian High Court decision in *Queensland Wire* v *BHP* (8.2.89) must be now taken into account in relation to these comments].

At this stage, I commend my "Hippopotamus Theory" to you as a basis of evaluation. I believe this theory is more applicable to many trade practices assessments than many "experts" in the field care to admit. Indeed I have a large soft toy hippopotamus in my office named "Potmus" to remind me constantly of the theory and its application to my daily toil. This theory states that one finds it very hard objectively to describe a hippopotamus. Any description is not likely to conjure up a very real picture of a hippopotamus. Describing a hippopotamus (as does the Oxford English Dictionary) as "a large African pachydermatous quadruped inhabiting rivers"**** conjures up about as real a picture of a hippopotamus as does the legislature describing commercially naughty conduct by the use of such terms as a "substantial degree of market power" a "dominant position" and the "taking advantage of" a market position. Nonetheless, I suggest that one certainly knows a hippopotamus when one sees such a creature. There is much similarity between defining a hippopotamus and defining one who is naughty in relation to market power. It is frequently not difficult to know a misuse of market power when you actually see it.

I await the possibility of the hippopotamus theory being cited by an enterprising and perhaps overly honest judge and thus having it written into the trade practices precedents. Though I have suggested to a number of judges the appropriateness of the theory as a method of honest assessment of trade practices conduct, unfortunately no judge has yet seen fit to enshrine it in the judicial competition law precedents.

VII What Types of Conduct May Constitute a Misuse of Market Power Breach if Engaged in by a Patent Holder? Are Any or All of These Types of Conduct Exempted From Competition Law?

In accordance with the Hippopotamus theory and akin to the approach taken in Part VI of this paper, it seems to me to be more appropriate to give examples of naughty conduct than to pontificate in generalities.

I must reiterate that a misuse of market power under section 46 of the Australian Act or use of a dominant position under section 36 of the New Zealand Act arises for evaluation only after the appropriate market has been defined and it has been ascertained that the party involved has the applicable power in such market as found.

In both Australian and New Zealand law, misuse of market power covers only unilateral conduct. It does not cover conduct engaged in by parties in combination with each other. The market power of all parties engaged in concerted conduct cannot be aggregated in either Australia or New Zealand for market power assessment purposes. This is quite different from the United

****The Macquarie Dictionary tries harder but the theory is still valid. The Macquarie Dictionary defines a hippopotamus as

> A large herbivorous mammal, having a thick hairless body, short legs and a large head and muzzle found in and near the lakes and rivers of Africa, and able to remain under water for a considerable time.

Clearly the Australian product is better than its English counterpart but not so much better as to destroy the validity of the theory put.

States position. In the United States monopolization can be effected either by combination or conspiracy or by unilateral act. With all the talk of "strengthening" section 46 in Australia throughout the 1984 to 1986 period, I can but adhere to a view I expressed in a 1986 "post-Amendment" paper[50] that

> . . . This omission is quite impossible to understand and why s.46 of our legislation does not cover aggregations of power by agreement, combination or conspiracy is quite beyond me. This is even more so when it is realised that a considerable number of United States monopolization cases have been brought pursuant to power obtained by a combination or conspiracy . . .

My conclusion[51] in that paper was

> If the facts of private litigation are considered, along with the administrative solutions reached by the Commission, it can well be argued that s.46 was, pre-amendment, highly effective. It is perhaps unfortunate that the one amendment to s.46 which would be beneficial has not even been contemplated. This amendment would be to provide that monopoly power can be acquired by agreement or arrangement as well as by the possession of unilateral power.

All American cases have to be read subject to the above highly significant Australasian variation. I might add that the wisdom of applying misuse of market power provisions to concerted arrangements has recently been recognised in Australia. Section 46 is to apply to Shipping Conferences *as a group entity* in projected amendments to the Trade Practices Act — and not only to shippers individually[52].

The fact that section 46 (Australia) or section 36 (New Zealand) does not apply to actions taken in concert does not mean that actions in concert escape the competition law net. Such actions may constitute an anticompetitive contract, arrangement or understanding[53], an illegal collective boycott[54] or an illegal price fixing agreement[55]. I deal with these aspects later in this paper. For the moment my comments are confined to misuses of market power.

Some of the more interesting examples of misuses of market power which could well apply to patent holders in appropriate circumstances are:

(a) Terminating supply because a distributor has successfully bid against the supplying party on a lucrative contract. The effect of termination in the United States *Klearflax Case*[56], which is authority for the proposition put, was that the product needed to fulfil the contract was not readily available and the capacity to fulfil the contract was diminished because the distributor's discount was reduced to "jobber level". The fundamental

50 W.J. Pengilley *"Avoidance of Prosecution for Misuse of Market Power under the New Amendment to the Trade Practices Act"* Management Forum Vol.12 No.3 (September 1986) p.139.

51 n.50 at p.153.

52 See Media Statement 41/87 of Senator Gareth Evans, Minister for Transport and Communications, dated 19 November 1987. The mooted changes have received Cabinet approval and seek to allow "greater application of normal, pro-competitive provisions of the Trade Practices Act to Australia's Liner Shipping."

53 Trade Practices Act (Australia) ss.45(1)(b), 45(2)(a)(ii); 45(2)(b)(ii); Commerce Act (New Zealand) ss.27, 28.

54 Trade Practices Act (Australia) ss.45(1)(a), 45(2)(a)(i), 45(2)(b)(i) and definition s.4D; Commerce Act (New Zealand) s.29.

55 Trade Practices Act (Australia) s.45A(1); Commerce Act (New Zealand) s.30.

56 *U.S.* v. *Klearflax Linen* 1944-47 Trade Cases 57407 (E.D. Minn.).

holding in the case was expressed in the following terms:

> Not only did (Klearflax) set out to prevent Floor Products from competing with it, but it also successfully dissuaded other distributors, jobbers etc. from bidding on this government contract. Klearflax, having a monopoly in the manufacture of linen rugs, had the power, and exercised it, so as to restrain any competition between itself and the distributors for this government business.

(b) Akin to the above is the Australian case of *Mark Lyons* v. *Bursill*[57]. The "cut-off" of supplies in this case was to prevent a ski boot retailer from discounting product at sales through halls and arcades rather than by selling through traditional retail outlets. Clearly the supplier was acting not only in his own interest but on complaint of competing resellers. The crux of the decision was expressed in the following words:

> I think that it is clear that one of the purposes which actuated Mr Bursill's decision to refuse the supply of in-line ski boots to Mark Lyons for the 1987 season was the desire to protect his established retailers from the competition presented to them by Mark Lyons' sales. Some people may regard that as a laudable motive but such a purpose clearly offends against sec.46(1)(c). The withholding of the boots is for the purpose of deterring or preventing Mark Lyons from engaging in competitive conduct -that is, the warehouse sales — in the Australian ski boot market.
>
> The claim under sec.46 is made out.

(c) Similar conduct to that referred to in (a) and (b) above was involved in *Eastman Kodak* v. *Southern Photo Materials*[58]. Southern Photo Materials was a wholesaler of photographic materials in Georgia. For a long time, it dealt in Kodak goods at "trade" prices. Kodak acquired control of competing wholesalers in Georgia and attempted, unsuccessfully, to buy out Southern Photos. Kodak, after its unsuccessful attempted acquisition, then refused to deal with Southern Photo Materials except at retail prices. The United States Supreme Court found that "the circumstances disclosed in the evidence sufficiently tended to indicate (monopolistic) purpose" in the refusal to deal involved.

(d) A variation of the above holdings is seen in *Lorain Journal*[59]. A newspaper reached 90 per cent of the families in Lorain, Ohio, even though the paper had a circulation of only 20,000. The town could not support a rival paper. It could, however, support a radio station. One was set up in 1948. As soon as the station was set up, the newspaper made it a condition of acceptance of advertisements that advertisers should not advertise by radio. The newspaper monitored radio advertising to ensure compliance. The trial court held that there was a plan "conceived to eliminate the threat of competition from the (radio) station". The court expressly held that the purpose and intent of the procedure was "to destroy the broadcasting company".

In all the above cases, it is not difficult to detect conduct one might regard as being commercially reprehensible. In all such cases, there is conduct which is not explicable other than in terms of a wish commercially to disadvantage a party by "foul" means. When the appeal has been made it is not difficult to see why the Umpire has raised his hand. The conduct is that which is

[57] (1987) A.T.P.R. 40-809.

[58] 273 U.S. 359 (1927).

[59] *Lorrain Journal* v. *U.S.* 1950-51 Trade Cases para.62957 (U.S. Sup.Ct.).

not to be tolerated by a civilised law attempting to preserve a free enterprise market. The elimination or disadvantaging of a particular party because such party engaged in innovative pro-competitive conduct is quite apparent.

It is suggested that the above conduct, or conduct akin to it, would not be saved by the "patent exemption" provisions in either the Australian or New Zealand acts. In terms of the Australian exemption [section 51(3)(a)], the conduct would not be a condition which relates to the invention to which the patent relates or to articles made by the use of that invention. In New Zealand, the conduct would not constitute "a contract, arrangement or . . . understanding . . . relating to the use, licence or assignment of any right existing by virtue of any . . . patent" [section 45(1)(a)]. Indeed, there is no contract, arrangement or understanding at all — purely the exercise of economic muscle. Furthermore, the conduct is not within the exemption in section 36(2) because it is not conduct related only to the enforcement of patent rights.

