National Competition Council

REVIEW OF SECTIONS 51(2) AND 51(3) OF THE TRADE PRACTICES ACT 1974

FINAL REPORT

MARCH 1999

National Competition Council
Casselden Place Level 12 2 Lonsdale Street Melbourne 3000 Australia
GPO Box 250B Melbourne 3001 Australia
Telephone 03 9285 7474 Facsimile 03 9285 7477

5 March 1999

The Hon Joe Hockey, MP
Minister for Financial Services and Regulation
Parliament House
CANBERRA ACT 2600

Dear Minister

In accordance with the terms of reference sent to us on 5 June 1998, I have much pleasure in presenting to you the Council's report on the competition effects of the exemptions from Part IV of the *Trade Practices Act 1974 (Commonwealth)* contained in sections 51(2) and (3) of that Act.

Yours sincerely

Graeme Samuel
President

Elizabeth Nosworthy
Councillor

David Crawford
Councillor

Robert Fitzgerald
Councillor

Paul Moy
Councillor

Commonwealth of Australia

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Inquiries or comments on this report should be directed to:

Ms Michelle Groves
Director
National Competition Council
GPO Box 250B
Melbourne VIC 3001
Australia

Telephone [03] 9285 7476
Facsimile [03] 9285 7477
Email info@ncc.gov.au
Website http://www.ncc.gov.au

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TERMS OF REFERENCE

I, PETER COSTELLO, hereby in accordance with the Commonwealth Government's Legislation Review Schedule, refer to the National Competition Council subsections 51(2) and 51(3) (exemption provisions) of the *Trade Practices Act 1974 (TPA)* for inquiry and report within nine months of receipt of this reference.

2. To meet the requirements of the Competition Principles Agreement (CPA) legislation/regulation which restricts competition should only be retained if the benefits to the community as a whole outweigh the costs, and if the objectives of the legislation/regulation cannot be achieved more efficiently through other means, including non-legislative approaches.

3. In undertaking this inquiry the Council should have regard to:

   (a) relevant Federal and State industrial relations legislation and international agreements relating to labour that recognise collective bargaining;

   (b) the common law doctrine of restraint in relation to restrictive covenants pertaining to employment, partnerships, and the protection of goodwill in the sale of a business;

   (c) standards made by the Standards Association of Australia;

   (d) the Government's obligations under intellectual property treaties and conventions arising from Australia being a signatory to various International Intellectual Property Agreements and Conventions, including the World Trade Organisation Agreement on Trade-Related Aspects of Intellectual Property Rights;

   (e) Australian intellectual property legislation including the *Copyright Act 1968*, the *Designs Act 1906*, the *Patents Act 1990*, the *Trade Marks Act 1995*, the *Circuit Layouts Act 1989* and the *Plant Breeder's Rights Act 1994*;

   (f) other nations' experience with provisions similar to s51(2) and s51(3) of the TPA (ie provisions that provide/allow for specific exemptions from the application of general competition laws);

   (g) consequential effects that the exemption provisions have through the Competition Code in each State and Territory; and

   (h) any other matters the Council considers relevant to this inquiry.

4. The Council is to have regard to the analytical requirements for regulation assessment by all Australian governments set out in the CPA. Without limiting the scope of the reference, the final report from the Council should:

   (a) identify the nature and, as far as reasonably practical, the magnitude of the social and economic problems that subsections 51(2) and 51(3) (exemption provisions) of the TPA seek to address;

   (b) clarify the objectives of the exemption provisions and determine whether these objectives continue to be relevant;

   (c) identify whether, and to what extent, the exemption provisions allow certain individuals/corporations to engage in specific anti-competitive conduct that may otherwise be prohibited by the general prohibitions in Part IV of the TPA;

   (d) identify relevant alternatives to the exemption provisions, including non-legislative approaches;

   (e) analyse, and, as far as reasonably practical, quantify the benefits, costs and overall effects of the exemption provisions and alternatives identified in (d) on the Australian economy;

   (f) list the individuals and groups that provided written submissions and/or were consulted during the review and take into account their views;

   (g) determine a preferred option for regulation — ie whether the exemption provisions should be abolished, modified or maintained; and

   (h) advise on possible mechanisms for monitoring and reviewing any changes to the exemption provisions after the Government's announced response.

5. In undertaking the review, the Council is to advertise nationally, take written submissions, consult with key interest groups and affected parties, and release a draft report or options paper for comment prior to a final report.

6. Upon receipt of the Council's final report, the Government will consider the recommendations made and announce what action is to be taken as soon as possible.

ABBREVIATIONS

AAH	Allen Allen & Hemsley
ADA	Australian Dentists Association
ACCC	Australian Competition and Consumer Commission
ACCI	Australian Chamber of Commerce and Industry
ACTU	Australian Council of Trade Unions
AIG	Australian Industry Group
AIRC	Australian Industrial Relations Commission
ANZCER	Australian New Zealand Closer Economic Relations
ASTEC	Australian Science and Technology Council
AWA	Australian Workplace Agreement
CA	Certified Agreement
Can	Canada
Cth	Commonwealth
BIE	Bureau of Industry Economics
DG IV	Directorate-General IV
DEWRSB	Department of Employment, Workplace Relations and Small Business
DPIE	Department of Primary Industries and Energy
DOPLAR	Department of Productivity and Labour Relations, Western Australia

EL rights	Electronic Layout rights
EU	European Union
IP	Intellectual Property
ILO	International Labour Organisation
IPAC	Industrial Property Advisory Committee
LCA	Law Council of Australia
LESANZ	Licensing Executives Society of Australia and New Zealand
NASA	Newsagents Association of South Australia
NZ	New Zealand
OECD	Organisation for Economic Cooperation and Development
PC	Productivity Commission
RoT Act	Restraints of Trade Act 1976 (NSW)
TPA	Trade Practices Act 1974 (Cth)
TPC	Trade Practices Commission
TRIPS Agreement	Trade Related Aspects of Intellectual Property Agreement
UK	United Kingdom
WRA	Workplace Relations Act 1996 (Cth)

EXECUTIVE SUMMARY

On 5 June 1998 the Commonwealth Treasurer, with the agreement of State and Territory Governments, requested the National Competition Council to review sections 51(2) and 51(3) of the *Trade Practices Act 1974 (TPA)*.

Sections 51(2) and 51(3) exempt from the competition rules in Part IV of the TPA the activities of firms in certain areas of the economy.

About Sections 51(2) and 51(3)

Section 51(2) provides a number of standing exemptions to the restrictive trade practices prohibited by Part IV of the TPA, except for secondary boycotts and resale price maintenance. The exemptions, in general terms, relate to:

- the negotiation of employment conditions;
- restrictive covenants in employment contracts;
- sale of business contracts and partnership agreements;
- use of approved standards; and
- export contracts.

Section 51(3) provides an exemption to some of the restrictive trade practices prohibited by Part IV of the TPA. It does not extend to the prohibited practices of misuse of market power and resale price maintenance. The exemption covers certain conditions in licences or assignments of intellectual property rights in patents; registered designs; copyright; trade marks; and circuit layouts.

About Legislation Reviews Under the CPA

This review arises under clause 5 of the Competition Principles Agreement (CPA), an intergovernmental agreement that forms part of the National Competition Policy (NCP). Clause 5 of the CPA requires all governments to review legislation that impose restrictions on competition.

Legislation affects Australians in a myriad of ways. For example, it affects the hours people can shop and what they can buy, the hours they can work, and the businesses they can run and how they can run them. Because many of Australia's goods and services are sold in global markets, the domestic regulatory environment also affects our international competitiveness.

Clause 5 of the CPA recognises that much legislation is necessary. For example, legislation is needed to ensure that some markets work properly and/or to help achieve community goals in areas such as equity, health, safety and the environment.

However, clause 5 also recognises that some legislation, particularly legislation that restricts competition, does not serve the broad community interest, even though it may serve some private interests.

Accordingly, under clause 5, each Australian government committed itself to review all its legislation that restricts competition, and to remove any restrictions unless it can be demonstrated that:

- ➤ the benefits of the restriction to the community as a whole outweigh the costs; and
- ➤ the objectives of the legislation can only be achieved by restricting competition.

If legislative restrictions on competition are to remain, it must be demonstrated that there are benefits to the Australian 'community as a whole' from keeping the restrictions – not just benefits to vested interests or regional interests.

The Scope of this Review

This review is unusual in that it relates to a piece of 'pro-competitive' legislation: namely, Part IV of the TPA. This legislation, rather than restricting competition, seeks to promote it by setting out certain rules for competition. It does this by, among other things, preventing mergers that would substantially lessen competition and by prohibiting practices such as price fixing.

The review is also unusual in that, rather than looking at whether the competition rules in Part IV are justified, it looks at whether particular exemptions to Part IV contained in sections 51(2) and 51(3) of the TPA are justified.

In principle, the exemptions in sections 51(2) and 51(3) constitute restrictions on competition because they restrict the operation of the competition rules in Part IV of the TPA. The extent to which the exemptions restrict competition in practice is examined in this review. This has needed to be considered because the activities covered by the exemptions may or may not be anti-competitive in the first place. For example, the use of recognised standards exempted by section 51(2)(c) does not in practice involve anti-competitive conduct. In contrast, some licensing and assignment of intellectual property exempted by section 51(3) may in practice restrict competition.

Most importantly, this is not a review of the areas of the economy covered by sections 51(2) and 51(3). Rather, it is a review of conduct in these areas that is exempt from Part IV of the TPA. For example, whilst section 51(3) covers intellectual property, the review is not a review of the intellectual property regime in Australia, but a review whether, and if so, how Part IV of the TPA should regulate licensing and assignment of intellectual property rights.

Framework for Review

The framework for analysing the potential restrictions on competition arising from sections 51(2) and 51(3) is outlined in clause 5 of the CPA and the Terms of Reference.

Under this framework, the Council is required to have regard to a number of matters, including:

- the objectives of sections 51(2) and 51(3) of the TPA;
- any restrictions on competition contained in sections 51(2) and 51(3);
- the likely effect of these restrictions on competition and on the Australian economy generally;
- the costs and benefits of the restrictions; and
- whether there are alternative ways of achieving the objectives of sections 51(2) and 51(3).

This Executive Summary now considers each of the exemptions in turn.

Employment Conditions (section 51(2)(a))

Section 51(2)(a) exempts from Part IV[1] conduct that relates to the remuneration, conditions of employment, hours of work or working conditions of employees. Its practical effect is to remove from the reach of Part IV, agreements and arrangements between employers and employees that relate to employment conditions.

Recommendation

The Council recommends that the section 51(2)(a) exemption be retained.

1 Except for sections 45D, 45E and 48.

Objectives

The objective of section 51(2)(a) is to excise the labour market from goods and services markets for the purposes of applying competition law, supporting a public policy observed both nationally and internationally that labour markets are treated differently to markets for goods and non-labour services. This policy is reflected in the mechanisms and institutions in place under Federal and State industrial relations legislation, international agreements relating to labour that recognise collective bargaining and the exemption of employment matters from competition laws in countries with regulatory and legal systems comparable to Australia's.

Restriction on competition and costs

In the absence of section 51(2)(a), certain employment agreements and arrangements are likely to breach Part IV of the TPA. This indicates that the exemption has implications for competition and therefore some potential costs.

While the industrial relations framework serves to minimise these potential costs, some costs arise in employment agreements or arrangements, particularly those established outside of the formal industrial relations framework.

Benefits

The exemption has a number of benefits:

- ➤ maintaining the primacy of the industrial relations framework in labour market relations;
- ➤ compliance with Australia's International Labour Organisation Treaty obligations; and
- ➤ the relative certainty it provides regarding the application of Part IV to employment agreements and arrangements.

The Council finds that the benefits of the exemption outweigh its costs.

Alternatives

There are no non-legislative means of achieving the objectives of the exemption. Authorisation and notification under the TPA are not practical alternatives to a standing exemption.

A revocation mechanism for the exemption could be considered for employment agreements or arrangements that are established outside of the formal industrial relations framework, as part of any future comprehensive review of competition policy and labour market arrangements.

Restrictive Covenants (sections 51(2)(b), (d) & (e))

Section 51(2)(b) exempts restrictive provisions in employment contracts. The exemption encompasses conditions of work between employer and employee and services provided by independent contractors pursuant to a contract for services.

Section 51(2)(d) exempts any provision in a contract, arrangement or understanding (otherwise called an 'agreement') between partners that relates to the terms of the partnership, the conduct of the partnership business or competition between the partnership and a party to that agreement. Section 51(2)(d) is concerned with more than restrictive covenants and extends to generally exempt partnership arrangements and conduct of the partnership business. It operates to prevent the normal conduct of a partnership from breaching the price fixing prohibitions in the TPA.

Section 51(2)(e) exempts any restrictive provision of a contract that is solely for the protection of the purchaser in respect of the goodwill of a business.

Restrictive covenants protected by section 51(2) continue to be subject to the common law doctrine of restraint of trade.

Recommendation

The Council recommends that the exemptions in sections 51(2)(b),(d) and (e) be retained in their current form.

Objectives

The objectives of these exemptions are to resolve any conflict between the application of the common law doctrine of restraint of trade and the TPA, to enable the use of certain restrictive covenants and to maintain certainty by ensuring that existing judicial consideration is relevant.

Restriction on Competition and Costs

The exemptions do not protect behaviour that would be likely to substantially lessen competition in a market. The majority of businesses relying on the exemptions are operating in competitive markets and have little market power. The application of the common law doctrine of restraint of trade adequately regulates the use of restrictive covenants.

Benefits

The exemptions provide net benefits by ensuring that appropriate commercial activities that rely on these types of agreements can continue with a degree of regulatory certainty. In the absence of the exemption these types of agreements would breach the per se provisions of Part IV, specifically the prohibitions on exclusionary provisions and price fixing.

The Council finds that the benefits of the exemptions outweigh their costs.

Alternatives

There are no alternative legislative means of achieving the objectives. Alternatives in terms of authorisation and notification under the TPA are not practical for these types of conduct.

Standards (section 51(2)(c))

Section 51(2)(c) provides an exemption for provisions in agreements dealing with recognised standards.

The exemption operates so that where there is an obligation on the part of a person to meet a standard of dimension, design, quality or performance prepared or approved by the Standards Association of Australia (SAA) or by a prescribed association or body, the arrangement is exempt from Part IV of the TPA.

The Australian Gas Association (AGA) is, to date, the only prescribed body for the purposes of Section 51(2)(c).

Recommendation

The Council recommends that the exemption in section 51(2)(c) be removed from the TPA and the Competition Codes in the States and Territories.

The Council's recommendation to remove the exemption is not intended to depreciate the importance and relevance of recognised standards to the community, governments and the courts. The Council recognises that national and international standards are pro-competitive and contribute to free trade. But the Council considers the exemption unnecessary because the use of recognised standards does not involve a breach of Part IV of the TPA.

Objectives

The ostensible objective of the exemption is to promote the development and use of recognised standards.

However, there is no evidence to suggest that the exemption promotes the development and use of recognised standards. Other factors, such as the expertise, resources and the standing of the SAA and AGA contribute to the market approval and use of their standards.

Restriction on Competition and Costs

Generally, the exemption does not involve a restriction on competition. This is because the exemption is unlikely to protect conduct that otherwise breach Part IV of the TPA. In the vast majority of circumstances, the use of SAA and AGA standards does not raise concerns under Part IV.

The exemption may, however, protect horizontal arrangements involving the collective adoption of standards of the SAA and AGA within an industry that are anti-competitive. Such circumstances are likely to be rare.

There are minimal costs associated with the exemption because it is unlikely to involve a restriction on competition.

Benefits

There are no benefits associated with the exemption. There is no evidence to suggest that the exemption offers benefits in terms of promoting the development and use of standards.

Alternatives

There are alternative non-legislative means of achieving the objective of the exemption. Steps taken by governments to reform the standards setting procedures of the SAA and review the use of standards in regulation are more direct, transparent and effective means of promoting the development and use of standards than an exemption from Part IV of the TPA.

Concerns that removal of the exemption will undermine the development of standards by the SAA and AGA, undermine the certification scheme operated by the AGA and undermine public safety are without foundation because the exemption does not address these areas.

Export Contracts (section 51(2)(g))

Section 51(2)(g) provides an exemption for a provision of a contract, arrangement or understanding that relates exclusively to the export of goods from Australia or to the supply of services outside Australia. The ACCC has received 216 notifications under the exemption.

Recommendation

The Council recommends that the exemption in section 51(2)(g) be retained in its current form.

Objectives

The objectives of the exemption are to facilitate exports, remove uncertainty about the application of the TPA to exports and to place Australian exporters in the same position as foreign exporters that benefit from similar exemptions.

Restriction on Competition and Costs

The exemption is unlikely to restrict competition in an Australian market and therefore, there are no costs.

Benefits

The exemption provides benefits in terms of certainty and placing Australian exporters on an equal footing with foreign exporters. The exemption may have increased use in the future due to reforms in statutory marketing arrangements and growth in the services sector.

Alternatives

Authorisation (and notification) under the TPA is not a practical alternative to the exemption, while other non-legislative means could not achieve the identified objectives.

Intellectual Property Rights (section 51(3))

Section 51(3) of the TPA exempts certain conditions in licences and assignments of intellectual property from some of the provisions of Part IV of the TPA. The section provides that conditions that 'relate to' the subject matter of patents, registered designs, copyright, trade marks, and circuit layouts are exempt from sections 45, 45A, 47, 50 and 50A. Section 51(3) does not exempt licensing and assignment conditions from the operation of sections 46 or 48.

Recommendations

The Council recommends that the exemption in section 51(3) be retained, but amended to remove protection of price and quantity restrictions and horizontal agreements.

The Council recommends amending section 51(3)(a) to extend the exemption to cover the intellectual property rights granted under the *Plant Breeder's Rights Act 1994 (Cth)* consistent with the protection provided for patents, registered designs, copyright, and EL rights.

The Council recommends amending section 51(3) to refer to the *Trade Marks Act 1995*, including references to the registration of services as well as goods and to authorised users rather than registered users.

The Council recommends that saving provisions be inserted into the TPA to preserve the effect of the current section 51(3) in relation to licences and assignments entered before amendment of section 51(3).

The Council recommends that the ACCC formulate guidelines for the assistance of industry on:

- when intellectual property licensing and assignment conditions might be exempted under section 51(3);
- when intellectual property licences and assignments might breach Part IV of the TPA; and
- when conduct in relation to intellectual property that does not fall within the exemption and is likely to breach Part IV of the TPA might be authorised.

The Council recommends that the ACCC aim to release the guidelines to precede or coincide with the date of effect of the amendment of section 51(3).

The Council recommends equivalent amendments to the Competition Codes in each State and Territory to the amendments recommended in respect of the Commonwealth TPA.

Objectives

There are two possible objectives of the exemption:

- to prevent a perceived clash between intellectual property law and competition law; or
- to provide intellectual property owners with greater certainty in which to undertake licensing or assignment of intellectual property rights.

When the TPA was enacted in 1974, there was a concern that intellectual property rights might be treated under competition law as economic monopolies, and that many normal licensing and assignment practices might be seen as an extension of those monopoly rights.

However, today it is recognised that intellectual property rights are best characterised as exclusive property rights similar to the exclusive rights associated with other forms of property rights. Only in rare cases do producers using intellectual property have sufficient market power to enable them to substantially lessen competition in the markets in which they compete. Therefore, the Council considers that there is no inherent clash between intellectual property rights and competition law.

Section 51(3) may provide intellectual property owners with greater certainty to use particular types of licensing conditions (such as exclusive licences, territorial restrictions). The Council considers that this objective may still remain valid.

Restriction on Competition and Costs

Section 51(3) exempts restrictive conditions in licences and assignments of intellectual property to the extent they 'relate to' the subject matter of intellectual property rights or goods and services produced using intellectual property rights. In the absence of section 51(3), these licensing and assignment conditions would be subject to all the competition law provisions in Part IV of the TPA, and some of these conditions may be in breach of those provisions.

In particular, the exemption may permit:

- horizontal arrangements such as price-fixing, cross-licensing, and patent pooling; and
- price and quantity restrictions,

that substantially lessen competition and reduce incentives to innovate. These costs outweigh the benefits that section 51(3), as currently drafted, provides.

Benefits

The exemption may foster a climate of greater certainty in which intellectual property licensing may take place. It may also reduce compliance costs associated with checking whether proposed conduct might be in breach of the TPA. The Council considers that the benefits of the exemption are relatively limited due to the narrow scope of the exemption.

Alternatives

The Council examined the following options:

- maintaining section 51(3) as is;
- exempting conduct considered within the scope of the grant of intellectual property rights;
- narrowing the exemption to remove protection of conduct considered most likely to substantially lessen competition (price and quantity restrictions, and horizontal agreements);
- replacing the exemption with a system of notification of agreements;
- a revocable block exemption; and
- repeal of section 51(3) and the issue of guidelines outlining the approach to be taken in relation to intellectual property licensing and assignment.

The Council considers that narrowing the exemption to remove protection of price and quantity restrictions, and horizontal agreements, is the best approach. The Council considers that this option imposes the least costs while preserving most of the current benefits provided by section 51(3). To assist with this, the Council is recommending that the ACCC issue guidelines on the scope of the exemption, and the application of Part IV to dealings in intellectual property rights.

A1 Review of Sections 51(2) and 51(3) of Trade Practices Act 1974

A1.1 Introduction

This review arises out of measures agreed by all governments under the *Competition Principles Agreement* (CPA) to review and, where appropriate, reform legislation that restricts competition. Commonwealth, State and Territory Governments agreed to undertake and complete reviews of legislation that restricts competition and implement appropriate reforms no later than the end of the year 2000.

Sections 51(2) and 51(3) of the *Trade Practices Act 1974 (TPA)* exclude certain conduct from Part IV of the TPA. In general terms, the excluded areas are:

- labour markets;
- restrictions in sale of business agreements, in partnership agreements and in employment agreements;
- standards;
- export arrangements; and
- intellectual property licensing and assignment.

Part IV of the TPA sets out the rules governing the conduct of firms in Australian markets. These rules prohibit conduct that undermines the competitive process in the Australian economy.

Sections 51(2) and 51(3) restrict competition because they allow firms to engage in conduct that would otherwise breach Part IV. The Commonwealth has requested the Council review the sections and recommend changes, where appropriate, in accordance with National Competition Policy legislation review obligations.

A1.2 Report Structure

Issues concerning each of the exemptions provided by sections 51(2) and 51(3) are considered in Parts B and C of this Report, respectively. The Council has made recommendations on whether conduct that is the subject of the exemptions should continue to be protected from Part IV of the TPA and whether alternatives to the provision of 'standing' exemptions should be implemented.

A1.3 Consultation

The Treasurer provided the Terms of Reference for this review to the National Competition Council on 5 June 1998. Subsequently, the Council released an Issues Paper on 15 June 1998 calling for submissions by 7 August 1998. A Draft Report was released on 12 November 1998, calling for further submissions by 24 December 1998. Submissions continued to be received through January and February 1999.

One hundred and ten submissions were received and submitters' comments on specific matters are reproduced in this Report. The Council also met with a range of groups and individuals over the course of the review. A list of submissions and meetings is at Appendix 2.

The Council would like to thank the individuals and organisations that participated in this review.

A1.4 Framework for Analysis

The framework for analysing the potential restrictions on competition arising from sections 51(2) and 51(3) is set out in clause 5 of the CPA and the Terms of Reference.

The principles in clause 5 of the CPA provide that legislation should not restrict competition unless it can be demonstrated that the benefits to the community of restricting competition outweigh the costs and that the objectives of the legislation can only be achieved by restricting competition.

The Terms of Reference ask the Council to have regard to a number of matters, including:

- the objectives of sections 51(2) and 51(3) of the TPA;
- any restrictions on competition contained in sections 51(2) and 51(3);
- the likely effect of these restrictions on competition and on the Australian economy generally;
- the costs and benefits of the restrictions; and
- whether there are alternative ways of achieving the objectives of sections 51(2) and 51(3).

Legislative restrictions on competition typically involve direct restrictions on entry into or exit from markets such as, controlling prices or production levels, restricting production processes, including advertising and promotions, and restricting the type or price of inputs. Sections 51(2) and 51(3) do not involve these type of direct restrictions but operate to exclude certain types of conduct or areas of the economy from the competition rules in Part IV.

While the exemptions in sections 51(2) and 51(3) create gaps in the application of the competition laws in Part IV of the TPA, all of the areas are regulated or influenced by other regulatory regimes. The exemption for labour markets recognises the existence of a separate regulatory regime for collective bargaining under industrial legislation. The exemption for restrictions in sale of business agreements, in partnership agreements and in employment agreements recognises the existence of a separate regulatory regime under the general law. The exemption for intellectual property recognises the influence of intellectual property legislation.

The Terms of Reference require the Council to take into account these other regulatory regimes. The Council interpreted this requirement to mean that it needs to assume that the other regulatory regimes will continue to exist and provide a strong indication of the Government's preferred policy approach for the regulation of these areas. The Council therefore examined the extent to which the other regulatory regimes are consistent with regulation under the TPA. These issues are examined in Parts B and C of this Report.

Where the Council found that the policy intent and operation of a regulatory framework governing particular conduct is not in conflict with Part IV, it has gone on to examine the costs and benefits of the exemption and make recommendations based on the balance between them.

In the situations where the Council found that a specific regulatory regime is in conflict, in either practice or policy, with the operation of Part IV, the Council gave considerable weight to the policy expressed in the specific regulation in assessing the costs and benefits of the exemption.

The Council examined the issues raised by sections 51(2) and 51(3) within this framework, taking into account also the objectives of the TPA and specific matters in the Terms of Reference.

A1.5 Exemptions under Sections 51(2) and 51(3)

Section 51(2) provides a number of standing exemptions to the restrictive trade practices prohibited by Part IV of the TPA, except for secondary boycotts and resale price maintenance. The exemptions, in general terms, relate to:

- employment conditions;
- restrictive covenants in employment contracts;
- sale of business contracts and partnership agreements;
- use of approved standards; and
- export contracts.

Section 51(3) of the TPA provides an exemption to the restrictive trade practices prohibited by Part IV of the TPA. It does not extend to misuse of market power in section 46 or resale price maintenance in section 48. The exemption covers certain conditions of licences or assignments of statutory intellectual property rights relating to:

- patents;
- registered designs;
- copyright;
- trade marks; and
- circuit layouts.

A1.6 Part IV of the Trade Practices Act

The object of the TPA, as stated in section 2 of the Act, is to enhance the welfare of Australians through the promotion of competition and fair trading and through provision for consumer protection. This makes it clear that the TPA is not concerned with the pursuit of competition for competition's sake. Rather, the overall objective of the TPA is to enhance the welfare of Australians. Competition, fair trading and consumer protection are the stated mechanisms by which that objective is to be achieved.

Greater competition can play a major role in enhancing the performance of the economy through improving productivity and economic efficiency.[2] Economic efficiency is important in enhancing community welfare by raising the productive base of the economy, providing higher returns to producers in aggregate and higher real wages (Hilmer 1993, pp. 3-4). The Productivity Commission also notes that increased economic efficiency makes the economy more resilient and so better able to adjust to changes in global economic conditions (see for example, Productivity Commission 1996, p. 2).

The policy objectives of the competition laws in Part IV have been described by the courts as proscribing and regulating agreements and conduct and procuring and maintaining competition in trade and commerce[3]. Part IV regulates:

- horizontal agreements: anti-competitive agreements between competing firms, such as price fixing;
- vertical agreements: anti-competitive agreements between firms at different stages of the production chain, such as exclusive dealing and resale price maintenance;
- misuse of market power: the use of market power to eliminate a rival or reduce competition; and

2 Economic efficiency consists of three components: *Technical or productive efficiency* which occurs when a firm produces the maximum possible output for a given set of inputs; *Allocative efficiency* which is achieved when resources are allocated to their highest valued uses; and *Dynamic efficiency* which refers to the use of resources so as to make timely changes to technology and products in response to changes in consumer tastes and productive opportunities (Hilmer 1993; Productivity Commission 1996).

3 *Refrigerated Express Lines (A'Asia) Pty Ltd v Australian Meat and Livestock Corporation (No 2) (1980)* ATPR 40-156 per Deane J.

- mergers and acquisitions: the merger with or acquisition of an entity that would result in a substantial lessening of competition.

There are three approaches to regulating conduct within Part IV. Some conduct is prohibited only if it 'substantially lessens competition' in a market. Some conduct is prohibited per se, i.e. outright without relying on a competition test. Some conduct is prohibited if it is found to be a misuse of market power for a proscribed purpose.

The prohibitions that rely on a competition test are:

- Sections 45(2)(a)(ii) and (b)(ii) - agreements that substantially lessen competition.
- Section 47 (excluding sections (47(6) and (7) - see below) - agreements involving the supply of goods or services subject to certain restrictions that substantially lessen competition; and
- Section 50 - mergers and acquisitions that substantially lessen competition in a substantial market.

The prohibitions that are illegal *per se* are:

- Sections 45(2)(a)(i) and (b)(i) with section 4D - entering into or giving effect to exclusionary provisions, which are essentially boycotts by competitors of another person;
- Sections 45(2)(a)(ii) and (b)(ii) with section 45A - entering into or giving effect to a price fixing agreement;
- Sections 47 (6) and (7) - third line forcing, which is the practice of supplying goods and services on the condition that the purchaser acquire other goods and services from a third party; and
- Section 48 - resale price maintenance, which is the practice of imposing a minimum resale price for goods and services.

Section 46 prohibits the misuse of market power. It relies on proof of a substantial degree of market power that is taken advantage of for the purpose of eliminating or substantially damaging a competitor, preventing entry into a market or deterring or preventing competitive conduct.

Exemptions from Part IV

Section 51 of the TPA provides a mechanism that allows for the exemption of conduct that would otherwise breach Part IV of the Act. Section 51(1) allows the Commonwealth, States or Territories by legislation or regulation to specifically authorise such conduct. The Commonwealth Treasurer may, however, override a State or Territory exception under section 51(1) by regulation. Sections 51(2) and 51(3) provide for 'standing' exemptions.

There are two alternatives within the TPA to the provision of 'standing' exemptions to Part IV. These are discussed in general terms below. Their relevance to each of the exemptions provided by sections 51(2) and 51(3) is considered in Parts B and C of this Report.

Authorisation

Currently there is provision under Part VII of the TPA to authorise conduct and arrangements that would otherwise breach Part IV. Under section 88, the ACCC may grant an authorisation in relation to conduct that might otherwise breach particular subsections of sections 45, 47, 48, and 50. Section 90 provides that the ACCC may not grant an authorisation in relation to arrangements which might breach section 45 unless it is satisfied in all the circumstances that the proposed conduct or agreement has a public benefit which outweighs the detriment to the public from any lessening of competition. Broadly similar tests apply in relation to conduct or arrangements which might breach sections 47, 48, or 50.

Notification

Conduct which might breach the exclusive dealing provisions of section 47 may be notified under section 93. Under this procedure, a corporation notifies the ACCC in writing of proposed conduct. This provides the corporation with protection from the provisions of section 47 for the proposed conduct.[4] The ACCC may then undertake a consideration of whether the likely benefit to the public from the conduct outweighs the likely detriment

4 Notification of exclusive dealing under sections 47 (2), (3), (4), (5), (8) and (9) provides immediate protection unless the notification is later revoked by the ACCC. Notification of exclusive dealing under section 47 (6) and (7) provides protection after a process under which the ACCC can accept or reject the notice.

to the public from the conduct. If the ACCC decides that the proposed conduct does not satisfy this test, it may give the corporation a written notice to this effect. The notification ceases to protect the proposed conduct 31 days after the notice is given.

Conduct which might breach section 46 (the misuse of market power provision) cannot be authorised or notified.

Extension of Competition Laws

Under the Conduct Code Agreement, Governments agreed to extend the operation of Part IV of the TPA to all business activities. Constitutional limitations had previously prevented application of the provisions of Part IV to unincorporated businesses operating within one State. Further, many State and Territory government businesses had 'shield of the Crown' immunity from the TPA.

To rectify this, State and Territory governments have enacted a modified version of Part IV, called the Competition Code, in each of their jurisdictions. This contains the rules set out in Part IV modified to refer to 'persons' rather than 'corporations'. The TPA was amended to remove 'shield of the Crown' immunity for State and Territory Government businesses. Consequently, competition laws now apply to the conduct of a greater number of businesses than before.

The exemptions in sections 51(2) and 51(3) also apply to the State and Territory Competition Codes enacted by each State and Territory.

Under clause 6 of the Conduct Code Agreement, the Commonwealth, States, and Territories agreed that if amendments are to be made to Part IV, then the States and Territories should implement equivalent amendments to their Competition Codes. To protect the interests of the States and Territories, clause 6 requires the Commonwealth to consult with the States and Territories and call on each to vote on changes to the Competition Code. Under the Agreement, the Commonwealth may put forward amendments to Part IV only if a majority of parties to the agreement support the amendment.

A1.7 Consultation with States and Territories

The Council wrote to the States and Territories inviting them to make a written submission to the Council's review of sections 51(2) and 51(3). It received submissions from a variety of State and Territory agencies. A list of all submissions is included at Appendix 2.

B1 Exemption Provided by Section 51(2)(a)

B1.1 Overview

Section 51(2)(a) exempts from Part IV[5] of the TPA any act done, or any provision of a contract, arrangement or understanding that relates to the remuneration, conditions of employment, hours of work or working conditions of employees. This includes, for example, agreements on wages and terms and conditions of employment reached between employees and employers through collective bargaining processes. The exemption applies to both employers and employees. Its practical effect is to remove from the reach of Part IV of the TPA, agreements and arrangements between employers and employees that relate to employment conditions.

The Council is required to assess whether the exemption should be retained, amended or removed. The framework for assessing this matter is set out in the Terms of Reference.

Recommendation

> The Council recommends that the section 51(2)(a) exemption be retained.

In making the recommendation the Council considers that:

- the objective of section 51(2)(a) is to excise the labour market from goods and services markets for the purposes of applying competition law, supporting a public policy, observed both nationally and internationally, that labour markets are treated differently to markets for goods and non-labour services. This

5 Except for the secondary boycott provisions under sections 45D and 45E and the resale price maintenance provisions under section 48. The Council notes that section 48 is not generally relevant to employment arrangements and agreements.

policy is reflected in the mechanisms and institutions in place under Federal and State industrial relations legislation, international agreements relating to labour that recognise collective bargaining and the exemption of employment matters from competition laws in countries with regulatory and legal systems comparable to Australia's;

- in the absence of section 51(2)(a), certain employment agreements and arrangements are likely to breach Part IV of the TPA. This indicates that the exemption has implications for competition and therefore some potential costs;
- the industrial relations framework serves to minimise these potential costs; however, some costs could arise in employment agreements or arrangements that are established outside of the formal industrial relations framework;
- the exemption has a number of clear benefits, which are identified as:
  - maintaining the primacy of the industrial relations framework in labour market relations;
  - compliance with Australia's International Labour Organisation Treaty obligations; and
  - the relative certainty provided regarding the application of Part IV to employment agreements and arrangements.
- there are no non-legislative means of achieving the objectives of the exemption;
- authorisation and notification are not practical alternatives to a standing exemption;
- a revocation mechanism for the exemption could be considered for employment agreements or arrangements that are established outside of the formal industrial relations framework, as part of any future comprehensive review of competition policy and labour market arrangements; and
- there should be a minor amendment to section 51(2)(a), as discussed in section B1.4 of this chapter, to address an apparent inconsistency between the operation of section 51(2)(a) and Part IV of the TPA.

B1.2 Objectives and Relevance of the Exemption

The objective of section 51(2)(a) is to excise the labour market from goods and services markets for the purposes of applying competition law. This supports a public policy that labour markets are generally regulated through the industrial relations framework and not the TPA.

Section 51(2)(a) allows practices to occur which are permitted under labour laws but in breach of Part IV of the TPA. Such practices would include collective bargaining activities that result in anti-competitive agreements and price fixing arrangements which are normally prohibited by section 45 and section 45A of the TPA.

Section 51(2)(a) acknowledges the inherent policy conflict between competition law, which largely serves to prevent economic entities from acting as cartels, and groups of employees and employers collectively pursuing their industrial interests. Kinter has characterised this policy conflict as follows:

> *Perhaps the clearest illustration of this conflict is the standardization of wages – at a uniformly higher level – that labor unions seek to achieve. Before the rise of labour unions, when individual laborers sold their services to employers, because of the unevenness of bargaining power, employers could play employees off against one another, driving down the wages that were paid. By agreeing collectively to withhold their services, organized labor can enhance its bargaining power and raise the wage level. Even today, one of the greatest concerns of organized labor is competition on wage levels from nonunion labor. On the other hand, the heart of antitrust policy is that suppliers of an input should not be allowed to exercise oligopoly power over the prices of the goods and services they sell, and thus competition among suppliers is mandated (Kinter 1989, p. 286).*

Peritz (1996) has described this policy conflict, and the resulting exemption from competition law applicable to labour markets, in terms of horizontal and vertical market transactions. That is, although horizontal rivalry among buyers and sellers of goods and non-labour services is the subject of close scrutiny by competition laws, vertical rivalry between buyers and sellers of labour is not. Instead, such rivalry is viewed as a public policy issue, with the prevailing policy approach supporting the maintenance of equal bargaining power and equitable wealth distribution. Peritz, as well as Lande and Zerbe (1985), have questioned the rationale for treating the labour market differently to markets for goods and non-labour services.

Peritz has commented:

> *We have been taught to view the contest over wages as a question of redistributing wealth between classes rather than a question of efficiency, as a question of politics rather than a question of economics. But the separation of vertical and horizontal dimensions, of distribution and efficiency questions, is not self evidently correct. Nor is it the product of some "objective" process of science (Peritz 1996, p. 96).*

Lande and Zerbe have commented:

> *There is a fundamental conflict between labor law and antitrust law. The antitrust laws reflect the powerful idea that competition should usually dictate the way our economy is organized, to the benefit of the economy as a whole, including workers. But the labor exemption to the antitrust laws suggests a different policy: workers should have the right to eliminate competition for wages, hours, and working conditions (Lande and Zerbe 1985, p. 297).*

A majority of submitters support the view that labour markets should be regulated differently to markets for goods and non-labour services.

The ACTU commented:

> *The notion that workers are merely sellers of a commodity fails to recognise that the nature of the employment relationship means that the worker is giving to the employer a degree of control over time and activity which is not part of the ordinary buyer/seller relationship. (ACTU, submission 15, p. 3).*

And that:

> *… a world where all human relationships were based on competition between atomistic and (exclusively) self-interested individuals is bleak and alienating. Co-operation and collectivity are values which characterise societies the world over. These traits are emblematic of our humanity and produce outcomes which are in the interests not only of those immediately involved, but of their families and society as a whole (ACTU, submission 15, p. 3).*

The NSW Cabinet Office commented:

> *The labour market is unique and quite distinct from the product and service markets. It is therefore appropriate that industrial relations and employment matters are treated differently and are exempt from the TPA. The longstanding recognition of the right of employees and employers to adopt courses of action and come to agreements that maintain or improve their respective positions in industry should not be interfered with by the application of the TPA (The Cabinet Office, NSW, submission 41, p. 1).*

Similarly, Professor Andrew Stewart commented that the labour market is not treated in industrialised market economies in the same way as markets for other 'commodities' (Professor Andrew Stewart, submission 22).

Howie and Maher stated that many employees, in particular women, lack bargaining power as individuals and must rely upon a collective approach to employment relations if they are to achieve equitable outcomes. Howie and Maher commented:

> *None of this may be measurable in accountancy terminology. If that is a problem, the wrong questions are being asked and competition principles, while supported in general, should be more emphatically interpreted as being subject to the social needs of a civilised society (Howie and Maher, submission 8, p. 2).*

The Department of Productivity and Labour Relations, Western Australia (DOPLAR) acknowledged the objectives and rationale for section 51(2)(a), commenting that:

> *It is a point of industrial relations and legal history both in Australia and internationally, that contracts of employment and their negotiation are dealt with in a way distinct from normal contracts for goods and services. This difference is a reflection of a variety of factors including:*
>
> *a) the imbalance in bargaining power between an employer and employee; and*
>
> *b) the social costs of allowing labour to be determined solely on the basis of competitive pressures (DOPLAR, submission 65, p. 3)*

The Department of Employment, Workplace Relations and Small Business (DEWRSB) noted that it recognised the role of section 51(2)(a) in separating the trade practices and industrial relations regimes in relation to employment arrangements. Notwithstanding this, DEWRSB considered that the two regimes should not be entirely separate. DEWRSB commented:

> *The draft Report recognises that there are competing objectives between labour relations policy and competition policy. DEWRSB agrees with that view. However, the draft Report takes a position that an appropriate point of intersection between them cannot be determined. It reflects a view that labour markets should be regulated through the industrial relations framework and not the TPA. This implies that any competition implications of collective bargaining and industrial agreements should be the exclusive province of labour law and industrial regulators and tribunals. This approach inevitably limits the capacity to consider wider economic effects, even where serious harm to competition may occur. It also assumes that all aspects of labour relations come within the formal industrial relations framework, which is not the case (DEWRSB, submission 87, p. 1).*

And that:

> *Clearly, labour relations policy objectives must be supported. However, DEWRSB considers that they should be tempered by the capacity for competing policy objectives to be considered. It is not novel for the law to seek to accommodate conflicting policy objectives. For example, under the TPA itself acts or omissions that would otherwise contravene relevant provisions of Part IV may be authorised where the public benefit of particular proposed conduct can be shown to outweigh any likely anti-competitive detriment. Similarly, s.51(2)(a) does not exclude all aspects of labour market issues from the application of the TPA, nor does it exclude all provisions of Part IV from applying to the matters specified in the exemption (DEWRSB, submission 87, p. 2).*

Section 51(2)(a) supports a public policy that labour markets are generally regulated through the industrial relations framework. The Council notes that in undertaking this review, it has been required to have regard to relevant Federal and State industrial relations legislation. The following discusses these matters and their relevance to the exemption provided by section 51(2)(a).

Australia's Industrial Relations Framework

Federal Industrial Relations Framework

The framework for industrial relations established by the Federal *Workplace Relations Act 1996 (WRA)* supports a direct relationship between employers and employees in industrial relations and agreement-making. The emphasis of the WRA is agreement making for wages and conditions at the workplace level and a more direct relationship between employers and employees when establishing agreements. However, the Act also provides for collective bargaining in agreement making. Consequently, the framework for industrial relations established by the WRA is relevant to the exemption provided by section 51(2)(a).

The WRA emphasises relationships and agreements for industrial relations at the workplace level, as opposed to agreements or awards covering occupational or industrial classifications applicable to businesses nationally.[6] The role of the award system, under the WRA, is to provide for enforceable minimum wages and conditions as a floor to provisions set out in workplace agreements.

The Australian Industry Group (AIG) explained:

> *Under the WRA awards of the Australian Industrial Relations Commission (AIRC) have legal effect binding on relevant employers to whom these awards apply. Awards set minima in terms of pay and conditions which employers may not reduce, unless by formal agreement under the WRA (AIG, submission 32, p. 6).*

The ACTU stated:

> *Section 3 of the WRA sets out the principal object of the Act, and makes reference to a number of issues closely related to collective bargaining and the maintenance of collective mechanisms for fixing wages and conditions, including:*
>
> *1. encouraging a flexible and fair labour market;*

6 Under the WRA, multi-business wage agreements can be made subject to specified conditions, including application of a public interest test by the Australian Industrial Relations Commission.

2. *enabling employers and employees to choose the most appropriate form of agreement;*
3. *to ensure the maintenance of an effective and enforceable award safety net;*
4. *ensuring freedom of association and that employee and employer organisations are representative and accountable and able to operate effectively (ACTU, submission 15, p. 5).*

Making Agreements under the Workplace Relations Act

The WRA provides two formal means by which agreements can be established: Australian Workplace Agreements (AWAs) and Certified Agreements (CAs). Both allow for collective bargaining at the workplace or enterprise level and union involvement in the process. The WRA also recognises that employers and employees may make informal agreements, however such agreements cannot be certified or approved under the WRA.

An AWA is an agreement between an employer and an individual employee. Although AWAs must be signed individually, they may be negotiated collectively with a group of employees. For example, employers and employees negotiating an AWA may appoint a bargaining agent, and employees can, if they wish, appoint a union as their representative bargaining agent. AWAs are approved by the Employment Advocate, a Commonwealth Government agency established under the WRA.

CAs are made at the level of a single business or parts of a single business and can be made between an employer and a union or with employees directly. Where agreements are made between an employer and employees directly, a union may represent its member(s) in negotiations and become bound by the agreement if this is requested by a member and agreed to by the union. To be recognised under the WRA, a CA must be approved by a valid majority of employees. CAs must also be approved by the Australian Industrial Relations Commission (AIRC).

Although the emphasis of CAs is single business agreements, multi-business agreements can be made subject to specified conditions, including the consent of all employers and the majority of employees to be covered by the agreement. Such agreements also need to be tested under public interest criteria by the Full Bench of the AIRC.