VIII Product "Tying"

What has been said to date has been said in the expressly limited context of section 46 of the Australian Trade Practices Act and section 36 of the New Zealand Commerce Act. However, the conduct of human beings does not usually fit neatly within the confines of various statutory definitions. When we get to "forcing" and "tying" products, we are in the position that both misuse of market power provisions and other statutory provisions may be applicable. Particularly is this so in Australia where there is a very extensive code dealing with exclusive dealing, which code is not repeated in New Zealand. It seems to me, therefore, that in relation to product forcing and product tying, an Australian plaintiff will have alternative remedies whereas a New Zealand plaintiff may be much more limited as to what he can do.

There are also specific provisions in relation to "tying" in section 112 of the Australian Patents Act and section 66 of the New Zealand Patents Act. These specific provisions are not dealt with in this paper. In practice, they have not proven highly effective as a restriction on tying. This is because no tie is illegal under the sections as a matter of law and because enforcement rights are given only to the parties to the agreement and not to third parties or any public enforcement agency.

Product "tying" essentially involves a supplier of one product mandating that a supplied party take a second product either from him (i.e. from the supplier) or from a party nominated by such supplier. In the case of a requirement that the second product be taken from the supplier himself, the practice is known as "full line forcing" or "product exclusivity". If the requirement is that the product be taken from a third party nominated by the supplier, the practice is known as "third line forcing". The distinction between the two is important for a number of reasons, perhaps the prime one of being that third line forcing is illegal *per se* in Australia (i.e. it is not subject to a requirement that it substantially lessens competition prior to its being illegal). Nothing but the fact of third line forcing has to be proven in order for illegality to be found. For this reason, I regard it as the more important practice with which to deal and I deal with it first.

1. *Third line forcing*

(a) The necessity for two products to be involved

The first analysis is to ensure that there are, in fact, two products involved. If there is only one product, there is no tie as a matter of law. So, whilst many may regard the McDonalds' trade name, real estate leasing, financing and hamburgers as separate products, if it can be demonstrated that they are so intertwined as to constitute one product — the McDonalds' franchise — then there is no product tie as a matter of law.

In *Principe* v. *McDonalds*[60] this is exactly what occurred. The court, after hearing extensive evidence from McDonalds as to the nature of its franchising concluded:

> Far from merely licensing franchisees to sell products under its trade name, a modern franchisor such as McDonalds offers its franchisees a complete method of doing business. It takes people from all walks of life, sends them to its management school, and teaches them a variety of skills ranging from hamburger grilling to financial management . . . its regime pervades all facets of the business; from the design of the menu board to the amount of catsup on the hamburgers. Nothing is left to chance . . . . In short the modern franchisee pays . . . for the right to become part of a system whose business methods virtually guarantee his success . . . .
>
> Given the realities of modern franchising, we think the proper enquiry is . . . whether (the various products involved) . . . are integral components of the business method being franchised. Where the challenged aggregation is an essential ingredient of the franchised system's formula for success, there is but a single product and no tie exists as a matter of law.

It should be pointed out that the conclusion in the McDonalds' case was reached only after very extensive evidence as to the interdependence of everything in the McDonalds' system. A different conclusion on this issue was reached in the case of McDonalds franchises for example, than that found in the case of Kentucky Friend Chicken franchises[61].

Assuming that two products can be found, third line forcing is present when a second product has to be purchased from a supplier nominated third party. In Australia, this is *per se* illegal pursuant to section 47(6) of the Trade Practices Act. The plaintiff does not require the assistance of section 46 relating to misuse of market power in order to demonstrate a breach of the Trade Practices Act.

The New Zealand situation is quite different. There is no *per se* breach where third line forcing is involved. Thus, one has to demonstrate a breach of section 36 relating to the use of a dominant position or one has to show a breach of sections 27 or 28 dealing with anticompetitive "contracts, arrangements or understandings". There is an initial problem here because the supplied party may assert that he was never a party to any contract, arrangement or understanding but was simply forced to take the product subject to the ancillary restrictions. For this reason, no doubt, the Australian exclusive dealing provisions in section 47 do not talk about the supplier and supplied having "a contract, arrangement or understanding" but about the supplier supplying "on the condition" (widely defined) that certain restraints are applicable.

Clearly third line forcing is far more kindly treated by the New Zealand legislature than it is by Australian law. It is not *per se* banned as in Australia

60 *Principe* v. *McDonalds* 1980-2 Trade Cases para.63556 (4th Cir. C.A.).

61 *Kentucky Fried Chicken* v. *Diversified Packaging* 1977 1 Trade Cases para.61339 (5 Cir. 1977); see also *Seigel* v. *Chicken Delight* 1971 Trade Cases para.73709 (9 Cir. 1971), *Carpa Ltd* v. *Ward Foods* 1976 2 Trade Cases para.60995 (5 Cir. 1976).

and it is untouched in any event in the absence of a "contract, arrangement or understanding" to engage in the practice.

(b) What is "tying"?

The essence of tying is that the sale of the "tying" product is conditioned on the sale of a "tied" product[62]. To be illegal under United States Law, the defendant must have "sufficient economic power" and a "not insubstantial" amount of commerce must be involved. An essential element of an illegal tying arrangement is co-ercion by the seller i.e. the seller must condition the sale. If the buyer is free to take either product by itself, then there is no tie.

(c) What are the competitive detriments in "tying"?

The principal ill of a tying arrangement is that it denies competitors access to the market for the tied product not because the party imposing the arrangement necessarily has a superior product in that market, but rather because of the leverage exerted as a result of its economic power in the market for the tying product and the demand for the tying product. Thus competition in the tied product is severely restrained because competitors "cannot offer their products on an equal basis with the party imposing the tie"[63].

There are other anticompetitive results which can be seen in third line forcing, and which are also applicable to much full line forcing. Without being exhaustive, some of these are —

(i) That such forcing denies access to competitive retail products.
(ii) That such forcing eliminates the capacity of a reseller to bid competitively for subsidiary products because of his need for the tying product.
(iii) That the forcing can create an extensive barrier to market entry for producers of subsidiary products.
(iv) That the forcing can be a method of pricing subsidiary products higher than their market price because of the difficulty involved in third parties being able to sell products competitive with the tied product.

The fundamental effect of such forcing thus can be to create a captive market.

(d) Why is "third line forcing" treated less kindly than "full line forcing" in Australia?

The difference between third line forcing and full line forcing (and the undoubted reason for the illegalisation *per se* of the former but not of the latter in Australia), is that the former, but not the latter, can be the subject of "kickbacks" given to the supplier of the tying product by the supplier of the tied product. These "kickbacks" used to be common in the petrol industry in Australia in the 1950s and 1960s where petrol suppliers were paid by manufacturers of Tyres, Batteries and Accessories ("T.B.A." items) to tie their petrol retailers into certain T.B.A. brands. A more modern example, until illegalisation in Australia, is that of the arrangements which used to exist between financiers and insurance companies pursuant to which a financier compelled a borrower to insure with a nominated

62 The propositions set out in this part of the text are gleaned from the United States cases of *Northern Pacific Railway Co.* v. *U.S.* 356 U.S. 1 (1958); *Foremost Pro Colour* v. *Eastman Kodak* 1983 Trade Cases para.65239 (9 Cir. C.A.).; *Kentucky Fried Chicken* v. *Diversified Packaging* (n.61); *Siegel* v. *Chicken Delight* (n.61); *Moore* v. *Jas H.Matthews & Co.* 1977 1 Trade Cases para.61376 (9 Cir. 1977).

63 *Moore* v. *Jas H.Matthews* (n.62).

insurance company, the insurance company paying a "kickback" commission to the financier involved.

In the case of full line forcing, there may be many of the market detriments specified above but there can be no "kickbacks" because the same party is the supplier of both the tying and the tied product. Some may argue that this is all a matter of morality and has little to do with economics. I believe this view is correct. All that can be said is that economics is not the only matter relevant to competition law.

(e) The New Zealand position on third line forcing

Whilst third line forcing is not *per se* banned in New Zealand, it may involve the illegal use of a dominant position if (on prior analysis) there is something like a forty-five to fifty per cent market share held by the party imposing the third line force. There is also the possibility (assuming a "contract, arrangement or understanding" can be found) that a third line force may be a breach of section 27 of the Commerce Act. Based on Australian authority, it appears that the United States requirements that there be "sufficient economic power" will be translated into New Zealand section 27 illegality if there is a market share of twenty to twenty-five per cent involved[64].

(f) Defences to Third Line Forcing

Assuming that a supplier prima facie infringes the law preventing third line forcing, the usual justification for the practice is that a tie is necessary to ensure product quality. This involves two considerations -

(i) In the usual case maintenance of standards can be achieved by the mandating of objectively specified product standards. If product standards are objectively specified, there will not, in the usual case, be a product tie as a matter of law for whilst standards are mandated, no third party is specifically named as the source of any subsidiary product. Any party may supply subsidiary product subject to meeting the necessary standards involved.

(ii) The basic justification for the nominating of a third party as the source of subsidiary products is that only by such nomination can standards be maintained. For example, it may be permissible for an ice cream supplier to nominate the supplier of topping to be added to such ice cream by a retailer because it is not possible "objectively to verbalise" the applicable quality standards of topping[65]. The United States reality, which would appear applicable to competition assessments and assessments as to whether there has been a misuse of market power in Australia and New Zealand, is however, that this defence[66]

> fails in the usual situation because specification of the type and quality of the product to be used in connection with the tying device is protection enough . . .
>
> The only situation, indeed, in which the protection of goodwill may necessitate the use of tying clauses is where specification for a substitute would be so detailed that they could not practicably be supplied.

64 Note prior analysis in this regard as to what constitutes the relevant "market". The conclusions as to threshold market share are reached from the Australian Trade Practices Commission's leading determination in *Shell* 1975-6 A.T.P.R. (Com.) 35-220 and the Australian Trade Practices Tribunal's leading determination in *Ford* 1977 A.T.P.R. para.40043.

65 *Susser* v. *Carvel Corp.* 332 F 2d 505; 1964 Trade Cases para.71103.

66 *Standard Oil* v. *U.S.* 1948-49 Trade Cases para.62432 (U.S. Sup.Ct.).

The real difficulty in the applicability of the above analysis to Australia is section 47(6) of the Trade Practices Act which bans third line forcing *per se*. It is possible, of course, to argue for authorization of the practice on public benefit grounds, the public benefit being the maintenance of standards. If this is genuinely the case, it seems hard to see why authorization should not be given. Even without authorization it can be argued that the product which the supplier is requiring the retailer to resupply is not two products [one (topping) tied to the supply of the other (ice cream)] but only one (ice cream with topping). Whether or not such an argument would succeed in Australia is problematical but a judge, wishing to achieve a sensible solution to a particular problem, and not to illegalise in Australia what is legal elsewhere, may well be impressed by such an argument.

(g) Is third line forcing exempt pursuant to the "patent exemptions" in Australia and New Zealand?

(i) *Objectivity in standards setting — no breach involved and hence no patent exemption relevant.*

If standards are objectively specified, there is no "third line force" and thus, in the usual case, no potential for illegality.

(ii) *Patent exemption defence — New Zealand*

If a party is nominated as the source of subsidiary product and this nomination is genuinely necessary to maintain the quality of goods produced pursuant to a patent, it seems that there is a good case for arguing that the restriction is one existing which controls the quality of goods to which the patent rights relate. Thus exemption would be conferred pursuant to the specific provisions of sections 45(1) and 45(2)(a) of the Commerce Act. Possibly there is a further exemption conferred by virtue of section 45(2)(b) in that the restriction is imposed "for the purpose of protecting the interest of the owner in technically satisfactory . . . exploitation of those (i.e. the patent) rights". It may also be, as product quality is so integral to patents and the goods produced pursuant to patents, that section 36(2) exempts third party nomination for genuine quality reasons from section 36 of the New Zealand Commerce Act relating to use of a dominant market position.

In all cases, it is, of course, necessary to examine the facts critically as often claimed "quality control" reasons will turn out to be spurious on detailed evaluation. Further, it seems to me that any such defence should be such as to come within the narrow United States grounds — something which will not be easy in most cases (see sub-paragraph (f)(ii) above).

(iii) *Patent exemption defence — Australia*

The situation in Australia is not at all clear in light of the provisions of section 47(6) imposing *per se* illegality on third line forcing. Nonetheless, it seems that a third party nomination genuinely imposed to ensure quality of product could well be argued to be a condition in a licence granted by a patent proprietor that relates to "the invention to which the patent . . . relates or articles made by the use of that invention". In order to so qualify, however, it would appear that the narrow United States "quality control" grounds of defence would have to be satisfied — not an easy matter by any means (see (f)(ii) above).

It is necessary to reiterate that the facts of any quality control claim must be examined critically. One must again issue the warning that claimed reasons for the imposition of a "quality control" restraint will frequently turn out to be spurious on detailed examination.

2. *Full line forcing*

Many of the principles applicable to third line forcing are also broadly applicable to full line forcing (or product exclusivity as it is also known). The major difference is that full line forcing is not illegal *per se* in Australia but is subject to a competition assessment. It is necessary only to state and summarize the position which has been reached on the logic previously stated in this paper. In broad terms

(a) there will be no misuse of market power or use of a dominant position unless the relevant market power is present (say a twenty-five per cent market share in Australia to a forty-five to fifty per cent market share in New Zealand — see Part V.3 above).

(b) In New Zealand, there will be a prima facie anticompetitive breach of section 27 of the Commerce Act if there is a "contract, arrangement or understanding" incorporating a full line forcing restriction and if the supplier has a market share in the order of twenty to twenty-five per cent[67].

(c) In Australia, there will be a prima facie anticompetitive breach of section 47 of the Trade Practices Act if there is a supply on a full line forcing "condition" and if the supplier has a market share in the order of twenty to twenty-five per cent[68].

(d) There will be more scope in the case of full line forcing than in the case of third line forcing for the argument that the supplier is supplying one product only and no second product is involved. To follow the prior ice cream analysis (see Part VIII.1(f)(ii)), it is easier for a supplier to argue that one product only is involved in the supply of either of the individual component parts of the product.

(e) It will not be a misuse of market power or use of a dominant position if the restriction is genuinely necessary to maintain quality or standards or if it is not possible to verbalise such standards because of the complexity or impossibility of doing so.

(f) It will not be an anticompetitive breach of section 27 of the Commerce Act or of section 47 of the Trade Practices Act if the circumstances set out in (e) above are present.

(g) The restriction will be exempt both from the Commerce Act and the Trade Practices Act pursuant to the "patent exemption" outlined above if the circumstances set out in (e) are present.

(h) In all cases, there is no infringement as a matter of law if there is no "tie". Thus if necessary quality standards are objectively specified and the supplied party can purchase from any party manufacturing in accordance with such standards, no "force" is involved. The supplier may himself supply subsidiary products but, if no "force" is involved, such supplier will have to meet the competition from others who may wish to supply such products in competition with him. Competition in the subsidiary product market is, in these circumstances, not restrained by the state of competition in the primary product market. (As to what constitutes a "force" see Part VIII.1(a) and (b) above).

67 n.64.
68 n.64.

IX TERRITORY AND CUSTOMER EXCLUSIVITY

Territory and Customer Exclusivity are akin in principle to Product Exclusivity (dealt with in Part VIII above). However, there are no cases in point in either Australia or New Zealand. Attempting to be definitive is, therefore, difficult.

Probably the main problem area will not be misuse of market power or use of a dominant position. It will be in section 47 of the Australian Trade Practices Act which illegalises *anticompetitive* product and customer exclusivity and section 27 of the New Zealand Commerce Act which illegalises *anticompetitive* contracts, arrangements or understandings. As previously stated, differences in result can occur because of the necessity in New Zealand that "a contract, arrangement or understanding" be proven whereas in Australia all that is necessary, prima facie, to come within the section is that supply is on the relevant restrictive "condition".

As in product exclusivity, the assessment of anticompetitive effect is premised on the market power of the supplying corporation. There appears to be no difference in principle between the quantum of market power required in order to trigger potential anticompetitive product exclusivity and that required in order to trigger potential anticompetitive customer and territory exclusivity — that is a threshold test in the order of twenty to twenty-five per cent[69].

The real question is whether territorial or customer exclusivity promotes competition or not. It frequently does so in the case of a new entrant dealer, for example, who wishes territorial exclusivity as a form of security for putting up his investment and making the applicable commitment to the supplier. Indeed the stimulation of new entry is the prime pro-competitive justification for territorial exclusivity.

Territorial exclusivity has many competitive benefits. Perhaps these are nowhere more eloquently set out than in the United States Supreme Court decision in *Continental TV* v. *Sylvania*[70] in which the court, after analysing much economic, marketing and academic literature on the point, concluded that it had been wrong a decade earlier to outlaw customer and territorial exclusivity *per se*.

In each case, legality will depend upon the relevant competition assessment which will itself involve an analysis of the comparative effects of preventing *intra-brand* competition in a certain area (by virtue of the fact that there is a brand monopoly in such area) as against the possible pro-competitive effects on *inter-brand* competition (which competition may come about by virtue of the establishment of a number of fully committed single brand distributors, each brand distributor competing in a territorial area against the brand distributor of another company).

As in the case of product exclusivity, there will be "business" justifications" which, if proven, will mean that an otherwise anticompetitive territory or customer exclusivity restriction will escape illegality.

Some of these "business justifications" which will negative an otherwise anticompetitive territory or customer exclusivity are as follows[71].

69 n.64.

70 *Continental T.V. Inc.* v. *G.T.E. Sylvania* 433 U.S. (1977) overruling the *per se* ban in *U.S.* v. *Arnold Schwinn & Co.* 388 U.S. 365 (1967).

71 See for further discussion Ransom & Pengilley *"Restrictive Trade Practices: Judgments, Materials & Policy"* (Legal Books — Sydney 1985) Chapter 6. For an analysis of exclusivity on a "Flow Chart Basis" see Ransom & Pengilley (supra) pp.912-915.

1. *Territorial exclusivity — some "business justifications"*
(a) Distributor security is necessary as, without it, the distributor will not make the applicable investment in plant and equipment or make the necessary commitment to his supplier.
(b) Territorial restrictions can be useful in rapidly tracing defective products.
(c) It is necessary for dealers to establish contact with specific customers. This means that dealers must be allocated specific territories in order that such a relationship can be established.
(d) In some cases, territorial restrictions may justify an equitable distribution of manufacturers' representatives who visit clients in various areas to give technical and back up advice but do not actually sell the product.