Consistent with the principles underpinning collective bargaining and countervailing power,[7] the WRA permits industrial action, although the circumstances in which action can occur are prescribed by the Act. For example, employees have a right to engage in industrial action such as strikes and employers have a right to lock out employees *while* negotiating AWAs and single-business CAs. Industrial action is not permitted during the term of an agreement. The WRA also includes provisions which make membership of unions and associations voluntary and prohibit compulsory unionism. Under the WRA, discriminating against individuals based on membership or non-membership of a union or employer association is unlawful. The WRA has introduced provisions for the registration of enterprise unions, which are associations of employees covering a majority of employees in an enterprise. The minimum requirement for registration of an enterprise union is 50 members.

The WRA provides for the establishment of AWAs in States and Territories, to provide for enforceable individual employment agreements between corporations and individuals. Complementary legislation to enable coverage of unincorporated employers is also being sought from the States. CAs and AWAs operate subject to any State law dealing with occupational health and safety, workers' compensation or apprenticeship. However, CAs prevail over State awards or State agreements to the extent of any inconsistency and AWAs operate to the exclusion of State awards or State agreements (DEWRSB, Changes in Federal Workplace Relations Law – Legislation Guide, February 1998, internet site).

State Industrial Relations Legislation

A similar industrial relations framework to that of the WRA exists under State industrial relations legislation. State industrial laws provide for agreement making at the workplace level and a direct relationship between employers and employees, and also continue to provide for collective bargaining in agreement making.

In Western Australia, the *Workplace Agreements Act 1993* establishes a system for collective workplace agreements and individual agreements, and provided much of the basis for the Federal WRA. While the Queensland industrial relations regime, under the *Workplace Relations Act 1997,* is based closely on the Federal WRA, Victoria's industrial relations powers

7 Countervailing power is the notion that power held by one group can be balanced or neutralised by the power held by an opposing group.

have been referred wholly to the Commonwealth to provide for the extension of the WRA and coexistence of this regime in Victoria. In NSW, the *Industrial Relations Act 1996* has as one of its objects, *the promotion of participation in industrial relations by employees and employers at an enterprise or workplace level*, and provides for a system of enterprise agreements and enterprise awards. Similarly, the South Australian *Industrial and Employee Relations Act 1994* provides for a system of enterprise agreements and for collective bargaining at the enterprise level. In Tasmania, the *Industrial Relations Act 1984*, as amended by the *Industrial Relations Amendment Act 1997*, also provides for a system of collective workplace agreements and individual agreements.

Several submitters commented on the conformity of the WRA with State industrial relations legislation.

Commenting on the WRA, the AIG noted:

> *Similar provisions apply under state legislation. (Most awards have enterprise flexibility and facilitative provisions which permit enterprise-level departure from award provisions in a number of circumstances.) (AIG, submission 32, p. 6).*

The Law Council also noted:

> *As a result of recent amendments, Federal and State legislation now encourage direct bargaining at an enterprise level between employers and either union representatives or employees, as opposed to the traditional process of industry level bargaining and/or arbitration by industrial tribunals resulting in awards (Law Council of Australia, submission 33, p. 2).*

And that:

> *The Workplace Relations Act (and most equivalent state laws) recognise certified agreements, which are agreements between employers and employees in relation to the terms of employment (Law Council of Australia, submission 33, p. 2).*

By excluding employment conditions and agreements from the application of Part IV, section 51(2)(a) recognises that there is a body of Commonwealth and State industrial relations legislation in place for regulating the labour market and for implementing labour market policy. The section 51(2)(a) exemption seeks to balance the safeguards against anti-competitive conduct in the TPA with the legitimate interests of employee and employer groups regarding wages and employment conditions.

International Obligations Relating to Labour

In undertaking this review, the Council has been asked to have regard to international agreements relating to labour that recognise collective bargaining as well as other nations' experience with provisions similar to section 51(2)(a). These matters are discussed below.

Australia is a signatory to a number of International Labour Organisation (ILO) Conventions providing for specific labour rights. As these Conventions recognise collective bargaining and freedom of association, they are relevant to section 51(2)(a).

The ILO is a United Nations agency which seeks the promotion of social justice and internationally recognised human and labour rights. It formulates international labour standards in the form of Conventions and Recommendations setting minimum standards of labour rights, relating to: freedom of association, the right to organise, collective bargaining, abolition of forced labour and equality of opportunity and treatment.

The Conventions are binding on countries that ratify them and signatories are required to report periodically to the ILO on measures taken to apply the Conventions in law and in practice. Compliance is examined by the ILO *Committee of Experts on the Application of Conventions and Recommendations* and compliance issues may be raised at the International Labour Conference and, if necessary, with the International Court of Justice.

The Hilmer Committee (Hilmer 1993), which considered section 51(2)(a) as part of a broad ranging inquiry into national competition policy in 1993, noted that removal of the section 51(2)(a) exemption could infringe Australia's ILO Convention obligations.

The Swanston Committee (Swanston Committee 1976) identified Convention number 87, *Freedom of Association and Protection of the Right to Organise, 1948* and number 98, *Right to Organise and Collective Bargaining, 1949* as being relevant to section 51(2)(a). Both Conventions were ratified by Australia in 1973.

Convention number 87, *Freedom of Association and Protection of the Right to Organise, 1948* provides, at Article 11, that each signatory take all necessary and appropriate measures to ensure that workers and employers may exercise freely the right to organise.

Valticos and von Potobsky have noted that Convention number 87:

> *… is the basic instrument for the international protection of freedom of association. It has been ratified by 109 States. It deals, on the one hand, with the right of employers and workers to establish trade union organizations (which it defines in Art. 10 as 'any organization of workers or employers for furthering and defending the interests of workers and of employers') and, on the other, with the rights and guarantees which such organizations should enjoy (Valticos and von Potobsky 1995, p. 94).*

Convention number 98, *Right to Organise and Collective Bargaining, 1949* states, at Article 4, that:

> *Measures appropriate to national conditions shall be taken, where necessary, to encourage and promote the full development and utilisation of machinery for voluntary negotiation between employers or employers' organisations and workers' organisations, with a view to the regulation of terms and conditions of employment by means of collective agreements.*

The ILO has commented:

> *The right to bargain freely with employers with respect to conditions of work constitutes an essential element in freedom of association, and trade unions should have the right, through collective bargaining or other lawful means, to seek to improve the living and working conditions of those whom the trade unions represent. The public authorities should refrain from any interference which would restrict this right or impede the lawful exercise thereof. Any such interference would appear to infringe the principle that workers' and employers' organizations should have the right to organize their activities and to formulate their programmes (ILO 1996, p. 159).*

The ACTU noted:

> *Australia is a party to a number of international instruments which require recognition to be given to the principle of the right of workers to bargain collectively, as well as to the need for legislative protection of employee entitlements to a range of conditions, including minimum wages and leave for various purposes (ACTU, submission 15, p. 6).*

And that:

> *The functioning of trade unions is dependent on their ability to negotiate collectively on wages and other conditions of employment, as this is their primary purpose for existing. The concept of freedom of association is stripped of meaning without the capacity for unions to represent their members in negotiations around their terms of conditions (ACTU, submission 15, p. 7).*

The ACCI commented:

> *Australia is also party to ratified Conventions of the International Labour Organisation which require certain things, for example to provide for collective bargaining and for associations of employees and employers to be able to be formed without undue influence and to freely operate. ILO Convention No.87 Freedom of Association and Protection of the Right to Organise provides that employee and employers organisations shall have the right to draw up their constitutions and rules, to organise their activities and to formulate their programmes and that the public authorities shall refrain from any interference which would restrict this right or impede its lawful exercise. ILO Convention No. 98 Right to Organise and Collective Bargaining, provides that appropriate measures shall be taken where necessary to provide machinery for collective agreements (ACCI, submission 9, p. 4).*

International Experience

Similar exemptions to section 51(2)(a) exist in countries whose economies and regulatory and legal systems are most like Australia's: the United States, Canada, New Zealand and the United Kingdom.

United States

In the United States, a number of statutes define the scope of exemptions for industrial relations matters from competition laws.

The *Sherman Act 1890 (U.S.)* is the principal competition legislation in the United States. While the *Sherman Act* is silent on its reach concerning industrial relations matters, the US Supreme Court has identified a 'non-statutory exemption' under which it is inferred that the *Sherman Act* is not applicable to certain labour activities (Kinter 1989, Roberts 1992).

The *Clayton Act 1914 (U.S.)*, which was designed to withdraw the power of the US Federal Courts to regulate labour through antitrust laws, exempts activities from antitrust laws including *terminating any relation of employment and recommending advising or persuading others by peaceful means* to cease working, when those activities arise out of a *dispute concerning terms or conditions of employment*. The *Norris-LaGuardia Act 1932 (U.S.)* reaffirms and broadens the exemptions provided by the *Clayton Act*, by declaring collective bargaining and union organisation protection from antitrust laws as a public policy of the United States (Gorman 1976).

Canada

The *Competition Act 1985 (Can)*, which is Canada's principal competition legislation, also provides an exemption for the activities of labour unions from competition law (Roberts 1992). Section 4(1) of this Act states:

Nothing in this Act applies in respect of

(a) combinations or activities of workmen or employees for their own reasonable protection as such workmen or employees ...

Correspondingly, section 4(1)(c) of the *Competition Act* provides an exemption for associations of employers for collective bargaining purposes, stating:

Nothing in this Act applies in respect of

(c) contracts, agreements or arrangements between or among two or more employers in a trade, industry or profession, whether effected directly between or among the employers or through the instrumentality of a corporation or association of which the employers are members, pertaining to collective bargaining with their employees in respect of salary or wages and terms or conditions of employment.

Together, section 4(1) and 4(1)(c) provide a similar exemption to that provided in Australia by section 51(2)(a).

New Zealand

Similar to Australia, agreements concerning remuneration of employees and conditions of employment are exempt from the *Commerce Act 1986 (NZ)* under section 44(1)(f). The *Commerce Act* is the New Zealand equivalent of the TPA and contains a number of provisions relating to restrictive trade practices similar to Part IV of the TPA. These include provisions relating to price fixing and to contracts, arrangements or understandings that substantially lessen competition.

Collective actions and agreements between employees and employers regarding employment conditions, and industrial matters generally, are covered by New Zealand industrial relations law.

van Roy has commented:

> *Collective actions and agreements between employers and employees concerning industrial matters are covered by a separate legal regime under the Labour Relations Act 1987. Although labour relations is part of economic policy, it is based on collective action and regulation rather than on individual action and competition. The social issues arising under labour law differ markedly from those relating to the conduct of firms in other markets. Therefore, provisions relating to remuneration, conditions of employment, hours of work or working conditions of employees are exempted from Pt II of the Commerce Act (van Roy 1991, p. 214).*

Commenting on exemptions under New Zealand trade practices law, Dr Lindsay Hampton discussed the New Zealand Government's consideration in 1992 of the extent to which competition law should apply to labour markets (Dr Lindsay Hampton, submission 18). He noted that the Interdepartmental Commerce Act Review Committee recommended against applying the *Commerce Act* to any conduct which reduces competition in labour markets, in view of the potential conflict associated with the manner in which the Act would regulate such practices. The Committee recommended that the labour relations regime deal with concerns about competition in labour markets

United Kingdom

The *Restrictive Trade Practices Act 1976 (UK)*, which was repealed last year, also provided an exemption in similar terms to section 51(2)(a) of the TPA. This Act dealt with anti-competitive agreements and cartels by prohibiting such arrangements unless exempted through a process involving public registration and scrutiny by the UK Director General of Fair Trading.

Section 9(6) of the UK Act stated:

> *In determining whether an agreement is an agreement to which this Act applies by virtue of this Part, no account shall be taken of any restriction or information provisions which effects or otherwise relates to the workers to be employed or not employed by any person, or as to the remuneration, conditions of employment, hours of work or working conditions of such workers.*
>
> *In this subsection "worker" means a person who has entered into or works under a contract with an employer whether the contract be by way of manual labour, clerical work, or otherwise, be express or implied, oral or in writing, and whether it be a contract of service or of apprenticeship or a contract personally to execute any work or labour.*

Section 9(6) provided that restrictions in agreements relating to workers to be employed or not employed by any person, and restrictions relating to the remuneration, conditions of employment, hours of work or working conditions of such workers, were exempt from the reach of the *Restrictive Trade Practices Act*.

A new competition law, the *Competition Act 1998 (UK)*, was passed in the UK in November last year. It contains a prohibition on anti-competitive agreements based closely on Article 85 of the European Community Treaty. While the Act does not contain a standing exemption for employment relations, it does have provision for attaching block exemptions at a later time and for the Director General of Fair Trading to authorise exemptions in specified circumstances.

The issue of the proposed *Competition Bill* not providing a standing exemption for employment relations was discussed by a Standing Committee of the House Of Lords which examined the Bill last year. In Committee discussions, it was stressed that the Bill, once enacted, would not apply to employment agreements and was not intended as an instrument for regulating employer/employee relations. It was also noted that if there were unexpected developments in respect of these matters, there would be a good case for exercising the Act's exemption provisions (UK Parliament - House Of Lords, internet site).

Conclusions on the Objectives and Relevance of Section 51(2)(a)

The objective of the section 51(2)(a) exemption is to excise the labour market from goods and services markets for the purposes of applying competition law. Section 51(2)(a) therefore allows practices to occur which are permitted under labour laws but in breach of Part IV of the TPA. This supports a public policy, observed both nationally and internationally, that labour markets are generally treated differently to markets for goods and non-labour services. This policy is reflected in the mechanisms and institutions in place under Federal and State industrial relations legislation, international agreements relating to labour that recognise collective bargaining and the exemption of employment matters from competition laws in comparable countries.

Having considered these matters, the Council believes that the objectives of the section 51(2)(a) exemption continue to be relevant.

B1.3 Submissions

The Council has received twenty-seven submissions commenting on the section 51(2)(a) exemption. All submitters supported retention of some form of exemption. The ACCI[8], DOPLAR and DEWRSB suggested that while an exemption should remain, the Council should investigate whether a mechanism for revocation of the exemption in certain circumstances should be put in place.

8 The Council notes that the ACCI raised the issue of a revocable exemption in its first submission but in a later submission did not support DEWRSB's proposal for a revocable exemption.

B1.4 History and Scope of Section 51(2)(a)

The first *Trade Practices Act (1965)* contained an exemption for employment matters similar to the current section 51(2)(a) exemption and was applicable to both employee and employer organisations. The *Trade Practices Act 1965* provided that in determining whether an agreement was examinable under that Act, regard was not to be had:

> *to any provision of the agreement relating to the remuneration, conditions of employment, hours of work or working conditions of employees.*

This exemption was continued when the current TPA was enacted in 1974, however the exemption was broadened in relation to employees and their organisations, by providing that regard was not to be had:

> *to any act done, or to any provision of a contract, in relation to the remuneration, conditions of employment, hours of work or working conditions of employees, or to any act done by employees or by an organisation of employees not being an act done in the course of the carrying on of a business of the employer of those employees or of a business of that organisation.*

In 1976, the Swanston Committee (Swanston Committee 1976) reviewed this exemption noting that many submissions to its review urged that the 'broad' exemption provided by the 1974 Act be repealed. The Committee also regarded the exemption as being too wide and recommended that it be recast along the lines of the 1965 exemption. Consequently, the scope of the exemption was reduced in 1977, being confined to:

> *any act done in relation, or to any provision of a contract, arrangement or understanding to the extent that the provision relates to the remuneration, conditions of employment, hours of work or working conditions of employees.*

In 1986, section 51(2)(a) was amended to its present form in response to the majority reasoning in *Ausfield Pty Ltd v Leyland Motor Corporation Ltd* (Heydon 1993). The exemption currently in place under section 51(2)(a) is now confined specifically to:

> *any act done in relation to, or to the making of a contract or arrangement or the entering into of an understanding, or to any provision of a contract, arrangement or understanding, to the*

> *extent that the contract, arrangement or understanding, or the provision, relates to, the remuneration, conditions of employment, hours of work or working conditions of employees;*

Section 51(2)(a) provides an exemption from sections 45, 45A, 46, 47, 50 and 50A of the TPA for acts done or contracts, arrangements or understandings which relate to employment conditions. It does not provide an exemption from the secondary boycott[9] provisions under sections 45D and 45E and the resale price maintenance provisions under section 48.

The secondary boycott provisions under section 45 were reintroduced into the TPA in 1996, having existed in the TPA between 1977 and 1994.[10] Section 45D was originally inserted in 1977 following a recommendation by the Swanston Committee and section 45E was added in 1980. The secondary boycott provisions currently in Part IV are substantially in the same form as those in the TPA prior to 1994. These provisions operate in conjunction with provisions of the WRA concerning boycotts. Together they reflect a policy that industrially related secondary boycotts[11] be dealt with under the TPA.

While the phrase "relates to" in section 51(2)(a) could be viewed as providing a wide scope for the exemption (Heydon 1993), the full Federal Court in *Ausfield Pty Ltd v Leyland Motor Corporation Ltd* held that there must be a 'direct relationship' between the conduct and remuneration before the exemption applied. Deane J required that the relationship be 'direct and immediate'.

Allen Allen & Hemsley noted:

> *The requirement that the relationship between the TPA and the employment conditions be 'direct and immediate', as interpreted by Dean J in Ausfield Pty Ltd v Leyland Motor Corporation of Australia Limited ensures the appropriate operation of the exception (Allen Allen & Hemsley, submission 39, p. 2).*

9 Secondary boycotts involve action by two or more people which hinders or prevents a third person from: supplying goods or services to a business; acquiring goods or services from a business; or engaging in interstate or overseas trade or commerce; where the target business is not the employer of those imposing the boycott.

10 Secondary boycott provisions were moved to the *Industrial Relations e 1988* in 1994.

11 That is, employee activities other than those directed against their own employer.

Further, Wilcox J in *Adamson v New South Wales Rugby League Ltd* considered that an arrangement that related to internal draft rules[12] for rugby players and was silent on remuneration and working conditions for players once recruited would not fall within the exemption.

Judicial consideration of section 51(2)(a), though limited, suggests therefore that the words "relates to" will not give the exemption a broad construction but will be restricted to conduct that has a direct or immediate relationship to working conditions.

Mr Ray Steinwall has suggested a number of amendments to section 51(2)(a), to address discrepancies and limitations in the form of the exemption.

Mr Steinwall noted that section 51(2)(a) provides protection from a contravention of Part IV of the TPA (except the secondary boycott and resale price maintenance provisions) for "any act done ..." and commented that these words:

> *... extend only to a positive act, not an omission. There is no reason in principle why the failure to do something should not be covered. Ideally the words should refer to "any act or omission" (Mr Ray Steinwall, submission 54, p. 5).*

The Council agrees that section 51(2)(a) should be amended to address an apparent inconsistency between the operation of section 51(2)(a) and Part IV of the TPA. Specifically, references to prohibited "conduct" in Part IV of the TPA are, by virtue of section 4(2) of the Act, references to "doing or *refusing to do* any act". Section 4(2) also provides that a reference to refusing to do any act includes a reference to refraining from doing it (otherwise than inadvertently). As an "omission", which refers to *not* doing something, amounts to "conduct" within the meaning provided by section 4(2), section 51(2)(a) in its current form does not provide an exemption from all "conduct" under Part IV. The Council agrees that this inconsistency should be addressed through an appropriate amendment to section 51(2)(a).

Mr Steinwall also commented that the manner in which "conditions of employment" is referenced in section 51(2)(a) may limit the operation of the

12 The NSW Rugby League case involved rules introduced by the League dealing with player drafts, which allowed clubs to draft a player who had not been contracted to continue with his current club. The NSW Rugby League considered these rules to be exempt from section 45 by virtue of section 51(2)(a).

exemption. He referred to the *ejusdem generis* rule to support this view, which states that: *when general matters are referred to in conjunction with a number of specific matters of a particular kind, the general matters are limited to things of the like kind to the specific matters* (Pearce and Geddes 1996). Mr Steinwall commented:

> *If it is intended to give the widest meaning to "conditions of employment", it would be preferable that the paragraph read as follows (or to the following effect):*
>
> *"conditions of employment, including but not limited to remuneration, hours of work or working conditions of employees" (Mr Ray Steinwall, submission 54, p. 6).*

The Council considers that the extent to which "conditions of employment" is confined under the *ejusdem generis* rule by the specific matters[13] listed in section 51(2)(a) is a matter for interpretation (Pearce and Geddes 1996, pp. 100-104). The Council notes, for example, that CCH states "conditions of employment" in section 45DD[14] of the TPA:

> *… extends beyond matters of wages or hours (because these are referred to specifically) and the physical conditions under which work is performed (because that is encompassed by the term "working conditions") (CCH 1998, 4-910).*

The Council notes that the words "remuneration, conditions of employment, hours of work or working conditions" in section 45DD are the same as those used in section 51(2)(a). The intention appears to have been to give the provision a *broad* meaning in relation to section 45DD and the exemption under section 51(2)(a), but not the widest. The Council notes that other submitters have not raised the meaning of this provision as being an issue for the operation of section 51(2)(a) in practice. The Council sees no justification for giving "conditions of employment" in section 51(2)(a) the widest meaning and considers that such an amendment would be inconsistent with section 45DD.

13 That is, "remuneration, hours of work or working conditions".

14 Section 45DD of the TPA outlines circumstances in which primary boycotts are permitted under Part IV. This section was introduced in 1996.

Mr Steinwall also commented on the possible application of the section 51(2)(a) exemption to independent contractors, stating:

> *It is a policy decision whether s51(2)(a) should extend to a contract for the provision of services in a similar way to paragraph (b). The aim of paragraph (a) is to remove aspects of the employment relationship from Part IV and have it regulated under the industrial laws. To the extent that the rights of independent contractors are regulated by the industrial laws, there is no reason in principle why paragraph (a) could not be extended to a contract for the provision of services (Mr Ray Steinwall, submission 54, p. 6).*

The Council notes that the rights of independent contractors are regulated by industrial laws to the extent that they are regarded as 'employees' under these laws. The term 'employees' is a common law concept and not generally defined in legislation. While the WRA has some specific provisions for "independent contractors"[15], the processes for agreement making under the WRA apply only to employees and employers and are exempt from the TPA due to section 51(2)(a). In contrast, arrangements between firms and independent contractors are not afforded an exemption by section 51(2)(a). This, in the Council's view, rightly acknowledges that independent contractors and firms are generally in a 'commercial' rather than an 'employee/employer' relationship.

Conclusions on History and Scope of Section 51(2)(a)

Employment arrangements and agreements are exempt from Part IV of the TPA only to the extent that section 51(2)(a) is applicable. Amendments to the TPA have over a number of years refined and reduced the scope of section 51(2)(a) having regard to previous legislative reviews, such as the Swanston Committee, and to cases involving the application of previous versions of section 51(2)(a).