2. *Customer exclusivity — some "business justifications"*
(a) Some distributors simply cannot service large accounts because they lack the training or scientific know-how.
(b) Dealers may not be able to meet the competition of other manufacturers who deal direct or bid for the same customer.
(c) Dealers may be unwilling or unable to market a new product which cannot return an immediate profit. Thus the supplier may retain certain accounts in order to compensate him for his greater "up front" risk.
(d) Customer restrictions are necessary to enforce valid territorial restrictions. Territorial restrictions make sense only if there are a limited number of dealers in each territory — generally only one. If an authorised dealer can sell to an unauthorised dealer for resale by such unauthorised dealer to the public, the territorial restrictions may be totally ineffective.

Probably territorial exclusivity restrictions are more justifiable — especially in the case of new entrants — than customer exclusivity restrictions. The latter generally appear to be more directly related to competitive restraints than the former.

It must be stressed that an allegation of the "business justification" is not necessarily substantiation of it. Courts in the United States have, for example, treated many of these claimed justifications with a considerable degree of scepticism in specific factual contexts.

3. *Is territorial and customer exclusivity "patent exempt"*

If there is an anticompetitive infringement or a misuse of market power, the question arises as to whether the restraint is "patent exempt".

Section 45(2) of the New Zealand Commerce Act clearly exempts territorial restrictions from the anticompetitive "agreement" provisions of the Act. It also appears that customer restraints are exempt under section 45(2) as being a control on "the nature (or) extent of the exercise of" patent rights. The word "extent" presumably relates to those who may or may not be resupplied as all other possibilities which might reasonably be encompassed by the term ("territory" "period" "type" "quality" "quantity") are expressly referred to elsewhere in the section. Thus the word "extent" must, as a matter of statutory construction, mean something apart from the words expressly mentioned. Customer exclusivity is the only meaning which readily springs to mind. Therefore, I believe that section 45(2) exempts customer restrictions pursuant to a patent licence from the anticompetitive "agreement" provisions of the New Zealand Commerce Act.

The question arises as to the exemption of territorial and customer exclusivity provisions from misuse of market power (section 45 Australian Trade Practices Act) and use of a dominant position (section 36 New Zealand Commerce Act). Patent legislation in Australia (Patent Act section 152(3)) provides that patents are to be treated as personal property and may be assigned for any place in or part of the country. New Zealand Patent legislation also recognises rights of patent assignment and licence (Patent Act 1953 section 84). These provisions do not specifically refer to exclusivity but I think this must be implied especially when, as previously discussed, a patent owner has, like other traders, a basic right to deal in accordance with his discretion. It is supportive of this proposition, but not dispositive of the issue, that the United States Patents Act specifically permits exclusivity as a right exploitable pursuant to the grant of a patent.

Even though decided under United States law, the decision in *Crown Zellebach Corporation*[72] seems hard to fault as a matter of commercial marketing principle in that it says:

> Territorial licences, without more, are a reasonable means for the patentee to secure the reward granted to him. Like other restrictions on the patentee, geographic limits may be imposed to protect the patentee's profits derived from his own exercise of the patent rights.

Customer restrictions, especially where they are imposed, as is often the case, as an adjunct to territorial restrictions, appear to be in the same position as territorial restraints.

My own view is that territorial and customer restraints when unilaterally imposed are "patent exempt" under both Australian and New Zealand law from what may be an otherwise illegal misuse of market power. I hasten to add that much of my conclusion is reached on my view of the commercial logic of marketing rather than on decided cases and, in law, this conclusion is far from certain.

4. *Conclusions as to customer and territorial restraints*

The conclusions reached in relation to territorial and customer restraints are that they may constitute anticompetitive restraints or misuse of market power in certain circumstances. In many cases, there will be "business justification" for the restraints which will save them from illegality. In any event, it seems that these restraints will in most situations, be exempt from the competition laws of both Australia and New Zealand because of the "patent exemptions" contained in such laws.

X. Patent Pools — Anticompetitive Agreements Between Competitors — And Akin Naughtiness

"Contracts, arrangements or understandings" between competitors are illegal in Australasia if they constitute:
— price fixing;
— an exclusionary provision; or
— are substantially anticompetitive.

It is not here necessary to go into the law as to what constitutes a contract, arrangement or understanding. The term, of course, encompasses "wink and nod agreements" "Rotary Club agreements" (as a Rotarian I am entitled to

72 *U.S.* v. *Crown Zellebach Corporation* 1956. F Supp. 118 (N.D. 111).

use this term but, of course, others should not), and any other type of arrangement which has some degree of mutuality or is considered to be binding in honour. I leave this topic and refer the interested reader to relevant commentaries[72a]. The latest Australian case in point at the time of writing is *T.P.C.* v. *David Jones*[72b]. I further commend to you the New Zealand analysis on this aspect by Mr.Justice Barker in his decision relating to the battle between Budget and Avis for access to the Auckland Airport[73].

1. *Price fixing*

Patent holders, like any other competitors, can be guilty of price fixing if they enter into an agreement which has the effect of "fixing, controlling or maintaining" prices or other charges of any description.

2. *Exclusionary provisions*

Patent holders, like any other competitors, can be guilty of engaging in collective boycotts. In particular, this can follow if "patent pools" are involved and the result of such a pool is a denial of supplies to a third party.

In Australia and New Zealand, collective boycotts are statutorily christened "exclusionary provisions". The exclusionary provision law in Australia and New Zealand is extremely severe and is, I argue, made this way because of an Australian mistranslation of the United States Sherman Act[74]. Australia having mistranslated the United States provisions, New Zealand also did so by copying the Australian Act. Exclusionary provisions in each country are banned *per se.*

Patent pools are extremely likely to result in an exclusionary provision and must be looked at with great care. For, in Australia and New Zealand, unlike the United States

- an exclusionary provision can be effected regardless of the status of the party denied supply. In the United States, the *per se* ban applies only if a group of *competitors* deny supplies to an individual *competitor* (actual or potential) or to a group of actual of potential *competitors.*
- in Australia and New Zealand the purpose of the arrangement is judged by its immediate purpose. This purpose will almost invariably be to deny supplies. In the United States, one is able to argue the long term object of the agreement which may be, for example, to maintain safety standards by jointly agreeing not to supply a person without certain minimum training qualifications. Although authorization on public benefit grounds may be possible in Australia or New Zealand if this is the case (and in the United

72a See, for example, *Australian Trade Practices Reporter* Vol.1 3-040 et seq. under heading *"Anticompetitive Agreements"* (C.C.H. Australia Limited).

72b *T.P.C.* v. *David Jones* 1986 A.T.P.R. para.40-671.

73 *Auckland Regional Authority* v. *Mutual Rental Cars (Auckland Airport) Limited & Ors.* High Court of New Zealand Case CP 1373/86. Judgment of Mr.Justice Barker 31 July 1987.

74 See W.J.Pengilley *"The Exclusionary Provisions of the New Zealand Commerce Act in Light of United States Decisions and Australian Experience"* — A paper given at a Trade Practices Workshop organised by the Centre for Commercial Law and Applied Legal Research of Monash University and held at Auckland New Zealand on 20-22 March 1987 [Republished since writing this paper in Vol 3 No 3 *Canterbury Law Review* pp 357–409(b)]; W.J.Pengilley *"Trade Associations and Collective Boycotts in Australia and New Zealand — A Mistranslation of the Sherman Act Down Under"* (published since writing of this paper in *"The Antitrust Bulletin"* (Federal Legal Publications, New York) — Vol.XXXII, No.4, (Winter 1987) pp.1019-1049.

States there is no such procedure), such an agreement would be illegal in Australasia without such an authorization.

— in the United States *per se* illegality follows only if there is an anticompetitive purpose. In Australasia, there is illegality *per se* if the purpose is to limit or restrict supply. The two propositions are quite different.

— in Australia and New Zealand, the legislation bans *per se* collective boycotts of classes of persons. This can follow in the United States but not as a matter of course, and certainly not as a matter of statute.

The *Swanson Committee*, set up to advise the Australian Government, in its 1976 Report got the translation of the United States Sherman Act right. Somewhere the Parliamentary draftsperson got it wrong. New Zealand got it wrong by copying the Australian error[75].

The point in this paper is not to bewail the error involved, much as such bewailing may be justified, but to point out how easily one can infringe *per se* bans in each country when entering into arrangements with competitors. Anyone contemplating a patent pool in Australia or New Zealand should approach the task with a high degree of caution for fear of infringing the *per se* ban on exclusionary provisions in each country. Decisions on the more generous United States law must be read with caution when translated downunder.

3. *Anticompetitive effects*

Anticompetitive effects may be caused by patent pools in a number of ways. Unless there are price fixing or exclusionary provisions elements, then the assessment is not *per se*. I would suggest that the following principles are relevant in an evaluation of the anticompetitive effects of patent pools.

(a) Does the arrangement have agreed territorial and customer restrictions?