15 Section 298S of the WRA prohibits industrial associations from taking discriminatory action against independent contractors and sections 127A-127C give the Federal Court the power to review and make orders on contracts for services made by independent contractors that are "unfair" and/or "harsh".

B1.5 Impact of the Exemption

Under the Terms of Reference, the Council has been asked to identify whether, and to what extent, section 51(2)(a) allows anti-competitive conduct that would otherwise be prohibited by Part IV of the TPA. As discussed below, the Council considers that at least some of the provisions of Part IV would have a direct impact on employer/employee agreements and collective bargaining if the exemption were removed. It is therefore likely that some employment agreements and arrangements could undermine competition and result in some costs.

The most relevant sections of the TPA are likely to be section 45 and section 45A, which deal with anti-competitive agreements and price fixing. While enforcement of section 45 is subject to the application of a competition test[16], section 45A provides that price fixing or controlling arrangements are illegal *per se*. Therefore, irrespective of whether or not price fixing or controlling arrangements prohibited by section 45A have a detrimental effect on the level of competition in a market, such conduct is in breach of the TPA.

The ACTU commented:

> *In the event that paragraph 51(2)(a) was repealed, collective agreements between groups of workers and one or more employers which set wages and/or conditions of employment could be held to be in breach of section 45 of the TPA, in that such an agreement reduces competition between firms in the labour market; that is, employers are not able to compete freely in relation to the price at which they acquire labour and the agreements are intended to have that effect.*
>
> *Such agreements, covering in effect what is the price of labour, could also be held to be price-fixing, which is per se illegal pursuant to section 45A (ACTU, submission 15, p. 2).*

The ACCI noted:

> *… it could be argued that organisation of an association and conduct of a collective negotiation, was prohibited price fixing, misuse of market power, anti-competitive conduct, or entering into a covenant to do any of these things (ACCI, submission 9, p.3).*

16 That is, a contract, arrangement or understanding must substantially lessen competition for section 45 to apply, unless it contains an exclusionary provision.

Relationship Between the TPA and Industrial Relations Legislation

A threshold question when considering the relevance of Part IV to employer and employee agreements and collective bargaining activities is whether the TPA would take precedence over the WRA and State industrial relations legislation if section 51(2)(a) were repealed. Because the exemption under section 51(2)(a) also applies to modified versions of Part IV of the TPA enacted by each State and Territory Government,[17] removal of the exemption would also apply to State and Territory competition laws.[18]

On the issue of whether the TPA would take precedence over the WRA if section 51(2)(a) were repealed, rules for statutory interpretation determine that a piece of Commonwealth legislation may override another piece of Commonwealth legislation where there is an inconsistency between the two Acts in question. Where this occurs, the most recent legislation prevails. However, where there is no such inconsistency, the two Acts may operate in parallel (Pearce and Geddes 1996).

In the case of the TPA and the WRA, there does not appear to be an inconsistency which would give rise to the WRA overriding the TPA[19], although as discussed previously there is a policy conflict between the two Acts. On the basis that there is no inconsistency between the WRA and TPA, both Acts may operate together. Therefore, were section 51(2)(a) repealed, conduct relevant to employer and employee agreements and collective bargaining activities, which is permitted under the WRA, may be subject to scrutiny under the TPA.

On the issue of whether the TPA would take precedence over State industrial relations legislation if section 51(2)(a) were repealed, section 109 of the Commonwealth Constitution determines that a piece of Commonwealth legislation will override State legislation, again where there is an inconsistency. Therefore, were section 51(2)(a) repealed, conduct relevant to employer and employee agreements and collective bargaining activities which is permitted under State industrial relations legislation may also be

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17 This is discussed further in Part A of this Report.

18 The Council notes that the Terms of Reference require it to have regard to consequential effects that the exemption may have through the Competition Code in each State and Territory.

19 The TPA preceded the WRA.

subject to scrutiny under the TPA and mirror competition laws in place under the Competition Code in each State.

Effect of Applying Part IV to Employment Agreements

The issues raised by submitters in relation to this matter indicate some divergence of views on the extent to which anti-competitive trade practices prohibited by Part IV would be relevant to employer and employee agreements and collective bargaining activities, were they not exempt from Part IV.

The ACTU commented:

> *While repeal of paragraph 51(2)(a) would not affect awards or agreements made or certified under the Workplace Relations Act 1996 (the WRA) or state industrial relations legislation, as opposed to over-ward arrangements which form part of employees' common law contracts of employment, the same principles would apply in relation to the alleged anti-competitive effect of these awards and agreements (ACTU, submission 15, p.3).*

The AIG also commented on the implications of removing section 51(2)(a) for industrial relations legislation and policy. It concluded that conduct sanctioned by provisions of the WRA, regarding awards and agreement-making, would not breach section 45 of the TPA. The AIG believed that such employment arrangements do not actually constitute a 'contract, arrangement or understanding' within the meaning of section 45, particularly in a single business environment. The AIG also commented that if conduct sanctioned by the WRA were to breach section 45 of the TPA:

> *… it would be a curious outcome in public policy terms for the adoption of provisions in one Act or of those in an instrument made under it to be outlawed by another (AIG, submission 32, p.10).*

Professor Andrew Stewart's submission took another view, commenting that removal of the section 51(2)(a) exemption could conceivably mean that many outcomes of labour market regulation under Federal and State law could be challenged under the TPA as being anti-competitive. He stated that this could create considerable uncertainty about the validity of awards and agreements made under Federal and State industrial relations law (Professor Andrew Stewart, submission 22).

Allen Allen & Hemsley commented:

> *If … section 51(2)(a) of the TPA was removed for contracts, arrangements or understandings between employees and employers, then such agreements would be subject to scrutiny under Part IV of the TPA. However, in relation to section 45 of the TPA, individual contracts between employers and employees, who cannot be viewed as competitors in any case, would not come within the ambit of the per se provisions of that section.*
>
> *The Workplace Relations Act 1996 (Cth) (the Workplace Relations Act) and most equivalent State laws recognise 3 forms of agreement or instrument which establish the terms and conditions of employment. These 3 forms are certified agreements, workplace agreements and industrial awards.*
>
> *Industrial awards operate with the force of statute and are made or altered by the Australian Industrial Relations Commission. Industrial awards are unlikely to constitute a contract, arrangement or understanding for the purposes of the TPA (Allen Allen & Hemsley, submission 39, p. 2-3).*

Allen Allen & Hemsley also noted that the removal of section 51(2)(a) would be likely to create a conflict between competition laws and industrial relations laws in relation to the conditions of employment.

Would Part IV be Breached?

Assuming that conduct relevant to employer and employee agreements and collective bargaining activities is subject to scrutiny under the TPA, section 45 and section 45A are the provisions most likely to be applicable, although there is a possibility that section 46 and section 47 could also be relevant in some cases.

Section 45A deals with price fixing, which is a *per se* offence and is thus prohibited outright under the TPA, whereas anti-competitive agreements must substantially lessen competition for section 45 to be breached. Where employment agreements control or fix prices across firms in relation to labour services acquired and supplied, it appears likely that such agreements would, unless authorised by the ACCC, breach section 45A if section 51(2)(a) were repealed. Mr Ray Steinwall commented:

> *The expanded reading by the Federal Court in the Super League*[20] *case of the circumstances in which parties will be regarded as in competition with each other, lends added support to the proposition that labour arrangements are liable to attract section 45A (Mr Ray Steinwall, submission 102, p. 3).*

Mr Steinwall also provided the following example:

> *Two sandwich shops operate side by side in an industrial estate. Each shop has two employees. The employers and employees of the two shops reach an agreement on the salary and other conditions of employment. In the absence of an exemption or authorisation, the arrangement would infringe section 45A (Mr Ray Steinwall, submission 102, p. 3).*

Analysis of whether employer and employee agreements and collective bargaining activities breach section 45 would require the application of a competition test before a breach could be determined. This would need to be undertaken on a case-by-case basis and would involve application of the standard market definition framework, which requires analysis of product, geographic, functional and temporal dimensions of markets. While this analysis is beyond the scope for this Review, the Council considers that section 45 could apply to some employment agreements, particularly those established collectively. The Council believes that section 45 is unlikely, however, to apply to awards imposed as an order in arbitration under the WRA and State industrial relations legislation, because these awards would not be seen as contracts, arrangements or understandings.

As noted by the ACCI, there would be considerable uncertainty associated with establishing which types of employment agreements and arrangements breached Part IV of the TPA.

The ACCI commented:

> *If the exemption were to be removed it is not clear to what extent these and other collective actions would be subject to prohibitions on anti-competitive conduct, or other prohibitions. For example it might be the case that conduct expressly authorised by a later statute (the Workplace Relations Act 1996) would continue to be*

20 *News Limited Australia v Australian Rugby Football League Limited (1996)* ATPR 41-521.

> *exempt, although this might conceivably be a matter of argument depending on the exact nature of the statutory authorisation.*
>
> *An express reference to protected action might be sufficient to provide an exemption, but a simple power to make a facilitative clause providing for collective agreement might not be. In any event parties to such collective action would not be clear about the state of the law, and this would be undesirable. It would not be workable to leave parties unclear about whether and to what extent such conduct is prohibited conduct.*
>
> *For example, if negotiation of a collective agreement is conducted without any statutory basis, such negotiation could be prohibited in many cases, while the resulting agreement once registered could be protected from the prohibition. Similarly distribution of recruitment literature could be anti-competitive if the association was engaged in a collective campaign in a particular area, but in other cases not anti-competitive conduct. Some of these outcomes would be very undesirable (ACCI, submission 9, p. 2-3).*

Conclusions on the Impact of the Exemption

The Council believes that the exemption provided by section 51(2)(a) may undermine competition given that certain employment agreements and arrangements are likely to be in breach of Part IV, were the exemption not in place.[21] The Council notes, however, that the discussion above is not intended as an exhaustive review of the legal implications of removing section 51(2)(a). These matters could only be clarified in law, were section 51(2)(a) not in place, through consideration by the courts of the legality of employment agreements and arrangements under Part IV.

B1.6 Benefits and Costs

Under the Terms of Reference, the Council has been asked to analyse, and, as far as reasonably practical, quantify the benefits, costs and overall effects of the section 51(2)(a) exemption on the Australian economy.

21 This is discussed further under 'Benefits and Costs'.

Benefits

Transactions, Compliance and Regulatory Costs

As a standing exemption to Part IV of the TPA, section 51(2)(a) makes relatively clear how the TPA will be applied to agreements and arrangements between employers and employees concerning employment matters.

Section 51(2)(a) therefore serves to minimise the transactions, compliance and regulatory costs which may, in the absence of the exemption, be associated with enforcing Part IV of the TPA in respect of all employment agreements and arrangements.

The ACTU commented that if, for example, it were necessary for employers and/or employees to obtain authorisations from the ACCC in relation to collective bargaining agreements, it is likely that such procedures would be time consuming and lead to costly litigation and enforcement procedures involving the ACCC and parties to employment agreements. The ACTU also commented that if all collective mechanisms in industrial relations legislation were in effect overridden by the TPA, a possible outcome of this would be to force every employer to negotiate individual arrangements with each employee. The ACTU considered this would involve considerable transaction costs (ACTU, submission 15).

Allen Allen & Hemsley also commented:

> *The removal of the exemption would result in the duplication of the regulation of the employment conditions of employees. This would be inappropriate as the Workplace Relations Act provides for minimum entitlements for employees and for the resolution of employment disputes by the Australian Industrial Relations Commission. Further, the duplication of such regulation would be inappropriate and cumbersome. It would also lead to numerous authorisation applications being lodged with the Australian Competition and Consumer Commission (ACCC) (Allen Allen & Hemsley, submission 39, p. 3).*

As noted previously, the ACCI emphasised the uncertainty associated with establishing which types of employment agreements and arrangements would breach Part IV of the TPA. Transactions, compliance and regulatory costs would be increased as a result of this uncertainty. Thus, a benefit of the section 51(2)(a) exemption is the elimination of transactions and compliance costs which would, in the absence of a standing exemption, be associated with negotiating and settling employment agreements that comply with Part IV of the TPA.

Also, minimisation of regulatory costs has the related fiscal benefit of lowering demand on public funds directed at enforcing the TPA. A further benefit of this is that resources allocated for TPA enforcement will be focussed on facilitating competition in markets for goods and non-labour services, which is likely to produce related benefits in labour markets.

Consistency with the Industrial Relations Framework

The exemption provided by section 51(2)(a) is aligned with Australia's framework for industrial relations. By exempting *both* employers and employees from the application of Part IV, section 51(2)(a) allows employers and employees to collectively bargain on employment agreements, as recognised by Australia's industrial relations framework.

In providing for collective bargaining and union involvement in industrial agreements, the industrial relations framework established by the WRA and corresponding State industrial relations legislation recognises the socially beneficial aspects of countervailing power, and collusion between employers and employees, in agreement making. Countervailing power is the theory that power held by one group, for example large employers, can be balanced or neutralised by the power held by an opposing group, such as a large trade union (Roberts 1992). To the extent that countervailing power keeps in check the power of groups of companies and employees in the market for labour, it might be viewed as furthering the socially desirable operation of a market economy.

Commenting on the operation of the TPA and the WRA, the AIG noted:

> *It is the Ai Group's fundamental proposition that these two pieces of regulation are complementary and largely exclusive in their purpose and coverage and that section 51(2)(a), for example, was inserted to safeguard against inadvertent and improper application of the TPA in circumstances governed by other federal legislation and by the Common law (AIG, submission 32, p. 2).*

Noting the possible conflict between the TPA and WRA were section 51(2)(a) to be repealed, the AIG also commented that repeal would result in an anomalous outcome for a major piece of Commonwealth legislation.

Similarly, the ACTU commented:

> *Section 3 and the substantive provisions of the WRA assume the basic principles of an industrial relations system which ensures that all workers receive fair and secure minimum employment conditions, and in which their right to bargain collectively with employers and be represented by trade unions are guaranteed. A departure from this policy is most unlikely to be acceptable to the Australian people, who have shown strong support for these principles as underpinning the industrial relations system, even as it moves towards greater flexibility and accommodation of individual bargaining (ACTU, submission 15, p. 6).*

The Council acknowledges that a benefit of section 51(2)(a) is that it ensures that the industrial relation framework governs the conditions of the labour market, rather than subjecting the labour market to two, often conflicting, forms of regulation.

Compliance with International Treaty Obligations Relating to Labour

As a standing exemption to Part IV of the TPA, section 51(2)(a) is consistent with Australia's international treaty obligations under ILO Convention number 87, *Freedom of Association and Protection of the Right to Organise, 1948* and number 98, *Right to Organise and Collective Bargaining, 1949*.

As a signatory to these Conventions, Australia is obliged to take action to enable their effective application through appropriate mechanisms such as section 51(2)(a). By complying with these agreements, Australia is viewed by the international community as an advocate of social justice and recognised human and labour rights, and in doing so is itself able to promote these public interest values to other countries.

The ACCI commented:

> *Each of these Conventions has been the subject of extensive discussion and application by ILO bodies, in the same way that the various prohibitions in the Trade Practices Act have been*

> *explained by the Courts through various decisions. It would be undesirable for legislative action to be taken which contradicts these international obligations, which are binding on the Australian Government, and which are voluntarily undertaken through ratification or through joining the ILO (ACCI, submission 9, p. 4).*

The ACTU noted:

> *There can be little doubt that if Australia were to move even further away from promoting collective bargaining, and repeal of paragraph 51(2)(a) would be a substantial move in that direction, that this would be seen by the ILO as serious breach of the Conventions, particularly given what appears to be something of an international consensus on the need to exempt the labour market from legislation designed to promote competition (ACTU, submission 15, p. 7-8).*

The ACTU supported the retention of section 51(2)(a):

> *… for essentially the reasons which led the Hilmer Committee to recommend that it should be retained. Its repeal would place Australia in breach of important international obligations in respect of a right which is recognised by virtually every country in the world (ACTU, submission 15, p. 8).*

Allen Allen & Hemsley commented:

> *The section 51(2)(a) exception is consistent with Australia's obligations under the relevant ILOC's and International Covenants. If the exemption was removed, collective actions and agreements between employers and employees concerning industrial matters would become subject to scrutiny under the restrictive trade practices provisions of the TPA. This could also create a conflict between competition laws and Australia's obligations under relevant ILOC's and International Covenants (Allen Allen & Hemsley, submission 39, p. 4).*

Professor Andrew Stewart also commented that removal of the exemption could conceivably infringe Australia's ILO obligations given that such a move may be viewed as severely undermining the guarantees given by Convention number 87 (Professor Andrew Stewart, submission 22).

Costs

Potential costs associated with the exemption arise due to limits it places on competition. As discussed previously, the Council believes that the exemption provided by section 51(2)(a) may undermine competition given that certain employment agreements and arrangements are likely to be in breach of Part IV, were the exemption not in place. The following discusses the potential costs of allowing conduct in labour markets that could, in the absence of section 51(2)(a), be in breach of Part IV.

Collusive Behaviour

As discussed previously, collusive behaviour between employers and between employees may be economically and socially beneficial where such behaviour is an appropriate use of 'countervailing power'. For example, Binger and Hoffman have commented:

> *… the argument often is made that workers need to join together because monopsonistic employers are paying them less than their marginal revenue products. If that is the case, then bilateral bargaining between union and monopsonist can actually be welfare improving if they are able to bargain to the joint maximum (Binger and Hoffman 1988, p. 458).*

However, such collusion is not always viewed as desirable. For example, where a company does not operate in a competitive market, it is not likely to offer strong resistance to the demands of suppliers of inputs such as labour. Employee groups may therefore be in a stronger strategic bargaining position than such companies, who may simply pass on increased labour costs to consumers through higher prices.

Stegman has commented:

> *There is a large literature in labour economics analysing Pareto efficient bargaining between employers and unions.*
>
> *… Note, however, that these bargains are "efficient" in the sense that there are no remaining opportunities for Pareto improvements for the two parties involved. This concept of an efficient bargain ignores the interests of third parties. In relation to the broader concept of allocative efficiency, the effect of efficient bargains between employer and union on third parties (e.g. consumers) is relevant. Concern for third parties provides a*

> *traditional justification for proscribing collusive behaviour. Therefore regulation might include forbidding collusive bargaining between a union and an employer where such bargaining implies harm to third parties.*
>
> *Consider the case where bargaining is between a monopoly union and an employer with monopoly power in the product market. The intuition here is that collusive bargaining might well be socially detrimental and therefore justifiably subject to a regulator's proscription (Stegman 1998, p. 5).*

Some commentators suggest that collusive behaviour by employees may raise issues for economic efficiency particularly where there is industry-wide collective bargaining (DiLorenzo 1989 and Weidenbaum 1979). For example, collusive behaviour by employees directed at achieving industry-wide wage increases in the absence of productivity improvements may be considered economically and socially undesirable where such behaviour raises the cost of labour beyond an efficient level over a long period.

Dilorenzo, commenting on North American anti-trust exemptions, has noted:

> *… there are numerous examples of blatant monopolisation, such as industry-wide labour agreements, which have been spared from enforcement. These exemptions have had a negative effect on manufacturing productivity and ultimately have harmed the very workers assumed to be helped (Dilorenzo 1989, p. 221).*

And:

> *… industry-wide, rather than company-wide, bargaining has been determined to be a hindrance to productivity. This is a subtle point, and requires some clarification.*
>
> *Unlike other countries such as Japan, American unions bargain on an industry-wide basis. This enables them to fix prices, i.e. wages, their members are paid, just as if there had been a conspiracy. Bringing such price-fixing conspiracies under the umbrella of antitrust would seem only fair (Dilorenzo 1989, p. 214).*

Commenting on economic issues related to the immunity of labour relations from antitrust laws in the United States, Weidenbaum has also noted:

> *… the existence of industrywide bargaining … raises the issue of monopolization of an industry or product market through a union*

> *representing all of the workers in that activity. Efforts to change public policy might well focus on the phenomenon of industry-wide collective bargaining in furthering a more competitive economy by reducing the various immunities to the antitrust laws (Weidenbaum 1979, p. 286).*

Lande and Zerbe have also commented:

> *... unions can be expected to take part of their rent in working conditions or featherbedding instead of wages. For both these reasons, the choice of inputs and working conditions will be affected by the existence of unions with monopoly power, and restrictive work practices and featherbedding associated with unions. And, although there are no reliable recent estimates, such practices impose a social cost (Lande and Zerbe 1985, p. 304).*

DOPLAR commented:

> *Unions have sought to erode the advent of single enterprise bargaining in Australia. This has been done through the adoption of what is referred to as 'pattern bargaining'. In 'pattern bargaining' unions negotiate identical agreements across large areas of a given industry. This practice side steps the more stringent test applicable to multi-employer agreements while often achieving an across the board increase in conditions which could not have been achieved through an award variation.*
>
> *It is the use of such practices which eliminates some of the competitive elements available through industrial relations legislation. It is in this area that a revocable "block" exemption could be used to constrain the actions of a particular union which exerted restrictive influence over a large part of the relevant industry (their market). It may be possible for a block exemption to be removed with respect to say, all agreements negotiated by a particular named union (DOPLAR, submission 65, pp. 4-5).*

The Productivity Commission's Draft Report on the black coal industry referred to instances of anti-competitive behaviour in the market for labour services in this industry. The Report noted a number of informal 'custom and practice' type provisos covering the use of contractors in black coal mining, specifically, rules that:

- *restrict the contracting companies or workers that can be engaged. For example, the Drayton Coal Industrial*

Agreement 1996 locks Drayton into using the United Mining Support Services (UMSS) for supplemental labour (sub. 48). UMSS is part-owned by the mine workers union;

- *otherwise influence the costs associated with engaging contractors – for example, by restricting contractors' conditions of employment; (Productivity Commission 1998, p.89)*

The Productivity Commission questioned whether the industrial relations legislation gives adequate consideration to any adverse consequences of restrictive provisions in employment agreements for other businesses not party to an agreement.

While employees and employers may have an opportunity to enter into collusive arrangements which raise the cost of labour beyond an efficient level, these arrangements are not likely to be sustainable where the employer is a firm operating in a competitive market (Binger and Hoffman 1988). In a market-based economy such as Australia's, where industries are faced with increased competition through globalisation and as an outcome of competition policy, it is apparent that the ability of employee groups to exert monopoly power over employers is becoming more and more tenuous. Although collusive behaviour by employees and employers may not always be considered economically and socially beneficial, particularly where it is sustained over a long period, there is a likelihood that such arrangements will dissipate where competition is able to operate effectively in markets for goods and non-labour services.