Whatever the merit of individual patent holders having a capacity to restrict licences territorially or as regards customers, this logic does not apply to agreements between competitors. In such case, the arrangement is one of market division and should receive the same competitive evaluation. This will almost certainly result in the agreement being regarded as anticompetitive. The New Zealand Act, but not the Australian, seems to permit arrangements between competitors involving agreed limitations as to territory and customers (Commerce Act section 45(2)). There appears to be no sound policy reason for permitting such an agreement between competitors even though unilateral vertical restraints in the same fields may be quite defensible in a variety of circumstances.

(b) Is there an intention to exclude access to information?

The cumulative power of the several statutory monokats (I am putting into practice what I preach — see Part V.2(b) of this paper) pooled together, may be very great indeed. If a non-party is allowed access to the pooled information and know-how on reasonable terms, the anticompetitive effect of the arrangement will be less and it may be able to be argued that it is no longer "substantial".

(c) What kinds of patents do the arrangements cover?

Is the pool limited to infringing patents or are complementary one also covered? Are fully competitive patents part of the pool?

[75] See W.J.Pengilley *"Trade Associations and Collective Boycotts in Australia and New Zealand — A Mistranslation of the Sherman Act Downunder"* (n.74).

(d) What is the reason for the pool?

The fact that a pool is entered into to settle threatened litigation may be a proper reason for the pool and may negative anticompetitive intent. As was said by Justice Brandeis in the *Cracking Case*[76]:

> Where there are legitimate conflicting claims or threatened interferences, a settlement by agreement rather than by litigation is not precluded by the (Sherman) Act . . . an interchange of patent rights is frequently necessary if technical advancement is not to be blocked by threatened litigation.

However, settlements of this kind must, of course, be real and not merely a guise for competitive restraints. Generally also, care should be taken in the total cross licensing of fully competing patents.

(e) What is the length and breadth of coverage?

Obviously a patent pool is more likely to lessen competition if it covers future as well as present patents.

(f) Does the pool encourage innovation or operate against this?

Restraints which appear to be innocent may, in fact, significantly discourage innovation. For example, a restraint that no party will take a licence from the group unless all others take a similar licence is likely to be regarded as anticompetitive even though each party has agreed to give to the other royalty free licences.

(g) How much market power is involved?

If too much market power is involved, the patent pool will have to be purer than Caesar's wife. To quote Justice Brandeis again in the *Cracking Case*[77]:

> If combining patent owners effectively dominate an industry, the power to fix and maintain royalties is tantamount to the power to fix prices . . . where domination exists, a pool of competing cross patents . . . is beyond the privilege conferred by the patents and constitutes a violation of the Sherman Act. The lawful individual monopolies granted by patent statutes cannot be unitedly exercised to restrain competition.

(h) Does the patent pool constitute a "bottleneck monopoly" or control access to an "essential facility"?

There is a well settled "essential facilities" or "bottleneck monopoly" doctrine in United States law[78]. This doctrine has never been applied in Australia as yet, though the Trade Practices Commission in its *Bankcard Determination*[79] made observations on the principles applicable to the doctrine. The doctrine has, however, been applied in New Zealand in the *Auckland Airport Decision* of Mr. Justice Barker. In that case his Honour held the following to be the basis of the "essential facilities" doctrine[80]:

76 *Standard Oil Co. (Indiana)* v. *U.S.* (1931) 238 U.S. 163,171.

77 n.76 p.174.

78 *U.S.* v. *Terminal Railroad Association* 224 U.S. 383 (1912); *Associated Press* v. *U.S.* 326 U.S. 1 (1945); *Gamco* v. *Providence Fruit Produce Building* 1952 Trade Cases para.67219; *Hecht* v. *Football League* (1977) 570 FR. 2d 982.

79 *Bankcard Determination* (1980) A.T.P.R. para.50100 (Australian Trade Practices Commission).

80 n.73. His Honour here cites the holding in *Hecht* v. *Pro Football League* (n.78). For some further elaboration of what is meant by an "essential facility" pursuant to this doctrine, see *Gamco* (n.78); *Bankcard Determination* (n.79); *Interface Group* v. *Gordon Publications Inc.* 1983 1 Trade Cases para.65466 (D.C. Mass.); *Northwest Wholesale Stationers Inc.* v. *Pacific Stationary & Printing Co.* 1985 Trade Cases para.66640 (U.S. Sup. Ct.).

> Where facilities cannot practicably be duplicated by would-be competitors those in possession of them must allow them to be shared on fair terms. It is illegal restraint of trade to foreclose the scarce facility. To be essential, a facility need not be indispensable; it is sufficient if duplication of the facility would be economically feasible and if denial of its use inflicts a severe handicap of potential market entrants. Necessarily this principle must be carefully delineated; the anti-trust laws do not require that an essential facility be shared if such sharing would be impractical or would inhibit the defendant's ability to serve its customers adequately.

The decision in the *Auckland Airport Case* makes it clear that the "essential facilities" doctrine is alive and well downunder. If patent holders engage in a patent pool then it will be, in my view, clearly illegal on anticompetitive grounds if such pool denies access to essential facilities. This is so, in my view, even if the pool technically escapes the *per se* exclusionary provision ban previously discussed.

4. *Patent exemption*

In New Zealand patent exemptions with potential relevance to patent pooling are far wider in scope than in Australia. For example, it seems that a New Zealand patent holder can have an agreement with a competitor patent holder which agreement may relate to the very vitals of competition such as territory (horizontal market division) or quantity of goods to be produced (horizontal quota arrangements) and gain exemption from the Commerce Act pursuant to section 45(2). In Australia, exemption appears to be available, broadly speaking, only for *unilateral* actions in relation to genuine quality control and for *unilaterally* imposed territorial and customer restrictions. This is because only these types of actions can be said to "relate to the invention" and there is no other wider Australian exemption such as that in section 45(2) of the New Zealand act relating to certain contracts, arrangements or understandings.

5. *Conclusions in relation to patent pools*

There are no cases in either Australia or New Zealand in relation to patent pools. Neither are there any evaluations of them by either of the respective competition authorities. However, such pools clearly run the risk of infringing trade practices law. In this part of the paper some of the relevant matters to be considered in relation to this risk are discussed.

XI "TRADE SECRETS"; "KNOW-HOW" AND THE LIKE

Patents never work without "know-how" to back them up. According to a number of studies[81], the necessary disclosure of "know-how" is frequently not made. It has been claimed, for example, in a George Washington University study that about fifty per cent of United States patents studied had to be supplemented by "Know-how" details before they became viable[82].

I do not wish to become involved in what may well be another area in which the patent system may be regarded as being inadequate. Nonetheless it cannot be ignored that a substantial factor in patent disclosure is often kept quite secret. The more important point I wish to make is that obviously "know-how" and trade secrets have substantial commercial value. This value

[81] See *"Working Paper of Patent Law Revision"* — prepared for the Department of Corporate Affairs (Canada) June 1976 which refers to a number of such studies.

[82] n.81 at p.50 et seq.

is, of course, quite independent of any patent disclosure or non-disclosure issues. A party may choose not to disclose. An invention may not quite be patentable.

The question is whether a party making the choice not to disclose who has the applicable market power to come within section 36 of the New Zealand Commerce Act or section 46 of the Australian Trade Practices Act can be compelled to disclose trade secrets or "know-how" because it breaches the law not to do so.

1. *The U.S. decision in Kewanee*

In 1973, the U.S. Sixth Circuit Court of Appeals held in *Kewanee*[83] that the United States patent laws overrode the common law rights of secrecy. Something which could be patented but was not, and possibly something which was essential to the operation of a patent but which was not disclosed, could, therefore, be subject to a court order compelling disclosure. This decision was overruled by the Supreme Court. In its judgment the Supreme Court noted that the "hoarding" of secrets was just as permissible a tactic as disclosure with patent protection. The Court noted that trade secrets laws do not conflict with patent law principles of disclosure and, indeed, that the two had co-existed for over a hundred years. The court also noted that trade secrets and know-how confidentiality[84] will encourage invention in areas where patent law does not reach, and will prompt the independent innovator to proceed with the discovery and exploitation of his invention. Competition is fostered and the public is not deprived of the use of valuable, if not quite patentable, invention.

The Supreme Court decision is a sensible one. It must be remarked, *en passant*, that the Sixth Circuit Court of Appeals decision was contrary to three other Circuit Court decisions at the time. It thus probably never had much chance of being upheld on appeal by the United States Supreme Court.

2. *Disclosure obligations — statutory provisions and Berkey-Kodak*

To finish this discussion, the following points should be added:

(a) Section 4M of the Australian Trade Practices Act specifically states that the Act does not effect the law relating to breaches of confidence. This law is that nothing has to be disclosed other than that which is required by the Patent Office in order that the patent may be obtained. A virtually identical provision to section 4M of the Australian legislation is contained in section 7 of the New Zealand Commerce Act.

(b) As has been discussed in Part VI above, the *Berkey-Kodak Case* clearly establishes that even a monopolist has no duty to pre-disclose technology to a competitor. This case is so decided because of the pro-competitive benefits of such a conclusion[85].

3. *Conclusions as to trade secrets and "know-how"*

The common law of confidentiality and "know-how" non-disclosure is thus untouched by competition policy. Disclosure of confidential material cannot be compelled either on the basis that patent laws have, in some way, overridden common law rights of confidentiality or on the basis that pre-disclosure of

[83] *Kewanee* v. *Bircon Corp.* 4478 F 2d 1074 (1973).
[84] *Kewanee* v. *Bircon Corp.* 416 U.S. 470, 485 (1974).
[85] n.27 and see comments in text as to the pro-competitive reasons for this conclusion.

technology can be required if the owner of the technology is a monopolist or otherwise holds the applicable quantum of market power prescribed by statute.