While achieving effective competition is a focus for national competition policy and for enforcement of the TPA generally, the Council recognises that at a national level this program is still evolving. Having regard to this, the Council believes that there is a potential that section 51(2)(a) may support collusive behaviour in some industries and other conduct which would breach Part IV of the TPA in the absence of section 51(2)(a), and therefore may result in costs to the community. For example, some of the costs that could be attributed to the raising of labour and other costs beyond an efficient level through collusive behaviour are:

- higher prices for consumers in the short term, caused by the higher labour costs of a non-competitive labour market;[22]
- restrictions on the number of people employed in the short term because of higher labour costs;
- restrictions on the number of people employed in the long term, caused by the higher labour costs of a non-competitive labour market stimulating substitution by firms towards more capital-intensive means of production; and
- lower productive and allocative efficiency, and consequently lower potential economic growth, because labour inputs are not being used according to their value to producers and consumers.

Collusive Behaviour and Australia's Industrial Relations Framework

While it is conceivable that costs could arise as an outcome of employment agreements or arrangements established by virtue of an exemption under section 51(2)(a), the Council observes that agreements and arrangements established within the industrial relations framework are settled at the enterprise/workplace level and that a public interest test is applicable to multi-business agreements. Specifically, the Council notes that although the WRA and corresponding State industrial relations legislation provide for collective bargaining and union involvement in agreement making, the emphasis is that of agreement making for wages and conditions at the workplace level and by individuals. Provision for collective action is also more heavily prescribed relative to previous industrial relations regimes. For example, under the WRA, multi-business wage agreements can only be made subject to specified conditions. Further, the role of the award system under the WRA is to provide enforceable minimum wages and conditions, as opposed to industry-wide employee/employer agreements.

22 The Council recognises, however, the complexity of labour markets and the range of factors that may affect their operation. These include: the demand for particular products or services; the productivity of particular categories of employees and the production techniques utilised by their employers; location factors such as the level of employment opportunities relative to the size of the available working population; the level of training and ability necessary for entry to particular occupations; and the division of the labour market into insiders and outsiders, with outsiders being the long-term unemployed and insiders being those currently in employment or recently unemployed.

Discussing the WRA, Winley has commented:

> *These two thrusts – decentralisation and decollectivisation – are the beginnings of a major philosophical change from the approach to labour market deregulation previously adopted in Australia. Indeed, the trend from a collective approach to labour market protection towards individual access to the system for protection, is a departure from the approach taken in much of the 'old' developed world (Winley 1997, p. 84).*

Sloan has also commented on enterprise bargaining, noting that:

> *Enterprise bargaining … is based on the proposition that the parties to bargaining are best-placed to assess their interests and to engage in negotiations that can produce a balanced outcome based on these interests.*
>
> *… A dual system, based on a voluntary opting-out model, can be good policy if the arrangement is essentially transitional. Awards continue in an interim way, with the focus on enterprise bargaining. In the meantime, awards are transformed to become mere vehicles for safety net wages and conditions (Sloan 1995, p. 225-226).*

Discussing the WRA, Dawkins has also commented that:

> *The continuation of the 'freeing up' of the labour market is a desirable complement to other microeconomic reforms and can be expected to have beneficial effects on economic efficiency (Dawkins 1997, p. 59).*

By promoting collective bargaining *at the workplace* for agreements on wages and conditions, as well as individual employer/employee agreements, the WRA and corresponding State industrial relations legislation have provided an industrial relations framework which is flexible and focussed on achieving wage outcomes which are linked to workplace productivity outcomes.

Having regard to this, the Council considers that the industrial relations framework serves to minimise the potential costs of allowing conduct in labour markets that would, in the absence of section 51(2)(a), breach Part IV of the TPA. The Council believes, however, that such costs could arise in employment agreements or arrangements that are established outside of the formal industrial relations framework. As a minority of the workforce come under informal workplace agreements,[23] the Council considers that these costs are unlikely to be significant overall, although they may have real effects within particular industries.

Conclusion on Costs and Benefits

Having regard to the apparent costs and benefits of the exemption provided by section 51(2)(a), the Council considers that the benefits of the exemption outweigh its costs.

B1.7 Alternatives for Achieving Objectives

The Terms of Reference require the Council to consider whether:

- the benefits of section 51(2)(a) outweigh the costs; and
- there is a less restrictive way of achieving the objectives of the exemption.

As it is the Council's view that the benefits of the section 51(2)(a) exemption outweigh its costs, a relevant question is whether the current 'standing' exemption approach should continue, or whether some other mechanism best serves the objectives of the exemption. As the objective of section 51(2)(a) is to excise the labour market from goods and services markets for the purposes of applying competition law, the only way to achieve this objective is by legislation.

Authorisation and Notification

As discussed in Part A of this Report, there is currently provision under Part VII of the TPA for the ACCC to *authorise* conduct and arrangements that would otherwise breach Part IV. Conduct which might breach the exclusive dealing provisions of section 47 may be *notified* under section 93.

23 The AIG has advised that some 15% of the workforce operate under informal arrangements (AIG, submission 110, p. 2).

As discussed previously, scrutiny of employment arrangements by the ACCC would carry with it transactions, compliance and regulatory costs. For example, the fees currently imposed by the ACCC for first time authorisation and notification are $7,500 and $2,500, respectively. Additional related authorisations and notifications are $1,500 and $500, respectively. Considering other legal costs which would be incurred by parties to these processes, the appropriateness of these exemption mechanisms for employment arrangements and agreements is questionable given the volume of agreements and arrangements that would be subject to such mechanisms if section 51(2)(a) were repealed. By way of illustration, in June 1998 there were approximately 6,740 federal wage agreements in place, covering an estimated 1.1 million employees, which had been certified or approved by the AIRC. Between 1991 and June 1998, the AIRC formalised a total of approximately 18,720 agreements (DEWRSB, Developments in Federal Agreements, June 1998, internet site).

Professor Andrew Stewart argued that it is difficult to see how the administrative costs of dealing with the revocation and granting of exemptions for employment arrangements (were the exemption under section 51(2)(a) not a standing exemption) would not outweigh the benefits of having a standing exemption in place (Professor Andrew Stewart, submission 22). Similarly, the Law Council commented that as the exemption applies to a large number of transactions, an authorisation or notification procedure would be an inefficient use of resources (Law Council of Australia, submission 33).

Revocable Exemption

Competition regulators within the European Union have issued a number of block exemptions in relation to conduct that is considered to be pro-competitive or neutral in terms of its effect on competition. Under arrangements in place in the European Union the regulator retains the power to withdraw the benefit of the block exemption in particular circumstances, especially where the party seeking the benefit of the block exemption controls a large part of the relevant market.[24] As discussed previously, the UK *Competition Act 1998* contains a prohibition on anti-competitive agreements based closely on the European Community Treaty and has provision for attaching block exemptions and for the UK Director

24 European Union block exemptions are discussed further in Part C of this Report.

General of Fair Trading to authorise exemptions in specified circumstances. As there is currently no provision within the TPA for a revocable block exemption, adoption of this approach in Australia would require an amendment to the TPA.

A revocable block exemption is similar to an alternative to section 51(2)(a) canvassed by the ACCI in its submission and in submissions provided later by DOPLAR and DEWRSB. The ACCI, DOPLAR and DEWRSB suggested that while an exemption for employment arrangements and agreements should remain, the Council should investigate whether a mechanism for revocation of the exemption in certain circumstances should be put in place.

The ACCI commented:

> *An alternative approach which avoided both uncertainty and unintended consequences … would be to leave in place a general exemption, but remove that exemption in any specific instances which are found not to warrant such exemption after careful and accurate assessment (ACCI, submission 9, p. 3-4).*

DOPLAR commented:

> *… if an exemption is to remain then it must be via legislative means. The only viable alternative to the current legislative system is a variation to the block style exemption used in the European Union, such that a general exemption would be maintained but which could be specifically revoked in justifiable circumstances (DOPLAR, submission 65, p. 4).*

DEWRSB commented:

> *While recognising the difficulty of reconciling the competing policy objectives of labour law and competition law, DEWRSB is of the view that a case exists for narrowing the scope of the exemption under section 51(2)(a). In particular, amendments could be made to establish arrangements whereby an exemption like that provided by section 51(2)(a) remains in place, but is revocable where the anti-competitive detriment to the community of the particular arrangements in question outweighed the labour law policy objectives (DEWRSB, submission 87, p. 1).*

And that:

> *The trade off mechanism proposed by DEWRSB would be a revocable exemption operating broadly as follows:*
>
> *(a) a general section 51(2)(a) exemption would be retained;*
>
> *(b) the exemption would be revocable by the ACCC on application, eg, by a Minister or an interested party;*
>
> *(c) the test for revocation would be similar to that for authorisations, ie, public benefit as against anti-competitive detriment;*
>
> *(d) the ACCC would have the ability to award costs against vexatious or frivolous applicants;*
>
> *(e) as with authorisation applications, review would be available by way of appeal to the Competition Tribunal and thereafter to the Federal Court;*
>
> *(f) there could be no revocation in respect of agreements made under Federal or State industrial relations legislation or agreements which were made under an award made by an industrial tribunal;*
>
> *(g) as noted earlier, the "contract of service" exemption in the definition of "services" in section 4(1) of the TPA may need to be omitted or modified.*
>
> *Further refinements of this approach may be appropriate, but the main purpose of this discussion is to consider the place of such a mechanism in balancing the competing labour relations and competition policy objectives (DEWRSB, submission 87, pp. 2-3).*

DOPLAR, while proposing a similar revocation mechanism, did not support the DEWRSB proposal that the exemption should only be revocable in respect of agreements which are made outside of the formal industrial relations system. It was also DOPLAR's contention that any interested person should be entitled to make an application and that the person need only demonstrate the anti-competitive impact of the agreement upon them to satisfy this test. DOPLAR identified 'pattern bargaining' as a practice which could, where its impact is of an anti-competitive nature, be addressed through a revocable exemption.

As discussed previously, a key benefit of the section 51(2)(a) exemption, in its current form, is the relative certainty it provides as to how the TPA will be applied to employer/employee agreements. This eliminates the transactions, compliance and regulatory costs that would be associated with negotiating and settling employment agreements if it were necessary for these agreements to not breach Part IV of the TPA. DEWRSB's proposal is to retain the exemption, thus providing some level of certainty, but some submitters have suggested that the somewhat indefinite nature of a *revocable* exemption raises the same issues of transactions, compliance and regulatory costs discussed previously in relation to removal of the exemption.

In response to DEWRSB's submission, the ACTU commented:

> *The costs of providing a revocation process would be considerable, in spite of the DEWRSB's view that these "do not appear likely to be significant". The real costs lie in legal representation for the parties, especially given that the anti-competitive effects of employment agreements would be a relatively new area of law, and that use of appeal processes is almost inevitable. The proposal for awarding of costs in cases of vexation or malicious claims is not likely to be much of a deterrent to a company wishing to use yet another legal avenue against trade union activity, leaving aside the limited application of the concept of vexatious or malicious claims.*
>
> *In the case of industrial action, the availability of revocation of the exemption would be combined with all other courses of action (eg sections 127 and 166A of the WR Act), increasing the litigiousness attached to the industrial relations process.*
>
> *In relation to agreements, the DEWRSB proposal would allow applications to be made after the coming into operation of an agreement, perhaps some considerable time. This must lead to business uncertainty, as employers would not be in a position to know whether or not their employment arrangements would withstand challenge on a ground which has never previously been a consideration (ACTU, submission 91, p. 4).*

Mr Ray Steinwall commented on the practical implications of DEWRSB's proposal for employers and employees negotiating and settling employment agreements. Mr Steinwall stated:

> *First, the parties cannot enter into the arrangement with the certainty that it is protected by an exemption.*
>
> *Secondly, if the parties wish to proceed with this arrangement, it can only be protected by an authorisation. There are considerable costs of obtaining an authorisation including the application fees*

> *and the legal and administrative costs in compiling material to support the authorisation. Assuming that these arrangements are repeated across the State, it gives some idea of the enormous transaction costs involved.*
>
> *Thirdly, authorisation involves considerable delay. The ACCC is required to make public its receipt of an application for authorisation. It is also required to prepare a draft determination, invite the applicant and other interested parties to provide submissions and to take account of matters raised at conferences called by the ACCC (Mr Ray Steinwall, submission 102, pp. 3-4).*

And that:

> *As a practical mater, it will also be necessary to address the time at which the exemption becomes revocable. For instance, … it is of no comfort to the parties to enter into an arrangement only to find that the exemption that they may have assumed would remain is subsequently revoked thereby exposing the arrangement to an automatic infringement of the Act. At that point in time it would also be too late for the parties to apply for an authorisation because the offence would have been committed prior to the exemption being revoked. Nor is it an answer to make the arrangement conditional on the exemption not being revoked or an authorisation not being granted. That is because the essential element of the offence is the concerted action by the parties to fix price which occurs at the instant that it takes place and is not protected because the arrangement is expressed to be subject to a condition precedent (Mr Ray Steinwall, submission 102, pp. 4-5).*

Mr Steinwall also commented that:

> *… given the nature of price fixing arrangements under section 45A, parties would be unable to engage in the most basic of discussions without that conduct infringing section 45A (Mr Ray Steinwall, submission 102, p. 6).*

And that:

> *Rights of appeal to the Australian Competition Tribunal and the Federal Court, while desirable would … result in further delays (Mr Ray Steinwall, submission 102, p. 7).*

The Law Council commented:

> *Introduction of a scheme of revocable exemptions would introduce another, unnecessary, layer of regulation to a complex area.*
>
> *On balance, and for reasons consistent with its earlier comments on Section 51(2)(a) of the Act, the Committee opposes the proposal of DEWRSB for a revocable exemption. It considers a scheme of revocable exemptions would be impractical, cost-ineffective and unnecessary (Law Council of Australia, submission 97, p. 2).*

The AIG commented:

> *... the uncertainty and regulatory and other costs associated with a regime in which the exemption in relation to legitimate and necessary common law and over-award agreements are exposed to action for revocation - whether by a Minister or by an "interested party" - are in our view unacceptable (AIG, submission 110, p. 4).*

The NSW Cabinet Office commented:

> *NSW opposes DEWRSB's submission to narrow the focus of s51(2)(a). DEWRSB's proposal would lead to confusion, role duplication and forum shopping if there is overlapping jurisdiction between labour law and competition law (The Cabinet Office, NSW, submission 101, p. 1).*

ACCI commented:

> *Employers already face a large number of statutory tests for formal agreements to be put in place, and placing on top of that a new set of potential regulatory requirements is potential double jeopardy (ACCC, submission 103, p. 1).*

Allen Allen and Hemsley commented that the proposal put forward by DEWRSB introduces a layer of complexity which is unwarranted and that such a revocable exemption would not be workable in practice (Allen Allen and Hemsley, submission 107).

Noting the views of submitters, the Council considers that the transactions and compliance costs associated with a revocation mechanism will be affected by:

- the scope of arrangements or agreements the mechanism could be applied to;

- who is able to apply for revocation;
- the circumstances in which section 51(2)(a) could be revoked;
- the grounds for revocation;
- whether conduct occurring before revocation could be in breach of Part IV;
- whether authorisation could be sought; and
- the mechanisms for review of revocation decisions.

The Council considers that a model for revocation appropriately addressing these elements would greatly lessen the uncertainty associated with a revocable exemption and the potential costs associated with any such mechanism.

Is a Revocable Exemption Justifiable?

The Council notes that although collusive behaviour by employees to achieve industry-wide wage increases may result in some costs to the community, provision for collective action and some other industrial practices is more heavily prescribed under the current industrial relations framework relative to previous regimes. As discussed previously, under the WRA multi-business agreements can only be made subject to, among other things, the consent of all employers and the majority of employees to be covered by the agreement, and a test using public interest criteria applied by the Full Bench of the AIRC. Also, the WRA includes provisions which make membership of unions and associations voluntary and prohibit compulsory unionism. Discriminating against individuals based on membership or non-membership of a union or employer association is also unlawful. Therefore, the potential costs of collective action and some other industrial practices are likely be lessened by the operation of the formal industrial relations framework. The Council notes also that only a minority of the workforce come under informal workplace agreements.

On balance, the Council does not consider a revocable exemption to be justifiable on the basis of evidence provided through this review.

The Council recognises, however, that although achievement of a more competitive labour market is implicit in the framework of Federal and State industrial relations regimes, through the move towards greater use of enterprise bargaining, competition is not a specific object of industrial relations legislation. While the Terms of Reference for this review require the Council to have regard to relevant Federal and State industrial relations legislation, the question of whether this legislation should focus more on competition principles is too broad an issue for this inquiry. The Council considers that if competition policy issues were to be considered within a future review of labour market arrangements, 'pattern bargaining' and other issues relevant to competition could be addressed through amendments to the existing industrial relations framework, if such issues are not at present effectively regulated within this framework.[25]

The Council considers that if, following a comprehensive review of competition policy and labour market arrangements, competition principles were to be made more explicit within the industrial relations framework, thus removing some of the policy conflict between this regime and the TPA, there could be a rationale for subjecting employment arrangements and agreements outside of this framework to Part IV of the TPA. The Council believes that conduct that is outside of such a revised industrial relations framework, and which is potentially detrimental to competition, should in certain circumstances be examinable under Part IV of the TPA.

B1.8 Conclusion

The Council recommends that the section 51(2)(a) exemption be retained. The Council believes that there should be a minor amendment to section 51(2)(a), as discussed in section B1.4 of this chapter, to address an apparent inconsistency between the operation of section 51(2)(a) and Part IV of the TPA.

25 The Council notes that it sees merit in DEWRSB's proposal that industrial relations tribunals could have regard more broadly to competition issues.

B2 Exemption Provided by Sections 51(2)(b)(d) and (e)

B2.1 Overview

Sections 51(2)(b), (d) and (e) provide exemptions for certain provisions in employment contracts, partnership agreements and sale of business agreements. These provisions, commonly known as restraints of trade or restrictive covenants, restrict the commercial and competitive opportunities of one of the parties to the agreement. All types of restrictive covenants are prohibited or regulated by the TPA except those exempted by sections 51(2)(b), (d), and (e).

Section 51(2)(b) exempts restrictive provisions in employment contracts. The exemption encompasses conditions of work between employer and employee and services provided by independent contractors pursuant to a contract for services. It covers all work relationships where the benefits provided under the agreement constitute services under the TPA (*Optical Prescriptions Spectacle Makers Pty Limited v Vlastaras (1991)* ATPR 41-150).

Section 51(2)(d) exempts any provision in a contract, arrangement or understanding (otherwise called an 'agreement') between partners that relates to the terms of the partnership, the conduct of the partnership business or competition between the partnership and a party to that agreement. The provision can apply while the party to the agreement is, or after he or she ceases to be, a partner. The agreement, however, must be between the partners in their role as partners and the partners must not be incorporated. Section 51(2)(d) is concerned with more than just restrictive covenants and extends to exempt specific partnership arrangements and conduct of the partnership business. This aspect of section 51(2)(d) will be discussed in greater detail in section B2.6 of this chapter.

Section 51(2)(e) exempts any provision in a contract that is solely for the protection of the purchaser in respect of the goodwill of a business. The exemption is limited to a contract for the sale of a business or shares in the capital of a body corporate carrying on a business.

The restrictive covenants that are the subject of these exemptions continue to be subject to the common law doctrine of restraint of trade.

Recommendation

The Council recommends that the exemptions in sections 51(2)(b),(d) and (e) be retained in their current form.

In making the recommendation the Council considers that:

- the objectives of the exemptions are to resolve any conflict between the application of the common law doctrine of restraint of trade and the TPA, to enable the use of certain restrictive covenants and to maintain certainty by ensuring that existing judicial consideration is relevant;
- the exemptions do not protect behaviour that would be likely to substantially lessen competition in a market;
- the exemptions are necessary because of the per se provisions of Part IV, specifically the prohibitions on exclusionary provisions and price fixing;
- the application of the common law doctrine of restraint of trade adequately regulates the use of restrictive covenants;
- the exemptions provide benefits by ensuring that appropriate commercial activities that rely on these type of arrangements can continue with a degree of regulatory certainty;
- authorisation and notification are not practical alternatives to the standing exemption for these types of conduct; and
- there are no non-legislative means of achieving the objectives.

B2.2 Restraints of Trade and the Common Law

Courts have been, and continue to be, hostile to restraint of trade provisions; particularly in employment agreements. As a consequence, the common law has developed a restraint of trade doctrine to address such restrictive provisions on a case by case basis. The common law, as it now stands, has developed from an outright refusal by the courts to enforce a restrictive covenant in the 18th and 19th Centuries, to recognition that covenants can serve a useful purpose provided certain conditions are met (see generally Trebilcock 1986 and Meltz 1995).

The modern approach to the restraint of trade doctrine has its origins in the decision of Lord Macnaghten in *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co [1894]* AC 535. According to Lord Macnaghten:

> *The public have an interest in every person's carrying on his trade freely; so has the individual. All interference with individual liberty of action in trading, and all restraints of trade of themselves, if there is nothing more, are contrary to public policy, and therefore void. That is the general rule. But there are exceptions: restraints of trade and interference with individual liberty of action may be justified by the special circumstances of a particular case. It is a sufficient justification, and indeed it is the only justification, if the restriction is reasonable – reasonable, that is, in reference to the interests of the parties concerned and reasonable in reference to the interests of the public, so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public (Nordenfelt, p. 565).*

That is, the test is to determine whether a restrictive covenant is reasonable with regard to:

- the interests of the parties to the agreement; and
- the public interest.

Courts will strike down restrictive covenants or parts of covenants they consider unreasonable. The emphasis, however, lies on what is reasonable between the parties. Courts appear to give less weight to whether or not the restrictive covenant is in the public interest.

Courts have tended to focus on the individual circumstances of each case and the reasonableness of the restraint at the time it was agreed. The restraint of trade doctrine has never developed or reflected a coherent economic theory of when such restraints may, or may not, be justifiable (Trebilcock 1986, p. 55).

Restrictive Covenants in Employment Agreements

The common law allows an employer to protect a legitimate proprietary interest. An employer can do so by restricting an employee's future employment opportunities provided the restriction is reasonable. That is, the covenant must "protect some 'legitimate interest' of the employer". Further, "the extent of the restriction imposed on the employee" must be "commensurate with that interest, being no greater that is strictly necessary to protect it" (Stewart 1997, p. 184).

The legitimate interests that an employer can protect include the protection of trade secrets and customer connections (*Lindner v Murdock's Garage (1950)* 83 CLR 628, see also Stewart 1997). However, a restrictive covenant cannot be used solely to discourage competition (Trebilcock 1986, p. 68).

A restrictive covenant that purports to restrict a former employee's ability to exercise his or her own skills and experience will not be enforced (Sales 1988, p. 601). Those skills and experience acquired by the employee during the course of his or her employment belong to the employee.

In addition, courts interpret covenants that impose restrictions on employees quite rigidly. For example, as Professor Stewart pointed out:

> *It is not legitimate to impose or obtain a covenant merely in order to prevent a valued employee joining one of the employer's competitors or setting up their own business in competition with the employer (see Herbert Morris Ltd v Saxelby [1916] 1 AC 688; Lindner v Murdock's Garage (1950) 83 CLR 628) (Professor Stewart, submission 22, p. 2).*

The common law has identified five distinct elements as providing adequate protection. These are that:

- proprietary interests only will be protected, such as confidential information or customer details;

- proprietary interests will be protected no more extensively than is reasonably necessary – the period for which the restraint is imposed should be just enough to provide the employer with adequate protection, (*Knogo Corporation v Halligan (1984)* ATPR 40-460, see also Meltz 1995, p. 111) and should not go beyond the geographic area in which the employee was employed (*Lindner v Murdock's Garage (1950)* 83 CLR 628, see also Stewart 1997, p. 205);
- the onus of proving both that a legitimate interest exists and that it is not too wide normally falls upon the party seeking to enforce the restriction;
- failure to meet this onus in either respect can result in the entire restrictive covenant being unenforceable; and
- where a covenant is held to be enforceable, the primary relief for breach is an injunction (Trebilcock 1986, p. 67).

In addition, the reasonableness of a covenant is assessed on three bases:

- the nature and extent of the particular activities the employee is required to refrain from doing;
- the area in which these activities must not occur; and
- the duration of the restraint (Trebilcock 1986, p. 79 and Stewart 1997, p. 197).

Restrictive Covenants in Partnership Agreements

Partnership agreements tend to combine elements of both sale of business and employment agreements. This is particularly so when it comes to the provisions concerned with retirement, termination or dissolution of the partnership because the partners are both the owners of, and employed by, their business. Therefore, the interests that partners seek to protect are:

- the protection of business secrets and customer connections; and
- the preservation of the goodwill present in the partnership (Mehigan et al 1986, p. 125).

Courts treat partnership restraints and employment restraints differently (Stewart 1997, p. 196). Restraints that would be considered unreasonable if imposed on an employee, are often seen as acceptable when imposed on a partner. The parties to partnership agreements, arrangements or understandings are considered to have greater equality of bargaining power and are more likely to have access to necessary information before agreeing to the restriction *(Brown v Cunich [1994]* ATPR 46-117. See also Stewart 1997, p. 197).

Restrictive Covenants in Sale of Goodwill

The common law recognises that goodwill attracts customers to a business. It also recognises that if the vendor of a business, having been paid an agreed amount for the goodwill by the purchaser, is allowed to set up nearby, the goodwill may be eroded to the detriment of the purchaser (CCH 1998, 14-270).

For a goodwill covenant to be effective, the thing sold must fall within the definition of goodwill: that is, it must be 'the advantage which a person gets by continuing to carry on and be entitled to represent to the outside world that he is carrying on a business which has been carried on sometime previously' (*Bacchus Marsh Concentrated Milk Co Ltd (in liq) v Joseph Nathan and Co Ltd (1919)* 26 CLR 410, per Isaacs J). If the agreement does not contain this characteristic, a court is likely to consider it to be an agreement to restrain competition (Meltz 1995, p. 123).

As with restrictive covenants in employment and partnership agreements, the restraint must be reasonable between the parties. If a court is satisfied that the restraint is reasonable between the parties, it is difficult to then prove that the public interest is adversely affected by the restraint (Trebilcock 1986, p. 247). Compared with employment contracts, courts tend to be less critical when examining restraints in contracts for the sale of goodwill, because it is assumed that the parties to the agreement are of equal standing. It has been argued that this less strict approach by the courts could also recognise that consideration for the restriction has been clearly paid to the vendor, whereas in employment contracts this is not so clear (Meltz 1995, p. 124).

The only test relevant to the sale of goodwill is whether the covenant is necessary for the protection of the purchaser (*T W Cronin Shoe Pty Ltd v Cronin (1929)* VLR 245, see also Meltz 1995, p. 124). The question the court considers is "What is the vendor selling to the purchaser? rather than what would the purchaser like to have to protect himself from the vendor's competition?" (Meltz 1995, p. 126).

Any restrictions imposed usually involve restrictions on the vendor's ability to compete with his or her former business. As with employment and partnership restraints, when determining whether the restrictive covenant is reasonable as between the parties the courts consider the activity to be restrained, the geographic area covered and the duration of the restraint (CCH 1998, 14-275, see also Van Roy 1991).

B2.3 NSW Restraints of Trade Act 1976

Provided a covenant falls within one of the exemptions, it is governed by the common law restraint of trade doctrine alone, except in New South Wales where the *Restraints of Trade Act 1976 (NSW)* (RoT Act) also applies.

Section 4(1) of the RoT Act provides that "A restraint of trade is valid to the extent to which it is not against public policy, whether it is in severable terms or not." This provision applies to all restraint of trade provisions covered by the exemptions.

Section 4(3) of the RoT Act confers on a court a broad discretion to either sever the invalid part of a restrictive clause or rewrite a restrictive covenant it considers invalid to make it workable. Before the court can exercise this power, however, it must be satisfied that the restrictive covenant is a manifest failure and that there had been a genuine attempt to draft the restrictive clause appropriately.

The RoT Act:

> *strengthens the public interest element in the common law test and enables the courts to strike out those parts of a restrictive covenant that are contrary to the public interest. (The Cabinet Office (NSW), submission 41, p. 5)*

If the exemptions in sections 51(2)(b), (d) and (e) were removed, it is likely that many restrictive covenants, allowed by the common law and the RoT Act, would be illegal under the TPA. This would reduce the operation of the common law doctrine of restraint of trade and the RoT Act.

B2.4 Objectives of the Exemptions

The primary objective of the exemptions appears to be to ensure that restrictive covenants of the kind described in the exemptions are only regulated by the common law doctrine of restraint of trade.[26] Though the TPA specifically provides for the continuing operation of the common law doctrine in section 4M, it is likely that some conduct that is permissible under the common law doctrine could be in breach of Part IV of the TPA. Without the exemption, the TPA would be likely to have some impact.

According to the Hilmer report:

> *The aim of these exceptions is to avoid further regulation of such contractual provisions by the TPA, and thus avoid introduction of a conflicting basis on which to regulate them (Hilmer 1993, p. 157).*

A number of submissions supported this view. For example:

> *Further regulation of restrictive provisions in employment contracts, partnership agreements and sale of business contracts protecting the goodwill of the business will introduce a conflicting basis of multiplicity of regulation by the TPA, the common law, and specialised legislation (Allen Allen Hemsley, submission 39, p. 4).*

Dr Hampton argued that the objective of similar exemptions in the New Zealand *Commerce Act* is to avoid just such potential conflict (Dr Hampton, submission 18, p. 1).

The potential conflict with the TPA is likely to affect the ability of businesses to continue to use the types of restrictive covenants covered by the exemption. The area of greatest conflict is likely to be with the exclusionary provision prohibition in section 45(2)(a)(i) and (b)(i) of the TPA. According to the Law Council of Australia (LCA):

> *It would appear that these exceptions are required primarily because of the per se prohibition against exclusionary provisions contained in Section 45(2)(a)(i) and (b)(i). In the absence of the per se prohibitions, it is highly unlikely that the restrictive covenants referred to would ever contravene the TPA (LCA, submission 33, p. 4).*

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26 Section B2.7 discusses the objectives of the wider operation of section 51(2)(d) in respect of partnerships.

With a per se prohibition, the restriction is prohibited outright and no consideration is given to the effects of the restriction on competition. Businesses, therefore, are not able to use these types of restrictive covenants unless they seek authorisation, even if the covenant might have little or no effect on the level of competition in a market.

A related objective therefore could be the ability for businesses to be able to continue to use these types of restrictive covenants without having to seek authorisation.

The common law doctrine of restraint of trade has governed these types of restrictions for a considerable period of time, with modern judicial consideration of the issues having been settled during the last century. Maintaining a level of certainty for businesses that use these types of restrictions could also be seen as an objective of the exemption, especially if this is coupled with a view that, on the whole, the restrictions do not substantially lessen competition.

In summary, the Council considers the objectives of the exemptions are to:

- resolve conflict between application of the common law doctrine of restraint of trade and the TPA;
- enable the use of the types of restrictive covenants that are the subject of the exemptions without authorisation; and
- provide certainty by preserving existing judicial consideration of these issues.

The Council's view is that all these objectives continue to be relevant.

B2.5 Submissions

The Council received 18 submissions addressing the exemptions. The submissions fall into the following categories:

- 14 submissions supported the exemptions;
- 1 submission questioned whether the common law deals adequately with competition issues in respect of restrictive covenants in contracts of employment of personal services, without commenting on whether the exemptions should be retained;

- 1 submission made recommendations for change to remedy some perceived discrepancies and limitations; and

2 submissions considered the economic costs and benefits of restrictive covenants, without commenting on whether the exemption should be retained.

B2.6 Implications for Competition

The Council is required to identify whether, and to what extent, the exemptions in section 51(2)(b), (d) and (e) allow businesses to engage in specific anti-competitive conduct that otherwise may be prohibited by the sections 45, 46, 47 and 50 of the TPA.

As detailed in Part A of this report, Part IV of the TPA has two different approaches to restrictive conduct. Some conduct is prohibited outright: exclusionary provisions, price fixing and third line forcing. Other conduct, however, is prohibited only if it substantially lessens competition in the market.

All submissions addressing the issue of implications for competition argued that restrictive covenants have little, if any impact on competition. Most noted that the common law examines restrictive covenants very closely and a restrictive covenant is more likely to be struck down as being unreasonable at common law before the effect of the restraint goes anywhere near breaching Part IV provisions.

For example, according to the Newsagents Association of South Australia (NASA):

> *… the courts are only prepared to support such restrictive covenants where the reasonableness of the restraint is well established [and]… should a restraint of trade clause be determined to be unreasonable – then the courts are unlikely to read the clause down to an acceptable level, but rather strike it out so that the restraint clause does not apply at all (NASA, submission 6, p 3, 4-5).*

The Hilmer Report considered the restrictive covenants provisions only briefly but noted that:

> *Contractual provisions of the kinds referred to in these exceptions are unlikely to substantially lessen competition in a market as distinct from lessening competition between individual competitors or potential competitors. In any event, the courts will strike down restrictions under the common law doctrine to the extent they are unreasonably wide (Hilmer 1993, p. 157).*

And in the opinion of Toyota Motor Corporation Australia Limited (Toyota):

> *The common law will prohibit restrictive covenants as being "unreasonable" where they go beyond protecting the legitimate commercial interests of the employer. The common law will prohibit restrictive covenants far more often than such a covenant will breach the TPA (Toyota, submission 10, p. 2).*

Professor Stewart, however, provided one example where it might be conceivable that a restrictive covenant could substantially lessen competition:

> *a firm may have come to dominate a product market through some technological innovation which is held within the firm as a closely guarded secret. Restrictive covenants may then be used to "lock up" key technical staff or at least prevent them from joining the firm's competitors, thereby removing one obvious way for the firm's competitive advantage to be eroded. However unless competition laws are to be used entirely to overthrow the legal protection afforded to trade secrets, it is difficult to see how matters could be otherwise (Professor Stewart, submission 22, p. 3).*

The submission from the Chief Minister's Department (ACT) made a similar point when it argued that restrictive employment contracts can restrict competition in the market by preventing more efficient practices or a greater range of services being introduced into the market (Chief Minister's Department (ACT), submission 38, p. 1).

Nonetheless, Professor Stewart noted that such restrictions, in any event, serve to enhance incentives in firms to develop and exploit useful information:

> *Arguably indeed the common law approach of making covenants of reasonable scope enforceable offers an incentive to firms to develop and exploit useful information, as well as to establish more effective and personalised contact with customers. To put it*

> *another way, the non-enforceability of post-employment restraints might create free rider problems and thus impact adversely on investment in innovation (Professor Stewart, submission 22, p. 3).*

Mr Tonking, discussing restrictive covenants in sale of business contracts, provided one reason why it is unlikely that such covenants substantially lessen competition in the market. He said:

> *It is fair to say that the majority of restrictive covenants in agreements for the sale of businesses would be unlikely to have an effect on competition in the relevant market generally because most such covenants are found in agreements for the sale of businesses at the smaller end of the scale, or businesses conducted by professionals such as medical practitioners or solicitors where markets are not particularly concentrated (Mr Tonking, submission 21, p. 1).*

He noted that while covenants affecting the sale of businesses having a large market share appear to be less frequent, it is in this area that difficulties are likely to arise. Coupled with a lack of decisions by the courts on covenants affecting large businesses, there is debate about whether such restraints might adversely affect consumer choice.

The LCA argued that it is difficult to envisage that the restraint, if directed to the goodwill of a business, could lead to a substantial lessening of competition:

> *Two different circumstances can be envisaged. First, a corporation in a concentrated market may sell its business to another corporation which has no existing presence in the market. A vendor restraint will not substantially lessen competition, as in these circumstances there will be a bare transfer of whatever market power the first corporation possessed. There will be a neutral competitive impact if the first corporation exits the market. Secondly, if the second corporation has an existing presence in the market, the transaction will fall to be regulated by section 50 in any event (LCA, submission 33, p. 4).*

However, the ACCC submitted that, in some circumstances, restrictive covenants could substantially lessen competition in a market:

> *…where a vigorous competitor is acquired, leaving a market in which the remaining firms comprise a comfortable oligopoly,*

> *competition may not be lessened but for a restrictive covenant preventing the seller from re-entering the market. The acquirer may have been prepared to pay a premium price to eliminate vigorous competition, expecting to recoup the outlay in increased profits… An example of this was the acquisition of Solo, a major independent petroleum distributor by Ampol, a major refiner and distributor of petroleum. A long-term restrictive covenant prevented the vendors from reentering the petroleum market. The covenant was only terminated in 1995 as part of the enforceable undertakings given to the Commission in relation to the Ampol-Caltex merger (ACCC, submission no 58, p.2).*

The ACCC recognises that this sort of anti-competitive activity is generally capable of being addressed through application of section 50 to the related acquisition. It further stated that very few agreements would be likely to substantially lessen competition.

The LCA suggested that it is the per se offences in the TPA that made the exemptions necessary. It argued that these restrictive covenants would rarely have sufficient competitive impact to result in a contravention and would only ever breach the TPA because the prohibition on exclusionary provisions in section 45 is a per se offence (LCA, submission 33, p. 4).[27]

A number of submitters suggested amendments to the exemptions to:

- extend the exemption in section 51(2)(b) to restrictions imposed on bodies corporate;[28]
- clarify whether the exemption in section 51(2)(d) applies to the formation of a partnership and to matters prior to the commencement of the partnership;[29]
- apply the exemption in section 51(2)(e) to a provision in a document rather than requiring the provision to be in a sale agreement;[30] and
- to not exclude bodies corporate from the exemption in section 51(2)(d).[31]

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27 The Council recognises that section 45A also is a per se prohibition but, in its opinion, it is unlikely that any restrictive covenant would breach that provision.

28 Mr Steinwall, submission 54, p.6.

29 op cit, p.7.

30 ibid

31 ACCC, submission 58, p.1.

In arguing for the exemption in section 51(2)(b) to be extended to restrictions imposed on bodies corporate, Mr Steinwall suggested that, while originally it may have been thought that bodies corporate could protect their own interests and would not require the exemption, this is no longer always the case, especially for small corporate bodies. The Council, however, sees the exemption as essentially providing protection for employers in that they can protect their proprietary interests when contracting with employees. The relationship between a business and a contracted corporate body is not of the same character as the one between employer and employee. Restrictions imposed by a business on a corporate body may have wider competition implications than those imposed on individual employees. Further, it is not clear that the common law doctrine of restraint of trade, as developed in relation to employer/employee, is the appropriate regulatory regime to apply to contracts of service between a business and a body corporate. The Council is not convinced that the suggested amendment should be made.

Mr Steinwall also stated in his submission that "it is unlikely that the paragraph (section 51(2)(d)) extends to the actual formation of a partnership or to matters prior to the partnership having formally commenced. It would be desirable to clarify whether this is the intent of the paragraph."[32] The Council agrees with Mr Steinwall in that it does not believe the exemption extends to matters prior to the partnership being formed. The Council considers that the exemption is sufficiently clear in its current format and does not require amendment.

Section 51(2)(e) currently exempts provisions in a contract for the sale of a business that are solely for the protection of the purchaser in respect of the goodwill of the business. Mr Steinwall argued that the exemption should be for provisions in a ‘document’ that are solely for the protection of the purchaser in respect of the goodwill of the business. The Council is of the view that the current wording of the exemption is appropriate. The Council found no evidence to suggest that the current wording caused any problems in protecting the goodwill of businesses. The Council does not consider it unreasonable to expect parties to include the restriction protecting the goodwill within the contract for the sale of the business rather than other documents that may be related.

In its submission the ACCC recommended that if section 51(2)(d) is to be retained, it should not be confined to "none of whom are a body corporate",

32 Mr Steinwall, submission 54, p.7.

as this limitation has some distorting effects.[33] The Council does not support the amendment proposed by the ACCC.

Widening the exemption so that bodies corporate within partnerships could utilise restrictive covenants is unlikely to increase the competitive costs of the exemption, as the conduct would still be regulated by the restraint of trade doctrine. However, section 51(2)(d) is concerned with more than restrictive covenants and it is in the other areas of activity that the Council is concerned. Amending the exemption to include bodies corporate could create inappropriate opportunities for corporations to engage in activity they otherwise would not have been able to. This could increase the costs of the exemption as a whole. This is discussed below.

Section 51(2)(d)

As mentioned earlier in the report, section 51(2)(d) is concerned with more than just restrictive covenants and extends to exempt specific partnership arrangements and the conduct of the partnership business.

Partnerships, as well as other legal structures such as corporations and unincorporated associations, can reduce the level of competition in a market by permitting collective business activity rather than requiring all the individuals to compete with each other. The Council was provided with an example of this in a submission from Mr Ralph Clarke MP (Submission no. 108). Mr Clarke detailed how a medical partnership operating in rural South Australia is resulting in all the doctors in the area providing services on the same terms and conditions as each other, including a refusal to bulk bill. All doctors practising in the area are in the partnership and operate two surgeries as one business. This example highlights the potential costs of co-operative business activities such as partnerships. The costs would have been the same if the doctors had formed a company rather than a partnership.

However, these costs are likely to be confined to markets where a partnership business can operate without competitive constraints. The underlying cause of the matter concerning Mr Clarke is the limited number of medical service providers who are willing to work in rural Australia. If there had been more than one medical business in the area, then local

33 ACCC, submission 58, p.1.

residents would have access to other businesses that might provide services on different terms and conditions.

Partnerships involve the association of two or more persons to carry on a business as co-owners for profit. By their nature, they require co-operative effort and agreement of the partners as to how the business is to be conducted. The terms and conditions under which the business provides its services are generally, and appropriately, determined by agreement of the partners. Individual partners would not normally be seen as competitors with each other.

Section 51(2)(d) is particularly important in that it protects partnerships from breaching the price fixing prohibitions in the TPA. Under section 45A(8) of the TPA, it is possible that persons who otherwise would be in competition with each other, except for the fact that they have a partnership agreement, might be in breach of section 45A.[34] As section 45A is a per se prohibition, the conduct is prohibited outright and there is no analysis of the effect of the conduct on the market. For example, a legal partnership made up of six solicitors could be held to be price fixing in determining the fees their business charges, because if they did not have a partnership agreement, they would operate as six individual solicitors each competing with each other for business.

It is not clear to the Council that this is an intended consequence of section 45A(8). The possibility that a partnership may be found to be price fixing because the partners collectively agree on the prices they charge for their services is contrary to the legal and commercial understandings that a partnership is a legal structure that permits individuals to pursue profit-making in association with others.

While collective business activity such as partnerships could reduce competition, they can also have significant benefits. In Mr Clarke's example, it is possible that the area might not have access to the number of different doctors currently available if those doctors had not been able to form a partnership. Partnerships allow for sharing of resources, access to skills of all the partners for the benefit of the business and co-operative activity that might mean that better or more useful services are available than if less efficient business arrangements were imposed. Indeed, the difficulty attracting professions such as doctors to rural areas could be greater if they

34 A partnership which reaches agreements on prices with other business is not protected by section 51(2)(d) from the prohibitions in section 45A.

are not permitted to join together to provide services in a partnership. By allowing such co-operative associations, society has judged that the benefits of such arrangements outweigh the costs.

As discussed above, the ACCC suggested that section 51(2)(d) be amended to cover partnerships that include bodies corporate. Notwithstanding this, submissions indicated little concern among businesses that the current exemption is too limited. The Council considers that amending section 51(2)(d) in this way could create a loop-hole that might allow corporations to engage in price fixing without the threat of section 45A being available. Corporations might enter a partnership solely to use the exemption. While the potential cost of this anti-competitive activity is difficult to assess the Council believes that the potential risks in extending the exemption are not warranted. The Council is of the view that the exemption as currently drafted is appropriate.

B2.7 International Experience

Restrictive covenants in employment and exclusive service contracts, partnership agreements and sale of goodwill contracts remain, on the whole, governed by the common law in Canada, the United States, United Kingdom, Australia and New Zealand (Trebilcock 1986, p. 383).

The legislation of countries such as New Zealand, Canada and the United Kingdom indicates a common trend. Where the prohibitive conduct is focussed on the impact a given conduct has on competition, exemptions are unlikely to be included in the relevant legislation. In contrast, where the prohibitive conduct is fairly broad and all-encompassing, exemptions are provided to ensure that conduct traditionally regulated by the common law remains regulated by the common law. That is, where there is a blanket per se prohibition on exclusionary provisions or restrictive covenants, similar to those in section 45 of the TPA, exemptions similar to those in sections 51(2)(b), (d) and (e) apply.

New Zealand

Section 29 of New Zealand's *Commerce Act 1986* contains a similar prohibition to that found in section 45 of the TPA. To overcome any potential ambiguity or conflict between the legislation and the common law, section 44(1)(c)(a) and (d) of the *Commerce Act* largely mirror the exemptions in section 51(2)(b), (d) and (e) of the TPA.

United States

Several states have legislation that prohibits restrictive agreements. In most cases, however, exceptions covering the sale of a business and the termination of a partnership or other professional relationship apply. In those states that have legislated prohibitions, there is a general reluctance to exempt employment contracts because such restrictions are perceived to be one-sided and to the detriment of the employee (see generally Kafker 1993). However, most states do not have legislation prohibiting restrictive covenants (see Ashbrook 1992). The common law continues to regulate those restrictive agreements not covered by legislation.