XII THE "NINE NO NOES"

1. *Luncheon Speech Law and Washington politics*

In the United States "Luncheon Speech Law" in the patent/competition area began about 1969. At that time a number of speeches were given by the Department of Justice to a number of Patent Groups around the nation. These speeches set out various views of the patent practices which the Antitrust Division of the Justice Department considered illegal under the antitrust law. The development of this aspect of law is described in a paper given at Monash University by Professor Thomas McCarthy of the University of San Francisco in the following terms[86]:

> Since the case law on the point was often sparse and unilluminating, these speeches had a significant impact on the advice attorneys gave their clients. These guidelines listed the "Nine No Noes" of patent antitrust law and became known as "luncheon speech law". The "Nine No Noes" were widely viewed as a list of *per se* illegal violations.

The "Nine No Noes" are:
(i) tie-ins of unpatented items to the patent licence.
(ii) assignment grant-backs of licensee improvements,
(iii) resale restrictions on a purchaser of a patent product.
(iv) tie-outs i.e. forbidding a licensee from making or selling competitive products.
(v) licensee veto over the grant of further licences.
(vi) mandatory package licensing of blocks of patents.
(vii) mandatory total sales royalties in which the royalty base includes non-patented items.
(viii) restrictions on the sale of the unpatented products of a patent process.
(ix) price restrictions on a manufacturing licensee.

As Professor McCarthy points out[87]:

> In some circumstances, these guidelines were more strict for patent licensing than in the non-patent field. The "Nine No Noes" were firmly grounded on traditionalist scepticism about the worth of patents and a desire to prevent almost any restrictive practice in patent use and licensing.

The burial of the "Nine No Noes" began in the Carter administration. Ky Ewing stated that the "Nine No Noes" showed a doctrine of patent-antitrust law which was "wooden, doctrinaire and perhaps even simplistic"[88].

In 1981 Abbott Lupsky totally repudiated the "Nine No Noes" as not reflecting the Reagan administration's policy. He said[89]:

86 T.McCarthy *"Monopolization and other trade practices in the exploitation of intellectual property"*. A paper given to a seminar at Monash University (April 1985).
87 n.86.
88 n.86.
89 This speech is reprinted in the 1985 Supplement to Oppenheim, Weston & McCarthy *"Federal Antitrust Laws"* (4th Ed. 1981) p.129.

> Where I depart from my predecessor . . . is in his assertion that the Nine No Noes have much independent validity as economically rational antitrust rules logically following from the premises stated. When one makes the analysis, one finds that the Nine No Noes, as statements of rational economic policy, contain more error than accuracy.

Indeed the Reagan Administration proposed to remove the *per se* analysis from all intellectual property licensing but the Bill failed to become law[90].

The latest "lunchtime speech law" on this subject, to my knowledge, is a speech by Charles F.Rule, Deputy Assistant Attorney-General of the Antitrust Division, given on 21 October 1986. In this speech, the cardinal line was that: [91]

> Over the last six years, we have sought to debunk the Nine No Noes indicating that they no longer represent our policy.

2. *The "Nine No Noes" in the context of market power*

The fundamental question, it seems to me, is whether a patentee has the applicable market power to come within the respective statutes in Australia or New Zealand. The "Nine No Noes" are not *per se*, or axiomatically, no noes. But they may be no noes if used to further a misuse of market power or bring about anticompetitive effects.

Market power analysis involves questions of the relevant market (which analysis has been discussed in Part V.2 of this paper) and whether the appropriate degree of power in that market is held. In earlier discussion at Part V.3 and Part IX of this paper the conclusions set out in Table II hereunder were reached as to the quantum of market power necessary to trigger the operation of the various Australian and New Zealand Sections.

TABLE II

QUANTUM OF MARKET POWER NECESSARY TO TRIGGER THE OPERATION OF THE RELEVANT SECTIONS UNDER AUSTRALIAN AND NEW ZEALAND COMPETITION LAW

[For detailed discussions see Part V.3 and Part IX of this Paper]

Relevant Provision

Australia

Percentage of Market-Power to trigger operation of the Section (Lowest percentage thought applicable)*

**S.46	Misuse of Market Power	25-30%
**S.47	Supply on a condition of product, territory or customer exclusivity	20%
#S.45	Anticompetitive contract, arrangement or understanding (NB. does not include *per se* breaches)	20%

[90] H.R. 3878, Title III (Sept.18, 1983). The legislation was re-introduced as the *Intellectual Property Rights Improvement Act* of 1986 — s.2525.

[91] C.F.Rule, Deputy Assistant Attorney General, Antitrust Division: *"The Antitrust Implications of International Licensing: Analyzing Patent and Know-How Licenses"* — a paper given to Legal Conference sponsored by the World Trade Association and the Cincinnati Patent Law Association — October 21, 1986. The paper is reprinted in C.C.H. Trade Regulation Reports Vol.5 under the heading "Topical Law Reports" at 50,482.

New Zealand

**S.36	Use of a dominant position	45-50%
# S.27	Anticompetitive contract arrangement or understanding (NB. does not include *per se* breaches)	20%

* NOTE: The cases emphasise that behavioural conduct is also of considerable importance in determining market power. These percentage tests are threshold tests only.

** Single entity conduct only[92].

Multi-entity conduct. The market share is that of the various entities combined.

The change in United States policy relating to the "Nine No Noes" should not be misunderstood. The retreat is based on the fact that there is no *per se* ban i.e. no ban regardless of the circumstances of the case. The retreat merely says that it is a matter of "rule of reason" (for Australia and New Zealand, read "competition") analysis or, in the appropriate case, an analysis of the statutory sections relating to misuse of market power. When the additional market power factor is thrown in, then the competition test operates more adversely to the patent holder and it will, it seems to me, be difficult for him to pass it in the usual case if the "Nine No Noes" or any of them, are present.

There is no reason why a patent holder should be treated any more favourably then a non patent holder other than in relation to exemptions statutorily conferred. Such case law as we have shows that the law gets tough when the market power thresholds set out in the above table come into play. The law will, no doubt, be equally tough when one or more of the "Nine No Noes" is engaged in by a party in a position of applicable market power.

Read down as above, it appears to me that the "Nine No Noes" still have teeth. Even the most ardent supporter of the Reagan policy does not say that the "Nine No Noes" never apply. In his October 1986 speech, Charles Rule whilst seeking "to debunk the Nine No Noes" nonetheless also said[93]:

> This does not mean that it is impossible for a patent license to violate the antitrust laws. The antitrust laws, however, only condemn patent licensing that either restricts competition among technologies that are economic substitutes, or is a sham designed to coordinate the pricing of products not directly related to the patent. In simple economic terms, licensing violates the antitrust laws when it decreases the demand elasticity facing the patent holder by restricting availability of competitive technologies.

Thus, even the Reaganites firmly believe that the "Nine No Noes" are not necessarily always legal. If any of them is utilised to misuse market power, illegality may well follow. In drafting patent licensing agreements, therefore, one would still be wise to have regard to the "Nine No Noes" if the client involved has, or is approaching, the applicable market power threshold.

XIII Price Discrimination

There is a price discrimination law in Australia. There is no such law in New Zealand. I oppose price discrimination legislation for a number of reasons

92 See Part VII of paper and notes 50, 51 and 62.

93 n.91.

into which it is not appropriate here to delve[94]. Nonetheless, it should not be forgotten that price discrimination is but a manifestation of misuse of market power (Australia) or use of a dominant position (New Zealand). Indeed, after much agonising, United States courts now appear to be finding in the concept of misuse of market power the solution to the apparently inconsistent propositions that everyone should charge the same price yet everyone should be competitive. Courts have thus held, in the United States, that price discrimination laws and monopolization under section 2 of the Sherman Act "are directed at the same economic evil and have the same substantive content"[95]. *The Blunt Committee* in Australia argued, unfortunately unsuccessfully, that Australia's price discrimination law should be repealed because all misuse of market power, of which price discrimination was but one manifestation, could be dealt with under section 46 of the Australian Act[96].

There has been but one fully reasoned case under Australia's price discrimination law — *Cool* v. *O'Brien*[97]. So incomprehensible is this decision that I once said of it that[98]

> The Federal Court (in *Cool* v *O'Brien*) has set business adrift on the sea of commerce without a buoy let alone a beacon with which to guide its conduct.

Nonetheless, a case of price discrimination which could be a misuse of market power was reported upon by the Trade Practices Commission in its 1979 Annual Report and deserves consideration here. The case involved differential pricing conduct which could well be engaged in by a patent holder which has the market power to do so. Pilkington — ACI ("PACI") held an Australian glass production monopoly. In a scheme introduced in 1977, it allowed certain favoured customers to aggregate purchases from all branches in order to qualify for bulk discount rates. Delivery was to individual branches of favoured customers, not to central warehousing facilities. Autonomous companies had no possibility of aggregation at all. The result was that a branch of a favoured customer may well buy less glass more cheaply than its independent competitor though such independent competitor had a larger throughput and larger purchases than the competitor branch of the favoured customer. The favoured customer branch, unlike the independent competitor, had the ability to aggregate nationwide for discount purposes.