United Kingdom

Under sections 6 and 11 of the United Kingdom's *Restrictive Trade Practices Act 1976*, agreements which contain certain specified restrictions must be registered. Restrictions specified in the provisions include restrictions on prices and charges, the terms and conditions on which people are to do business or the persons with whom business is to be done. Exemptions similar to those specified in the TPA are also available, but are found, for example, in the Schedule to the Act[35] or in Orders established under the Act.[36]

The *Competition Act* has recently replaced the *Restrictive Trade Practices Act*. Clause 2 of the *Competition Act* prohibits agreements that may affect trade within the United Kingdom and "have as their object or effect the prevention, restriction or distortion of competition within the United Kingdom". There are no exemptions similar to section 51(2)(b), (d) or (e) in

35 *Excluded Professional Services Listed in Schedule 1 to the Restrictive Trade Practices Act 1976 (as amended).* This list contains all those professions that would be included in the section 51(2)(d) exemption, although the UK exemption is much broader.

36 *Restrictive Trade Practices (Sale and Purchase and Share Subscription Agreements) (Goods) Order 1989, SI 1989/1081* and *Restrictive Trade Practices (Services) (Amendment) Order 1989, SI 1989/1082*. These Orders exempt conduct similar to that envisaged under the section 51(2)(e) exemption.

the Act. However, it is unlikely that restrictive provisions in employment contracts, partnership agreements or sale of business agreements will breach the clause 2 prohibition.

Canada

Section 45 of Canada's *Competition Act 1985* similarly prohibits persons from unduly limiting, preventing or lessening competition or doing anything that may restrain or injure competition unduly. It does not, however, prohibit parties from entering into restrictive arrangements where such arrangements do not "restrain or injure competition unduly". Accordingly, as restrictive provisions in employment contracts, partnership agreements and sale of business agreements are unlikely to "restrain or injure competition unduly", exemptions from that Act are not necessary.

B2.8 Costs and Benefits

The Council is required to examine the costs and benefits of the exemptions.

A separate but related issue is the costs and benefits of the existence of the types of restrictive covenants featured in the exemptions. Most of the submissions received by the Council on this matter were directed more to the costs and benefits of the restrictive covenants themselves.

For example, in relation to restrictive covenants protecting the sale of goodwill:

> *The protection afforded by common law is not protection against competition per se but is protection against the vendor whittling away the goodwill of the business by soliciting his old customers directly (Mr Tonking, submission 21, p. 3).*

And:

> *Without such restrictive provisions being possible [in a sale of goodwill agreement] it would render the sale of a business void of any true value and effectively allow vendors to receive consideration without reciprocation (Allen Allen Hemsley, submission 39, p. 5).*

The NASA submitted that the exemptions have a direct impact on the treatment and perception of a business's goodwill and value (NASA, submission 6, p. 2). The Pharmacy Guild of Australia and Small Retailers Association of South Australia expressed similar sentiments (Pharmacy Guild of Australia, submission 28 and Small Retailers Association of South Australia, submission 29).

The AIG commented that restrictions in employment agreements might be necessary to ensure that essential trust can be maintained between employer and employee during the course of that employment as well as to protect an employer's trade secrets and other sensitive information (AIG, submission 32, pp 4-5).

According to the AIG:

> *Were provisions preventing or limiting an employee from engaging in outside employment to become subject to the prohibitions in section 45, it is our view that that essential trust would be eroded. It would thus change the nature of the employment relationship for the worse if employees were free to engage in "outside" employment without restrictions or limitations and this could have a significant negative effect on a business (AIG, submission 32, p. 5).*

Costs of Exemptions

The exemptions themselves have competitive costs only if they allow conduct that otherwise would be in breach of Part IV of the TPA. There may be regulatory costs in maintaining an unnecessary exemption, but that is a different issue.

As discussed previously, the types of conduct exempted by sections 51(2)(b)(d) and (e) are mostly unlikely to breach the competition test provisions of Part IV as they are unlikely to substantially lessen competition in a market. However, conduct exempted by sections 51(2)(b)(d) and (e) is likely to breach sections 45(2)(a)(i) and (b)(i), the prohibitions on exclusionary provisions, as they are per se offences.

Part IV of the TPA includes several per se offences. The Hilmer Report in examining the types of competitive conduct rules that operate under the TPA, said:

> *The anti-competitive impact of some kinds of conduct may be so unambiguous that they should be prohibited outright without having to demonstrate their impact in each particular case. Where this conduct can be defined with sufficient certainty, prohibition of it per se will often be warranted (Hilmer 1993, p. 28).*

Clearly, the types of conduct protected by the exemptions do not have these characteristics. Their anti-competitive impact is not so unambiguous that they should be prohibited outright. Indeed, all submissions argued that the anti-competitive impact of the restrictive covenants, in a Part IV sense, is very small. For example, the LCA stated that the cost of these exemptions is quite limited:

> *The competitive process will rarely, if ever, be undermined to any appreciable extent by the operation of these exemptions, when coupled with the limiting factor of the common law doctrine of restraint of trade. Where there is no appreciable effect on competition, there will not be any resultant increase in costs for consumers, or any real reduction in choice (LCA, submission 33, p. 4).*

While it is not possible to state unequivocally that conduct protected by the exemption will not fail the competition test of the TPA, the Council agrees that the conduct protected by the exemptions is unlikely to do this. Consequently the exemptions, in protecting the restrictive covenants from the operation of Part IV, impose no significant competitive costs. The exemptions are required for protection from the per se offences of Part IV.

Moreover, any competitive cost arising as a result of the exemptions is reduced by the operation of the common law restraint of trade doctrine. While it can be said that the doctrine may not place the emphasis on the public interest that competition law does, the doctrine's scope ensures that many restrictive covenants would be found to be invalid before they would be in breach of the TPA.

Benefits of Exemptions

As indicated above, without the exemptions, restrictive covenants would most likely be prohibited outright under sections 45(2)(a)(i) and (b)(i). To use these types of restrictive covenants, a business would need to seek authorisation of the particular agreements, regardless of the size of the business or the amount of the agreement. For example, a restrictive covenant may be used in a partnership agreement between owners of a local flower shop or in a sale of goodwill contract between the purchaser and vendor of a local milkbar.

An authorisation can be a costly process, perhaps unaffordable for small business. The exemption process provides a benefit by removing the requirement for a business to seek an authorisation for conduct which does not substantially lessen competition but might breach the per se prohibitions in Part IV.

According to the LCA, given the vast number of transactions that these exemptions apply to, an authorisation or notification procedure would be an inefficient use of the ACCC's and the business community's resources (LCA, submission 33, p. 6). The ACCC submitted that requiring all such agreements to be scrutinised under the authorisation or notification provisions would involve unnecessary regulatory costs for the small number of agreements likely to substantially lessen competition.[37]

It is probable that removal of these exemptions would result in a considerable reduction in the use of restrictive covenants in employment, partnership and sale of business situations. This, in turn, could lead to a significant reduction in the value of a business or partnership, or the terms and conditions upon which an employee is employed. Accordingly, many submissions received detailed the necessity for these types of restrictions to allow what is current, widespread commercial practice.

Another benefit of the exemptions is that they make clear that these area of business practice are subject only to the common law doctrine of restraint of trade rather than both the common law and Part IV of the TPA. All submissions commented on the level of certainty that has now been achieved in the application of the common law doctrine and on the appropriate way that the common law deals with the 'reasonableness' of individual restrictions.

37 ACCC, submission 58, p.2.

The Hilmer Report stated that:

> *There are obvious benefits in having this area of law subject to the degree of certainty and consistency provided by judicial precedents on such matters (Hilmer 1993, p. 157).*

The Council is of the view that the competitive and regulatory benefits of the exemptions outweigh the costs.

B2.9 Competition Code

As discussed in Part A, the Competition Codes have extended Part IV of the TPA to cover the majority of business conduct in Australia. The exemptions in section 51(2)(b)(d) and (e) were also extended.

Prior to the introduction of the Competition Codes, many of the businesses using these types of restrictive covenants, would not have needed to rely on the exemption. This is because common business arrangements such as partnerships and unincorporated businesses were not covered by Part IV.

Businesses not previously covered by Part IV now continue to be able to use restrictive covenants in the way they are used to only because of the exemptions.

If the exemptions are now removed, or amended, a larger number of businesses would be impacted than would have been prior to the introduction of the Competition Codes. Many of these would be in the small business sector.

B2.10 Alternative Ways of Achieving the Objectives

As stated previously, the objectives of the exemptions are to ensure there is no conflict in the regulation of restrictive covenants and to ensure judicial certainty in the area. As the exemptions were included in the TPA to achieve these objectives, the Council considers there is no way the objectives can be achieved through non-legislative means. Therefore, any alternative could only be achieved through legislation.

The Council has identified two alternative means of achieving the objectives of the restrictions in sections 51(2)(b)(d) & (e). However, removal has some adverse consequences. The first alternative is to remove the exemptions and require businesses to seek authorisation for per se offences. For example, businesses would incur significant costs if they are required to pay the appropriate authorisation fee each time a restrictive covenant protecting the goodwill is included in the sale of business agreement. Or, in the absence of any restrictive covenant to protect goodwill or to protect an employer's legitimate interests from a former employee, the value of a business could drop significantly.

The second alternative is to reduce the scope of the exemptions so they only cover the per se offences in Part IV, leaving the restrictive covenants subject to the competition test provisions. While this option would address the issue of regulatory costs associated with having unnecessary exemptions, it is likely to result in considerable uncertainty as both the TPA and common law doctrine would potentially apply. The costs associated with generating uncertainty are likely to exceed any benefits that might be gained from more specific exemptions.

B2.11 Conclusion

The Council considers that the benefits of the exemptions outweigh the costs. This is particularly so given the nature of the restrictive covenants usually entered into and the type of people and size of business who use them most. Accordingly, the Council recommends that the exemptions in sections 51(2)(b), (d) and (e) be retained.

B3 Exemption Provided by Section 51(2)(c) - Standards

B3.1 Overview

Section 51(2)(c) provides an exemption from Part IV of the TPA for provisions in agreements dealing with recognised standards. The exemption operates so that where there is an obligation on the part of a person to meet a standard of dimension, design, quality or performance prepared or approved by the Standards Association of Australia (SAA) or by a prescribed association or body, the arrangement is exempt.

The Australian Gas Association (AGA) is a prescribed body for the purposes of Section 51(2)(c) and is to date the only prescribed body.[38]

Recommendation

> The Council recommends that section 51(2)(c) be removed from the TPA and the Competition Codes in the States and Territories.

The Council's recommendation to remove the exemption does not imply an undermining of the importance and relevance of recognised standards to the community, governments and courts. The Council recognises that national and international standards are pro-competitive and contribute to free trade. It is because the use of recognised standards do not involve a breach of Part IV of the TPA that the Council considers the exemption unnecessary.

In making the recommendation, the Council considers that:

- the ostensible objective of the exemption is to promote the development and use of recognised standards;

38 Regulation 8 of the *Trade Practices Regulations*.

- however, there is no evidence to suggest that the exemption promotes the development and use of recognised standards. Other factors, such as the expertise, resources and the standing of the SAA and AGA contribute to the market approval and use of their standards;
- concerns that removal of the exemption will undermine the development of standards by the SAA and AGA, undermine the certification scheme operated by the AGA and undermine public safety are without foundation because the exemption does not address these areas;
- the exemption is unlikely to protect conduct that otherwise breaches Part IV of the TPA because, in the vast majority of circumstances, the use of SAA and AGA standards does not raise concerns under Part IV. The exemption may, however, protect horizontal arrangements involving the collective adoption of standards of the SAA and AGA within an industry that are anti-competitive. Such circumstances are likely to be rare;
- as a consequence of the above points, the exemption does not achieve its objective, the exemption is unlikely to involve a restriction on competition and the exemption has no associated benefits and minimal costs;
- there is no reason to maintain the exemption in the Competition Codes of the States and Territories if the exemption is removed from the TPA;
- there are alternative non-legislative means of achieving the objective of the exemption. Steps taken by governments to reform the standards setting procedures of the SAA and review the use of standards in regulation are more direct, transparent and effective means of promoting the development and use of standards than an exemption from Part IV of the TPA; and
- the recent changes in the United Kingdom under the *Competition Act 1998* suggest that a standing exemption for standards like section 51(2)(c) is unnecessary. The approach under the *Competition Act* to standards appears to be one of case by case exemption rather than a standing exemption as found in section 51(2)(c) of the TPA.

B3.2 Standards

Standards are published documents setting out technical specifications relating to the design, material, processing, safety, quality or performance characteristics of a product (Link 1983; Standards Australia 1998b, p. 2). Standards may take the form of information standards, product/service quality standards, design standards, safety standards, product/service compatibility standards and testing standards (Standards Australia 1998b, p. 6).

The use of standards in trade is common. Businesses typically require suppliers to comply with a relevant standard as a condition of trading and governments typically require tenders to comply with service quality and other standards.

Standards have developed over a long period of time from standards for weight and measure to national and international standards for a vast array of goods and services. There are now over 5700 Australian Standards covering areas such as quality assurance, lift safety, fire safety, transportation of chemicals, electrical wiring, gas pipeline construction and children's helmets.

Standards may be mandatory or voluntary. Mandatory standards are standards that must be complied with by law and are found in legislation or regulations. Out of approximately 5700 Australian Standards, just over half are referenced in legislation as mandatory standards, with the remainder as voluntary standards (Commonwealth Interdepartmental Committee on Quasi-regulation 1997, p. 35).

An example of a mandatory standard is a consumer product information standard or safety standard. Under section 65E of the TPA, the relevant Minister has the power to prescribe standards prepared or approved by the SAA or another prescribed body as a consumer product information standard or safety standard. By virtue of sections 65C and 65D of the TPA, corporations are prohibited from supplying goods that do not comply with a consumer product information standard or safety standard.

Voluntary standards have no legislative force and parties are free to adopt or comply with them. They may be included in a contract so that a party to the contract has an obligation to the other parties to comply with the standard.

Standards have various purposes, including:

- to provide a minimum level of information to manufacturers and purchasers about a product or service;
- to ensure compatibility between related products;
- to establish minimum acceptable levels of product quality; and
- to reduce production costs by limiting product variety. In other words, to benefit from economies of scale and scope in producing standardised products (Link 1983; Department of Premier and Cabinet (Vic) 1996, p. 58).

Standards are seen as providing benefits to the community in terms of facilitating domestic and international trade, opening markets by eliminating product incompatibility, reducing barriers to entry, promoting safety, efficiency, quality and environmental improvement (Australian Chamber of Commerce and Industry, submission 31; AGA, submission 12; Department of Primary Industries and Energy (Cth), submission 24; SAA, submission 4; Allen Allen & Hemsley, submission 39; Cabinet Office (NSW), submission 41).

Standards today are more performance based as opposed to prescriptive. Performance based standards specify a desired outcome without specifying any particular way of achieving that outcome (Standards Australia 1998b, p. 6). Performance based standards permit greater flexibility in complying with the standard and allow for future use of new materials and methods. They are less likely to hinder competition and innovation than standards that are prescriptive. Prescriptive standards can create barriers to market entry by mandating particular technologies and reduce scope for innovation. Studies in the United States of performance standards imposed by regulatory agencies have shown that performance standards encourage innovation because firms will seek out the best means of achieving the desired outcomes of the standard (Gates 1998, p. 30).

B3.3 Standards Bodies

Standards Association of Australia

The SAA is the peak standards body in Australia through a Memorandum of Understanding with the Commonwealth Government. The SAA is an independent non-profit organisation established in 1922 and later constituted as a body corporate under Royal Charter in 1950 (Standards Australia 1998a, p. 16) and operates under the trading name Standards Australia. Standards prepared by the SAA are known as 'Australian Standards', which is a registered trade mark of the SAA (National Occupational Health and Safety Commission, submission 37, p. 2).

Following the report in 1995 of the Kean Committee, the Commonwealth Government and SAA entered into a new Memorandum of Understanding in February 1998 (Committee of Inquiry into Australia's Standards and Conformance Infrastructure 1995). The Memorandum of Understanding covers the following areas:

- Preparation of Australian Standards by the SAA and by bodies accredited by the Standards Accreditation Board (SAB) of the SAA.
- Participation by SAA in international and regional standardisation.
- Preparation of standards by Commonwealth agencies and authorities that may or may not involve the participation of the SAA or the reference of Australian Standards. (Australian Council of Trade Unions, submission 15, p. 9).

The AGA and the Australian Communications Industry Forum have been accredited by the SAB to prepare Australian Standards (SAA, submission 4, p. 2).

The policy of the SAA is to base Australian Standards on international standards to the maximum extent feasible. The SAA directly adopts international standards unless it believes there are good reasons to the contrary (Standards Australia 1998, p. 15). Approximately 25 % of current Australian Standards are fully or substantially aligned with international standards (Standards Australia 1998a, p. 17). The Australian Chamber of

Commerce and Industry indicates that countries are adopting international standards to conform with the General Agreement on Tariffs and Trade and that the procedures used by standards associations must be aligned with international standards in accordance with the World Trade Organisation agreement on Technical Barriers to Trade (Australian Chamber of Commerce and Industry, submission 31).

Many Australian Standards prepared by the SAA are published jointly with Standards New Zealand, the New Zealand standard setting association, as joint standards.

Standards prepared by the SAA are developed through a process involving transparency and consensus (Standards Australia 1998, p. 2; Australian Chamber of Commerce and Industry, submission 31; Allen Allen & Hemsley, submission 39). The SAA makes its standards setting process open to interested parties and publishes documents for general public comment. The SAA also establishes a committee with relevant expertise that prepares and adopts a standard only if the majority of committee members agree.

Australian Gas Association

The AGA is a national body representing around 1000 members involved in the Australian gas industry. The AGA was formed in 1962 by the amalgamation of the National Gas Association of Australia and the Australian Gas Institute.

The AGA prepares standards for gas appliances and components and runs a certification scheme called the Australian Gas Appliance and Component Approval Certification Scheme. The scheme involves testing gas products against standards of safety and efficiency. Approved gas products are sold with an approval certification badge. An important part of the Certification Scheme is the gas appliance energy label or star rating, which is a mandatory requirement for residential gas water heating, space heaters and central heaters. The scheme is funded by manufacturers under a budget that is ring-fenced from AGA's other activities and is open to members and non-members of the AGA (AGA, submission 12, p. 2). In 1997, the AGA had 1542 certificates in force under the scheme, with 104 new certificates issued and 1010 product verification audits completed.

As noted above, the AGA has been authorised by the SAB to develop Australian Standards. Standards that have been prepared by the AGA are also progressively being transferred to become Australian Standards following public consultation (AGA, submission 12, p. 2).

Other Standard Setting Bodies

Standards are also developed by a number of other organisations including the National Occupational Health and Safety Commission, National Food Authority, The Therapeutic Goods Administration, the National Health and Medical Research Council and National Standards Commission. Standards developed by these organisations are generally voluntary unless made mandatory by regulation or legislation.

B3.4 Objectives of the Exemption

The Council considers that the objective of the exemption is to encourage the development and use of recognised standards. Submissions and commentators identify this as the objective of the exemption (SAA, submission 4; AGA, submission 12; Australian Council of Trade Unions, submission 15; Australian Chamber of Commerce and Industry, submission 31; Cabinet Office (NSW), submission 41; Van Roy 1991). Heydon, for instance, comments that:

> *[The exemption] endorses the need for the development of proper standards governing commercial behaviour. Such standards can only become effective if extensively used (Heydon 1993, p. 1665).*

The exemption attempts to achieve its objective by providing certainty that observing recognised standards will not be taken to contravene Part IV of the TPA.

The Council considers that the following factors explain the inclusion of the exemption in trade practices legislation:

- the existence of an exemption in the English *Trade Practices Act 1956* for standards of the British Standards Institution;
- the assumption that complying with recognised standards did not relate to the control or distortion of markets (Acting Attorney

General 1962, p. 3106 and p. 3108). Standards were recognised as valuable in facilitating trade in domestic and international markets and ensuring product quality and safety and, therefore, important to the development of the Australian economy; and

- the perceived uncertainty at the time that trade practices legislation was first introduced in Australia about the application of the legislation to recognised standards. There may have been concerns at that time that trade practices legislation might hinder the development and use of recognised standards because of its generality and the uncertainty as to how it would be applied by the regulator and the courts.

Out of these factors, the Council considers that the existence of the exemption is best explained as a carry over from the 1965 Trade Practices Act. The 1965 Trade Practices Act in Australia was built on the English *Trade Practices Act 1956*. This legislation required agreements to be registered with the then Trade Practices Commissioner for possible examination. The exemption for standards removed the requirement to register agreements relating to the use of recognised standards. In the context of the 'registration' structure of the 1965 Australian Trade Practices Act the exemption can be seen as reducing unnecessary administrative costs for businesses. This is because without the exemption, agreements relating to the use of recognised standards were potentially registrable. The current TPA introduced in 1974 adopted a very different approach based on broad prohibitions rather than a 'registration' approach. The exemption for standards, however, was carried over into the 1974 TPA even though the use of standards was seen as pro-competitive and unlikely to be prohibited under Part IV of the TPA.

The Council considers that the objective of encouraging the development and use of recognised standards continues to be relevant. This is because the development and use of recognised standards is generally pro-competitive and can operate to enhance consumer welfare. This is consistent with the aim of the TPA to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection.

It is important to distinguish the objective of encouraging the use of standards from the question of the objective of the exemption. The Council considers that the exemption does not achieve its objective because there is no evidence to suggest that the exemption actually encourages the development and use of standards. This is discussed further in section B3.9 on the benefits and costs of the exemption.

B3.5 Submissions

The Council received submissions from 22 organisations and individuals addressing the exemption. The submissions fell within the following categories:

- 17 supported retention of the exemption;
- 2 suggested removal of the exemption; and
- 3 provided information concerning the exemption without commenting on whether or not it should be retained.

Most submissions supported retention of the exemption on the basis that standards are pro-competitive and that the exemption is necessary for the development and use of standards of the SAA and AGA.

The Council considers that the exemption is unnecessary. This is because standards are generally pro-competitive and the use of SAA and AGA standards is unlikely to create concerns under Part IV of the TPA. In addition, the Council found no evidence to suggest that the exemption promotes the development and use of standards. These matters are considered further in the following sections on the objectives, implications for competition and benefits and costs of the exemption.

B3.6 Implications for Competition

The implications of the exemption for competition arise from the scope of the exemption and the extent to which standards restrict competition.

Scope of the Exemption

The scope of the exemption determines the range of conduct that is protected from the operation of Part IV of the TPA.

The exemption operates so that a provision in a contract, arrangement or understanding obliging a person to comply with or apply standards of dimension, design, quality or performance prepared or approved by the SAA or by a prescribed association or body, is not to be taken to contravene Part IV of TPA.

The Council notes that there is significant misapprehension about the operation of the exemption. In particular, there is misapprehension that the exemption is wide enough to protect the following areas:

- mandatory standards;
- activities of standard setting committees of the SAA and AGA and people participating in those standard setting committees;
- schemes established to test and certify compliance with standards; and
- the use of standards in occupational health and safety.