Manifestly the practice could not have been cost justified. The Trade Practices Commission concluded in relation to its negotiations with PACI that "as time went on it became increasingly doubtful that PACI could continue to justify the discount policy . . . in terms of 'meeting competitive prices' "[99]. The Commission also noted that the trading terms "had . . . threatened the very

94 See W.J.Pengilley *"Handbook on Price Discrimination* (Business Law Education Centre Melbourne 1984); *"Price Discrimination Law — The Present Position and the Impact of Legislative Proposals"* (The Australian Director (June/July 1984) p.14); *"Summary of the Effects of s.49 of the Trade Practices Act and Comments on Proposed 1984 Amendments"* (The Bulletin of the Commercial Law Association of Australia (May 1984) Vol.16 No.2 p.27; *"Price Discrimination Law: Is it of Assistance to Anybody?"* (Management Forum (June 1985) Vol.11 No.2 p.105).

95 *D.E. Rogers Associates* v. *Gardner Denver Co.* n.24.

96 *Blunt Committee* — see references at n.24 above.

97 *Cool* v. *O'Brien* n.25.

98 W.J.Pengilley *"Price Discrimination Law: Is it of Assistance to Anybody?"* — n.94.

99 *Trade Practices Commission: Fifth Annual Report — Year Ending 30 June 1979* para.5.32.

viability of an important group of medium to small glass manufacturers"[100].

In 1979, the Commission after some two years investigation accepted a new discount structure with lower variations and State rather than national discount aggregations. It is not surprising, however, that complaints continued. The Commission in 1982 noted that "PACI were again revising their discount structure and it considered the proposed new scheme would further reduce the risk of Section 49 challenge"[101]. In 1983, the Commission announced "that there was general acceptance in the industry of the revised pricing policy"[102].

I previously commented that, notwithstanding my dislike of the Australian price discrimination law, the PACI case gave rise to "as good a case of anticompetitive price discrimination as could have been presented (to the Commission)"[103]. The Commission, however, preferred to negotiate rather than litigate — with mixed results as has been seen.

The PACI policy was clearly damaging a competitor in a market within the Australian section 46 and PACI clearly had the applicable market power. It is more difficult to bring the conduct within section 36 of the New Zealand Act but one could well argue that it prevented or deterred a person from engaging in competitive conduct because of the differential supply price involved. I think the case represents conduct in which those with market power should be very reluctant to engage for fear of breaching the competition law.

There is nothing which would "patent exempt" conduct of this kind from either the Australia or New Zealand legislation.

XIV Freedom to Deal

There is a tendency frequently to turn qualified propositions into absolutes. This is probably manifested as well as anywhere else in the proposition that there is a "Right of Freedom to Deal".

Certainly competition depends upon certain freedoms — and the freedom to deal is one of these. It would be an unwarranted intrusion into matters of individual choice if the competition laws mandated that a supplier had to supply whoever knocked at his door. Further, it is not improper for a person to refuse to deal for the most outlandish reasons — for example, that the supplier does not like dealers who have red hair[104].

There certainly is a freedom to deal or not to deal, as one wishes. However, one may not terminate a dealer or refuse to deal with a person for a reason which is prohibited by competition law. This is not unreasonable as a matter of policy. In some cases, such conclusion has been reached by judicial reasoning.

100 n.99 para.5.48.

101 *Trade Practices Commission 1981-2 Annual Report* para.4.9.2.

102 *Trade Practices Commission 1982-3 Annual Report* para.4.8.6.

103 W.J.Pengilley *"Competition Policy — Some Ramblings in Ill-Defined Areas"* Australian Journal of Law and Society Vol.2 No.1 (1984).

104 With the increasing avalanche of anti-discrimination etc. legislation, it is possible that this statement may now have to be qualified to some degree. Probably if the red haired person is an Irishman, he may be able to claim victimisation on racial grounds. If the red haired person is a woman, all sorts of problems may arise. If the person is a red haired Maori or Aborigine, then it may be expected that the results will be even more serious and if the red haired person is infirm, then victimisation on grounds of medical health might be demonstrable. It is not here intended to cite all the relevant statutes or examine this situation further. The purpose of this footnote is merely to alert the reader to the possibility that all kinds of statutes extraneous to competition law may, on occasions, impact upon the rights of parties under competition law.

In others (and in particular under the Australian exclusive dealing code) it follows pursuant to statute.

1. *Resale price maintenance*

The resale price maintenance legislation of both Australia and New Zealand specifically states that it is illegal to withhold supplies for various resale price maintenance reasons[105]. In relation to such provisions the then Chief Justice of Australia, Sir Garfield Barwick said in *Mikasa*[106] that[107]:

> The sense of the provisions . . . is that the supply has been withheld for the reason that the person from whom it has been withheld is likely to sell the goods, if supplied to him, at a price less than the price specified.
>
> . . . In my opinion it is not correct to so emphasize the participle in the phrase "for the reason that" as to interpret the paragraph as requiring the withholding of the supply to be for one reason only. In my opinion if the likelihood that the would be purchaser would sell at less than the specified price is an operative reason for withholding that supply, the supplier engages in the practice of resale price maintenance, however many other reasons the supplier may in fact have for not supplying the goods to a would be purchaser. The likelihood of price cutting is not required, in my opinion, to be the predominant reason; it is enough if it is an operative reason, that is to say, a substantive reason in the totality of reasons for the withholding of the supply . . .

There is no patent exemption in either Australia or New Zealand in respect of resale price maintenance activities.

2. *Exclusive dealing — Australia*

The same logic as that applicable to resale price maintenance applies in Australia in relation to third line forcing and full line forcing with anticompetitive product, territory or customer restraints. For example, section 47(7) of the Australian Trade Practices Act specifically provides that a breach of the Act occurs if a corporation refuses to supply goods or services for the reason that the supplied party has not agreed to acquire other goods or services directly or indirectly from another person. Section 47(3) provides that exclusive dealing is engaged in if a supplier refuses to supply for the reason that the supplied party will not involve itself in anticompetitive product, customer or territorial restraints. I might comment that the Australian legislation makes pretty heavy weather of it all. It deals with such double negatives as the illegality of withholding supplies because the supplied party has, for example "not agreed not to acquire" certain goods or services. It is, therefore, little wonder that his Honour, Mr. Justice Stephen (as he then was) of the High Court characterised section 47 of the Australian Trade Practices Act as being "replete with double negatives and proliferating alternatives (which) defy accurate synopsis"[108].

3. *Misuse of market power (Australia); use of a dominant position (New Zealand)*

In the absence of explicit sections dealing with a refusal to supply, one

[105] Trade Practices Act (Australia) ss.96(3)(d) and 96 (3)(e); Commerce Act (New Zealand) ss.37(3)(d) and 37(3)(e).

[106] *Mikasa (N.S.W.) Pty Ltd* v. *Festival Stores* (1972) 127 C.L.R. 617.

[107] n.106 pp.634-635. See also statutory definitions of purpose or reason now contained in s.4F of the Trade Practices Act (Australia) and s.2(5) of the Commerce Act (New Zealand).

[108] *T.P.C.* v. *Tooth & Co.* (1979) A.T.P.R. para.40-127 at p.18366.

has to look at the nature of the particular infringement itself. In the case of misuse of market power (section 46 Trade Practices Act (Australia)) or use of a dominant position (section 36 Commerce Act (New Zealand)), it is basically a question of whether the refusal to supply falls within the definition of the offence. So, it may be "taking advantage" of market power not to supply a party who is acting in a manner competitive with other retail outlets (*Lyons* v. *Bursill*[109]). However, it may not be so if one is denying supply for reasonable business reasons -such as the reason that a monopoly producer wishes to sell the product itself rather than supply it to others for re-sale (*Queensland Wire Industries* v. *B.H.P.*[110]). As discussed (Part VI. 2 and 3 above), the essence of a breach of the misuse of market power provisions lies in some commercial reprehensibility. If the applicable market power is present (see Part V. 3 above), the question will be one relating to the degree of reprehensibility involved.

[AUTHOR'S NOTE: In relation to the citation to *Queensland Wire Industries* v *BHP*, see now, however, the High Court decision in that case — Judgment 8 Feb. 1989].

4. *Refusals to supply for exclusionary provision or price fixing reasons*

Refusals to supply for exclusionary provision reasons or for reasons or price fixing by agreement (see discussion Part X) will be direct breaches of the applicable sections involved. For all relevant purposes, the law in

5. *Unilateral refusals to supply for exclusive dealing reasons (New Zealand)*

Unilateral refusals to supply in New Zealand for third line forcing or anticompetitive full line forcing reasons create an interesting situation.

Such conduct is not covered in New Zealand by the extensive statutory code which exists in Australia. In New Zealand illegality occurs not because of a refusal to supply because certain conditions are not agreed (as in the Australian position) but because there is an anticompetitive contract, arrangement or understanding involved. If the contract, arrangement or understanding is anticompetitively illegal, then it will be a breach of the Commerce Act (section 27) to enforce the illegal tie.

It will be more difficult, however, if a potential supplier refuses to supply because the potentially supplied party will not enter into an anticompetitive illegal contract, arrangement or understanding. Presumably, in this case, as there is no actual breach because there is no contract, arrangement or understanding involved, proceedings could be instituted against the potential supplying entity only for an attempt to bring about the creation of an illegal contract, arrangement or understanding[111]. Aiding and abetting proceedings may also be successful. Further, it might successfully be argued that an inducement was being offered by the potential supplying company to the potential supplied entity. It is clear law that an inducement may consist of promising "good things" as well as threatening "bad things"[112]. It thus seems

[109] n.12.

[110] n.49.

[111] Aiding, abetting, attempting and inducing a contravention of the Commerce Act are covered in s.80. Injunctions may be issued against such conduct (s.81) and damages also are available (s.82).

[112] *R* v. *Bodsworth* [1968] 2 N.S.W.R. 132 (N.S.W. Ct. of Crim. Appeal).

that stating to a party that supply will be available only on the basis that a certain illegal agreement is entered into is sufficient to constitute an inducement (by the promise of supply) to enter into the relevant illegal agreement.

6. *There is nothing unique to patent holders in the law relating to refusals to deal*

None of the above law is particularly or peculiarly applicable to patent holders. The law for patent holders is the same as for all other trading entities. However, as has been seen, (Part VI), parties with applicable market power retain a very substantial freedom to deal as they will and it is the exceptional, not the usual case, which involves the potentiality of breach of competition law.

7. *The Australian Trade Practices Commission comments on refusals to deal*

The Australian Trade Practices Commission in introductory comments to an Explanatory Leaflet issued by it probably puts the law on the "right to deal" issue as accurately as is possible in a generalised statement. The commission says[113]:

> Suppliers are not obliged under the Act to supply everyone who orders their goods. There are sound reasons for this. In your own business you may have some reservations about selling goods to all comers.
>
> You may be a wholesaler or manufacturer who finds it too costly or inconvenient to sell to people who come in off the street. Or you may dislike dealing with certain customers because they do not present your goods properly; lack particular skills, expertise or technical qualifications; or do not make enough effort to sell your goods. But there are some circumstances where a refusal to deal is governed by the Trade Practices Act . . . (the Commission then goes on to discuss resale price maintenance, misuse of market power, exclusive dealing, trade union pressures resulting in a refusal to deal and refusals engaged in by virtue of a contract, arrangement or understanding)

XV CONCLUSIONS

1. *The view of patent holders has for some time been unduly pessimistic*

There has for too long been too much doom preached by patent holders as to the restrictions placed upon them by competition law. I believe this has been for four basic reasons.

(i) The failure to recognise that patent power is not market power (see Discussion Part V.2).

(ii) The above failure has led to a characterisation of certain practices as being illegal in all circumstances whereas, in fact, such practices are illegal only when they represent an improper exercise of market power. The "Nine No Noes" in the United States represent a good example of this (see Discussion Part XII).

(iii) In New Zealand, it appears as if a forty-five to fifty per cent market share is required before there can be a misuse of market power (see Part V.3(a)), whilst in Australia a twenty-five per cent plus share would appear to be required (see Part V.3(b)). In the field of anticompetitive unilateral exclusive dealing, it appears as if a twenty to twenty-five per cent market share must be present (see Part VIII.1(e) and Part IX).

[113] *"Refusals to Deal"* Explanatory Memorandum issued by the Australian Trade Practices Commission: May 1987.

A good deal of market conduct thus has no real risk of breaching the competition law.

(iv) Patentees, over years, seem to have emphasised their need for favoured treatment by pressing for various exemptions from competition legislation. Pro-patent lobbyists have assumed that virtually every activity based on patent licensing has overtones of illegality. This is simply not true as the discussions in Part VI of this paper clearly shows. Above all, patent holders, like others in a position of market power, retain substantial freedom in relation to dealing. Patent holders do not have to pre-disclose trade secrets to competitors nor compulsorily license their products. They retain significant freedoms in relation to quality control and various forms of exclusive dealing. Neither are the common laws of trade secrets or know-how disturbed by competition law.

In defence of the views of patentees in seeking "exemptions" it is true to say that the patent system has been, over time, subject to considerable litigious attack. A number of the principles establishing the freedom of the patentee have been firmly established relatively recently. Patentee attitude now may, therefore, be able to be more relaxed than it could have been a decade or so ago.

2. *The effect of patent exemptions*

Concentration on the exclusion of patent related activities from the constraints of competition law is, therefore, in my view, largely misconceived in its emphasis. Nonetheless, patent holders have managed to receive some different treatment under competition law and it is appropriate to summarize what I believe to be the effect of such exculpatory provisions.

(a) *The effect of exempting provisions — Australia*

The Australian patent exemption is quite narrow. There is no exemption in relation to resale price maintenance or misuse of market power. Exemptions from other competition sections are thus, for all relevant purposes here considered, confined to otherwise illegal contracts, arrangements or understandings and otherwise illegal exclusive dealing. The thrust of the exemption is that the activity must be a "condition" that "relates to" the patent or articles made from the relevant invention.

In my view, the patent exemption operates to permit unilaterally imposed territorial and customer exclusivity. If quality standards are mandated, the provision may exempt third line forcing (*per se* banned under section 47(6)) if such practice is, within the United States decisions on the point, genuinely aimed at assuring quality and is the least restrictive method of achieving this end. Because of its narrow scope, this defence is unlikely frequently to succeed.

Both of the above conclusions are reached with some considerable doubts.

It seems that the patent exemption in the Australian Act does not exempt any of the "Nine No Noes" if the particular practice is a misuse of market power. Neither, however, are such practices banned *per se*.

The patent exemption does not, in my view, exempt patent pools from assessment as to their anticompetitive effects, but neither are these *per se* banned. Neither, in my view, does the patent exemption permit restrictions to be imposed on a licensee as to prices he will charge or permit the licensee to enforce quota restrictions. These arrangements have to run a competitive evaluation for legality assessment or be evaluated as to whether or not they constitute price fixing arrangements.

(b) *The effect of the exempting provisions — New Zealand*

Exactly the same position applies in Australia as in New Zealand in relation to resale price maintenance.

Broadly the same conclusions run in New Zealand as in Australia regarding the prohibition on use of a dominant position. However, the threshold of "dominance" is higher than Australia and the section would not normally be activated below a forty-five to fifty per cent market share.

There are no exclusive dealing provisions in New Zealand. Thus, for present purposes, the only relevant exemption provisions are those relating to otherwise illegal contracts, arrangements or understandings being price fixing arrangements, exclusionary provisions or anticompetitive arrangements.

In this regard, the New Zealand provisions are very generous compared with their Australian equivalent. So, not only are unilateral territorial and quality arrangements, for example, exempt from competition analysis, but horizontal agreements on these aspects appear also to be exempt. This gives rise to exemption of arrangements which I believe, on policy grounds, to be quite wrongly exempted because they do not relate either to the patent or to its exploitation. There cannot be any real justification, for example, for horizontal agreements which control quotas or divide territories. Whatever the merits of these practices when unilaterally determined (and I see merit in territorial exclusivity even if not in quota restrictions), these merits become almost impossible to see when the restrictions are determined jointly by agreement between competitors. Because New Zealand opted not to have an exclusive dealing code and to govern all anticompetitive practices on the basis of whether it constituted a "contract, arrangement or understanding" the New Zealand patent exemption is an exemption not only of unilateral conduct or of conduct between licensor and licensee, but is also an exemption of horizontal conduct by agreement between competitors. The New Zealand Act, unfortunately, does not seem to embrace the obvious wisdom of the United States Supreme Court in its 1914 *Eastern States Lumber Dealers Association* decision[114] where the court observed:

> A retail dealer has the unquestioned right to stop dealing with a wholesaler for reasons sufficient to himself . . . but . . . when plaintiffs . . . combine and agree . . . quite another case is presented. An act harmless when done by one may become a public wrong when done by many acting in concert.
>
> When (an entity) goes beyond his personal right and combining with others of like purpose, seeks to obstruct the free course of interstate trade and commerce . . . he exceeds his lawful rights, and such action brings him and those acting with him within the condemnation of (the Sherman Act).

An amendment to the New Zealand patent exemption to recognise the differences between horizontal and vertical arrangements would appear to be quite fundamental.

(c) *Fair Trading Act (New Zealand and Australian States); Trade Practices Act Part V (Australia — Commonwealth)*

I again draw to the attention of my readers Part III of this paper —

[114] *Eastern States Retails Lumber Dealers Association* v. *U.S.* 234 U.S. 600 (1914).

"*Be aware of the Exocet we do not here discuss: the recently enacted Fair Trading Laws*". Had I not been limited to a discussion of the interface between competition law and intellectual property law, I believe that probably a paper on the impact of Fair Trading legislation may have been more useful than that which I have given. Still, there will be more conventions of your august body to which, no doubt, lawyers will be invited to give papers. One could do much worse at a future convention than discuss Fair Trading legislation.

(d) Closing comments

I end with the citation from the *Bath Tub Trust Case*[116] which appeared earlier in this paper. This citation expresses the view that patent rights deserve respect and, indeed:

> Rights covered by patents are indeed very definite and extensive; but they do not give. any more than other rights, a universal licence against positive prohibition. (The antitrust law) is a limitation of rights; rights which may be pushed to evil consequences and therefore restrained.

By a process of probing the limits of both patent and competition law will the limits of each be found. This paper has been an attempt to suggest some principles and guidelines. There is a long way to go before we have any clear answers.

115 n.114 at 614.
116 n.9.
117 n.9.