Most concerns about the removal of the exemption derive from a misapprehension about its operation.

The exemption in section 51(2)(c) is not wide. Miller noted that:

> *Section 51 has been drafted carefully to ensure that the exemptions it provides for are not interpreted as having a broad application (Miller 1997, p. 242).*

The exemption is limited to:

- standards prepared or approved by the SAA, AGA or other prescribed body;
- standards of dimension, design, quality or performance; and
- contracts, arrangements or understandings obliging a person to comply with or apply standards of the above type.

The majority of circumstances in which recognised standards are used and to which the exemption applies is where a business requires a supplier to comply with or apply SAA or AGA standards of dimension, design, quality or performance.

Application to Voluntary Standards Only

The exemption is directed to voluntary standards and has no effect on mandatory standards. Where a standard is made mandatory by legislation or regulation, a provision in a contract, arrangement or understanding obliging a person to comply with or apply the standard will not breach Part IV of the TPA. Further, the anti-competitive effect of legislation and regulations is dealt with in section 51(1) and not section 51(2)(c).

The Department of Primary Industry and Energy, for example, stated that:

> *The SAA and AGA standards are applied to all Australian gas pipelines, appliances and components. Those which do not comply are prohibited from being sold in Australia (Department of Primary Industries and Energy, submission 24, p. 2)*

As a consequence, a provision in a contract, arrangement or understanding obliging a person to comply with or apply an SAA or AGA standard relating to Australian gas pipelines, appliances and components that must otherwise be complied with by law will not breach Part IV of the TPA.

Activities of Standard Setting Committees

The exemption does not cover the activities of standards setting committees of the SAA or AGA. In particular, the exemption does not protect people participating in standards setting committees of the SAA or AGA. This is because the exemption applies to arrangements to comply with or apply standards that have already been *prepared or approved* by the SAA or AGA. The activities of standard setting committees relate to the preparation and approval of standards and are not covered by the exemption. In other words, the exemption is directed to the use of standards already prepared or approved rather than the earlier development stage of standards.

People who participate in standard setting committees of the SAA or AGA and are involved in the exchange of information on prices or the preparation of standards intended to exclude competitors are not protected by the exemption and are subject to the prohibitions in Part IV of the TPA against price fixing and boycotts.

Certification Schemes

Schemes that are established to test and certify compliance with standards, such as AGA's certification scheme, are not covered by the exemption. This is because the exemption applies to arrangements in which one party agrees to comply with or apply certain standards prepared or approved by the SAA, AGA or other prescribed body.

Occupational Health and Safety

Some participants stated that removal of the exemption would undermine public health and safety because it will discourage use of occupational health and safety regulations prepared by the National Occupational Health and Safety Commission (NOHSC) in conjunction with the SAA (SAA, submission 4; AGA, submission 12; National Occupational Health and Safety Commission, submission 37; Australian Council of Trade Unions, submission 15). The NOHSC submitted that:

> *To remove the exemption from Part IV of the TPA at this stage would jeopardise the operability of the OHS regulatory frameworks in the jurisdictions while Australian Standards are referenced extensively by regulators as mandatory and non-mandatory instruments. This situation would impede the ability of the jurisdictions to maintain the OHS regulatory frameworks and could create an unacceptable increase to the level of risk to public safety (NOHSC, submission 37, p. 5).*

The NOHSC indicates that Australian Standards are used in the occupational health and safety framework in the following ways:

- Australian Standards are used in the National Standards, Approved Codes of Practice and Guidance Notes developed by the NOHSC;
- Australian Standards are referenced in State and Territory occupational health and safety legislation; and
- Australian Standards are used by regulators, employers, employees, OHS professionals and interested parties as common reference points or "measuring sticks" to assess OHS performance. Regulators extensively reference Australian Standards as mandatory and non-mandatory instruments in the occupational health and safety context.

Occupational health and safety legislation in most jurisdictions include provisions enabling National Standards and Approved Codes of Practice prepared by the NOHSC to be approved by the relevant Minister for the purposes of providing practical guidance to employers and others. In most jurisdictions, failure to comply with an approved code of practice or standard can be used as evidence of a breach of duty by an employer.

- Advice received by the NOHSC from the Office of General Counsel and provided to the Council by the NOHSC stated that the exemption might apply to Codes of Practice developed by the

NOHSC because they could be considered an 'arrangement or understanding' (NOHSC, submission 109).

The Council considers that removal of the exemption will not have an impact on the use of standards in the occupational health and safety context:

- NOHSC standards and codes of practice referencing Australian Standards that have been adopted by governments as mandatory will not be affected by the removal of the exemption. This is because the exemption does not apply to Australian Standards made mandatory by legislation or regulation;
- NOHSC standards and codes of practice referencing Australian Standards that have been approved by a relevant Minister for the purposes for providing practical guidance to employers and others will not be affected by the removal of the exemption. This is because such conduct is unlikely to amount to a contract, arrangement or understanding. In addition, it is unlikely that such standards would substantially lessen competition in a market because they relate to health and safety and employers and others are free to comply with them or not.

Standards and Competition

Standards generally have significant pro-competitive benefits because they contribute to product compatibility, convey information to consumers and manufacturers and ensure quality. Standards can therefore contribute to achieving the aim of the TPA to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection.

Submissions suggested that the exemption does not restrict competition. For example, the SAA in its submission to the Hilmer report commented that:

> *Within the narrow exemptions offered under Section 51(2)(c), it is difficult to see realistic circumstances in which reference to an Australian Standard could be deemed to be a restraint or restriction on trade (SAA, submission 4, p. 2).*

and

> *It is an irony that, although this provision is included as an exemption to the law on restrictive practices, it is generally accepted that national and international standards are a major contributor to free trade and fair competition (SAA, submission 4, p. 1).*

van Roy suggests that standards of dimension, design, quality or performance would not normally be considered anti-competitive (van Roy 1991, p. 27).

The Law Council of Australia stated that it is difficult to envisage a situation where a provision obliging a person to comply with a recognised standard would be likely to substantially lessen competition (Law Council of Australia, submission 33, p. 5).

The ACCI stated that there is no evidence that standards represent any restriction on competitiveness, either between states, nationally or internationally (ACCI submission 31, p. 6).

The Cabinet Office (NSW) commented that the exemption does not appear to be restrictive (Cabinet Office (NSW), submission 101, p. 1).

The ACCC considered that most standards are unlikely to be anti-competitive (ACCC, submission 58, p. 1).

Whilst it has been recognised that standards can increase product compatibility, reduce entry barriers for new technologies, increase consumer protection and expand the opportunities for product substitution, they can also have a negative impact on competition. Standards have the potential to stifle innovation, especially where they are mandatory or prescriptive, and can increase the costs of production.

Competition concerns about standards under Part IV may arise because the development of standards necessarily involves co-operation among competitors. Participants in standard setting committees may have economic incentives to develop standards that entrench a particular technology or exclude competing technologies. Competition concerns will arise where the resulting standard reflects a proprietary standard of an industry participant or where the standard is set at a level that can only be achieved by incumbent manufacturers that are members of the standards association (Law Council of Australia, submission 33; Department of

Primary Industries and Energy (Cth), submission 24). The standards may deprive consumers of desired products and services, eliminate quality competition, inhibit innovation and facilitate collusion.

The ACCI noted:

> *… the need for vigilance against the continued risk of vested interests unduly influencing the content of standards, despite the tradition of transparency and consensus in standard setting procedures (ACCI, submission 42, p. 2).*

Advice received by the NOHSC from the Office of General Counsel and provided to the Council by the NOHSC noted that:

> *An area where section 51(2)(c) might currently offer some protection to what would otherwise be anticompetitive behaviour is in those circumstances where the establishment or use of an Australian Standard in a market has the effect of a boycott (NOHSC, submission 109, p. 4).*

Dr Hampton noted that the collective adoption of standards will not normally be anti-competitive but concerns arise when it is used as a cloak for price fixing or boycotts (Dr Hampton, submission 18, p. 7).

The Cabinet Office (NSW) submitted that:

> *Removal of s51(2)(c) may potentially create the situation where compliance with relevant standards could be interpreted as participating in anti-competitive conduct (Cabinet Office (NSW), submission 101, p. 1).*

Other submissions indicated a similar concern that removal of the exemption could open participants in the standard setting committees of the SAA and AGA to litigation under Part IV of the TPA on the basis that their activities constitute unacceptable collusion of some kind (Office of Energy (WA), submission 70; Institute of Engineers Australia, submission 71; SAA, submission 44).

These concerns are more likely to arise where there is "standards capture". Standards capture arises where standards associations become captive to the interests of the predominant players in an industry, to the detriment of the overall development of the industry. Competition may be reduced because new and imported products that have the potential to increase the degree of competition in the manufacture and sale of those products could be excluded. This is important in the information technology industry because it can result in market power accruing to one or more firms through the technology becoming the installed base of the industry. The costs of conversion can make it extremely difficult to challenge this market dominance (OECD 1996b, p. 153).

The Department of Primary Industries and Energy (Cth) raised the issue of standards capture in respect of the AGA but considered that the diversity of interests represented by the AGA, its transparent processes and open membership precludes the risk of "standards capture" for standards set by the AGA (Department of Primary Industry and Energy (Cth), submission 24, p. 1).

The advice from the Office of General Counsel suggests that the risk that a standard prepared by the SAA would amount to a boycott may be rare given the transparent consensus process for standards, and that generally, international standards are adopted to conform with the General Agreement on Tariffs and Trade (NOHSC, submission 109, p. 5).

In addition, the Council notes that where the establishment or use of an Australian Standard in a market has the effect of a boycott, the activities of the standard setting committee in preparing and approving that standard are open to scrutiny under Part IV because the exemption does not cover those activities.

The Council believes that, on balance, it is difficult to envisage a situation where a provision obliging a person to comply with a recognised standard breaches Part IV of the TPA. The submissions did not identify any anti-competitive conduct associated with the exemption. The vast majority of circumstances involving the use of SAA or AGA standards will involve businesses requiring their suppliers to comply with such standards and will not involve anti-competitive conduct.

The Council considers that the circumstances in which the collective adoption or use of standards of the SAA or AGA in an industry amounts to a boycott in breach of Part IV of the TPA are likely to be rare. This is because the risk of standards capture is low for the SAA and AGA given their transparent consensus process for standard setting; the adoption of international standards that conform with the General Agreement on Tariffs and Trade; and the development of performance based standards.

B3.7 Broader Competition Implications of Standards

Broader competition concerns arise from the nature of standards and the use of standards in regulation.

The ACCI raised concerns in this area and suggested that the Council recommend an independent review by the Productivity Commission to examine the use of standards in regulation, to examine the implementation of the Kean Committee findings, and assess the extent to which standard setting may continue to create barriers to entry and innovation (ACCI, submission 42).

The Commonwealth Government's response to the Kean Committee included, among other things, a new Memorandum of Understanding with the SAA addressing the development and setting of standards. This included the establishment of the SAB in 1997 to accredit other bodies for the purposes of standard setting.

These matters are not affected by the exemption and are outside the terms of reference for this review. The Council, however, notes some steps taken by governments aimed at addressing the matters raised by ACCI.

Current initiatives in this area are set out in the Federal Government's *More Time for Business* (Prime Minister 1997). Under one initiative all governments agreed to include legislation that prescribes standards in the legislation review program under the Competition Principles Agreement (Prime Minister 1997, p. 74). Governments also agreed in principle not to use voluntary standards in regulation from July 1997 unless the standard represents a minimum effective solution to the problem being addressed.

A Commonwealth Interdepartmental Committee on Quasi-regulation reported in December 1997 (Grey-Letter Law report) to the Government about the extent of quasi-regulation including the use of standards in regulation (Commonwealth Interdepartmental Committee on Quasi-regulation 1997). The report recommended, among other things, that low cost access to Australian Standards referenced in legislation be provided to businesses, that steps be taken to provide information on the status of the SAA and its standards, and that regulations only reference parts of voluntary standards essential to satisfying regulatory objectives.

Governments have also established a working group that is developing a national database of external instruments, including standards, referenced in legislation. Tasmania indicates that preliminary results show that over 2800 Australian Standards are referenced in legislation (Department of Treasury and Finance (Tas), submission 2).

B3.8 International Experience

The international experience indicates various approaches to dealing with standards under competition laws.

An exemption to the same effect as section 51(2)(c) exists in New Zealand. In Canada an exemption exists by way of a defence to an action for a breach of its competition laws but the defence is unavailable if the arrangement has an anticompetitive effect. The United States does not have a specific exemption from competition laws for standards.

The United Kingdom currently has an exemption covering recognised standards but is reforming its competition laws through the *Competition Act 1998*. It is unclear whether the existing exemption will continue. The approach under the *Competition Act* appears to be one of case by case exemption rather than a standing exemption as found in section 51(2)(c) of the TPA.

United Kingdom

The United Kingdom exemption for standards is found in section 9(5) of the *Restrictive Trade Practices Act 1976 (UK)*, sections 1 and 2 of the *Restrictive Trade Practices Act 1977 (UK)* and the *Restrictive Trade Practices (Standards and Arrangements) Order 1990 SI 1990/888*.

Section 9(5) of the *Restrictive Trade Practices Act 1976 (UK)* provides an exemption for standards of dimension, design, quality or performance and for the provision of information or advice to consumers approved by the British Standards Institution or other prescribed body.

The *Restrictive Trade Practices Act 1976* has been repealed by the *Competition Act 1998*. This comes into force on 1 March 2000 and seeks to place United Kingdom competition law more in-line with European Union law.

The manner in which existing exemptions will be treated under the *Competition Act* is unclear. The *Competition Act* makes provision for the regulator, the Director General of the Office of Fair Trading, to exempt agreements from the prohibitions in the *Competition Act* on a case by case basis if certain criteria are met. This is similar to the authorisation and notification process under the TPA. The *Competition Act* also makes provision for 'block exemptions' for certain classes of agreement and conduct.

A draft consultation paper by the Office of Fair Trading on the application of the *Competition Act* to trade associations, professional bodies and self regulatory organisations noted the following in relation to the case by case exemption of standards:

> *Trade associations may play a role in the negotiation and promulgation of technical standards in an industry. Because the members are then limited by the standard in the make-up of the products that they can offer, there is a restriction of competition and, if entry barriers were to be significantly raised as a result of adoption of the standard, the effects could be appreciable (Office of Fair Trading 1998, p. 12).*

and

> *Technical standards can help to promote safety and protect consumers and are therefore likely to be good candidates for exemption. The benefits would, however, have to be assessed against any effects on competition in deciding whether exemption would be ultimately justified (Office of Fair Trading 1998, p. 15).*

The approach under the *Competition Act* to standards, therefore, appears to be one of case by case exemption rather than a standing exemption as found in section 51(2)(c) of the TPA.

New Zealand

The NZ exemption is contained in section 44(e) of the *Commerce Act (NZ)* and is in similar terms to section 51(2)(c).

Canada

The *Competition Act (Can)* contains a general prohibition on anti-competitive conduct and agreements, to which a specific defence is provided for conduct or arrangements that relate only to certain matters, including:[39]

- the defining of product standards;
- the definition of terminology used in a trade, industry or profession;
- the sizes or shapes of the containers in which an article is packaged; and
- the adoption of the metric system of weights and measures.

Under section 45(4) of the *Competition Act (Can)*, the defence is not available for conduct or an arrangement that has lessened or is likely to lessen competition unduly in respect of: prices; quantity or quality of production; markets or customers; channels of distribution; or restricts any person from entering into or expanding a business in a trade, industry or profession.

The exemption in Canada, unlike the exemption in section 51(2)(c), is not an absolute exemption because it is unavailable if the arrangement has an anticompetitive effect.

United States

The United States does not provide a specific exemption for standards from its anti-trust laws. Standards are assessed through the concept of boycotts under the prohibition in the *Sherman Act* against monopolisation. A boycott, in general terms, is where competitors agree to boycott the goods or services of a third party. It is addressed under the TPA through the prohibition against exclusionary provisions. In the context of standards, a boycott may arise because those adhering to the standard agree not to deal with goods or services not meeting the standard.

Professor Areeda provides the example of several automobile tyre manufacturers agreeing to produce only five types of tyres under a scheme of common specifications. Professor Areeda comments that "[s]uch

39 Section 45(1) and 45(3) of the *Competition Act (Can)*.

standardization might deprive some consumers of a desired product, eliminate quality competition, exclude rivals' ability to monitor each other's prices." (P. Areeda, *Antitrust Law*, par 1503, p.373 (1986) as quoted in Gellhorn and Miller 1995). In the case of *Allied Tube & Conduit Corp v Indian Head Inc. 486 U.S. 492 (1988)*, the US Supreme Court noted that standards are implicitly agreements not to manufacture, distribute or purchase certain types of products. The actions of standard setting associations could breach antitrust laws where the association rejected a proposed new standard for meritless reasons so as to drive out competitors. The likelihood of breaching antitrust laws is reduced where the standard setting association uses transparent and consensual procedures and standards are technically based (Gellhorn and Miller 1995).

B3.9 Benefits and Costs

Participants identified the costs and benefits arising from the exemption as outlined below.

Benefits

Benefits Associated with Standards

- Most submissions addressed the benefits and costs of standards rather than the exemption in the TPA. Submissions considered benefits include the enhancement of fair trading and consumer protection by assisting consumers and businesses in evaluating goods and services; the promotion of competition by providing uniform, and universal rules which apply to all market participants; promoting compatibility between related products in the manufacturing chain; and promoting competition by making products more readily substitutable and facilitating the development of service industries for standardised goods.
- The Council considers that submissions overstate the benefits and costs of the exemption by focusing on the benefits and costs of standards generally. This is because as most submissions accepted, the exemption has little or no influence in promoting the use of AGA and SAA standards. Because the exemption has no impact, it is not appropriate to attribute any benefits from using standards to the exemption.

- Even if the exemption has some effect on the use of standards, it is difficult to determine the portion of benefits of standards that should be attributed to the exemption. For example, a business may choose to comply with a standard because of consumer demand and commercial necessity even without the exemption (Law Council of Australia, submission 33; Toyota Motor Corporation, submission 10).

Encouraging the Development of Recognised Standards

Some submissions indicated that the exemption encourages the development of standards by protecting representatives and nominating organisations on standard setting committees of the SAA and AGA from the possibility of litigation arising under the TPA (SAA, submission 4; AGA, submission 12; Office of Energy (WA), submission 70; Institute of Engineers Australia, submission 71).

As noted in section B3.6, the exemption covers the use of standards and does not cover the activities of standard setting committees of the SAA or AGA. As a result, there is no benefit from the exemption in terms of protection of individuals or organisations. Any perception that the exemption protects the activities of standard setting committees of the SAA and AGA is based on a misapprehension of the exemption.

Encouraging the Use of Recognised Standards

The SAA, whilst suggesting that more standards are likely to have been prepared as a result of the exemption and that without the exemption some standards needed to facilitate trade may not have been prepared, acknowledged that there is little direct and substantial evidence that the exemption encourages or discourages the wide use of standards (SAA, submission 4, p. 3).

Toyota and the Law Council of Australia considered that any wider usage of SAA standards relative to other standards is attributable to factors other than the exemption, such as:

- the reputation, expertise and quality of the SAA and AGA itself;
- the resources and mechanisms the SAA and AGA have in place to implement the introduction of standards, publish standards

widely, monitor the effectiveness of its standards and revise its standards as needed; and

- the lack of resources of many non-profit industry and consumer associations to commission the development, publication and updating of standards (Toyota Motor Corporation, submission 10, p. 4; Law Council of Australia, submission 33).

Toyota suggested that businesses are not aware of the exemption when using standards in agreements and that the use of standards is driven by commercial necessity (Toyota Motor Corporation, submission 10, p. 4). Similarly, the Grey-Letter Law Report noted that the use of voluntary standards by businesses is normally driven by commercial considerations (Grey-Letter Law report, p. 43).

The Law Council of Australia stated that it is a common aspect of commercial activity to find contractual obligations relating to standards (Law Council of Australia, submission 33, p. 5). Allen Allen & Hemsley commented that the exemption does not appear to be relied on very often (Allen Allen & Hemsley, submission 39, p. 6).

There are several factors that may encourage use of standards of the SAA and the AGA relative to the standards of other associations. These include:

- the position of the SAA as the peak standards body in Australia under a Memorandum of Understanding with the Commonwealth Government;
- the existence of the SAA since the 1920s and the existence of the AGA since 1962, resulting in the development and use of their standards before the existence of the exemption;
- the recent use of voluntary SAA standards by courts as benchmarks in determining issues such as negligence, for example, the use of a SAA kerb height standard in *Anne Christina Benton v Tea Tree Plaza Nominees 1995* 64 SASR 494 (Grey-Letter Law report, p. 36); and
- the recent Memorandum of Understanding between the SAA and the ACCC on co-operation between the two organisations in relation to standards.
- The Council found no evidence to suggest that the exemption promotes the use of standards. It considers that other factors, as identified above, contribute far more heavily to standards of the SAA and AGA having significant market use.

Distinguishing Compliant Firms

The NSW Cabinet Office submitted that the benefits to business that are provided by the exemption are significant because:

> *[Performance based] standards are reasonable in the vast majority of cases, and distinguish firms that do meet requirements from those that do not.*
>
> *Amendments that enable non-compliant firms to trade freely alongside compliant firms could unfairly disadvantage the latter and develop an uneven playing field. The benefits to business that are provided by section 51(2)(c) are therefore significant (Cabinet Office (NSW), submission 41, p. 6).*

The Council notes that the exemption does not alter the behaviour of firms because the exemption does not compel firms to comply with standards. Under the exemption, firms are free to comply with or not comply with voluntary standards. Firms may decide to "to produce non-standard items (whether innovations or not), if that produces a competitive advantage"(Heydon 1993, p. 2297). The Council considers that the exemption does little to distinguish between compliant and non-compliant firms in relation to standards.

Costs

Costs Associated with Complying with Standards

- Standards can increase compliance costs for business, but only to the extent the exemption itself promotes the use of standards. As noted above in relation to benefits of the exemption, there is no evidence to suggest that the exemption promotes the use of standards. Accordingly, the Council considers that any costs associated with standards are not attributable to the exemption.

Costs Associated with Standards that Restrict Competition

- Submissions identified no costs in terms of increased entry barriers, increased costs of production or compliance, limited numbers of firms participating in the industry or limits on the ability to innovate associated with the exemption.

- In section B3.6 the Council found that the exemption is unlikely to restrict competition because the actions exempted are unlikely to breach Part IV of the TPA and the circumstances in which the collective adoption or use of standards of the SAA or AGA in an industry amounts to a boycott in breach of Part IV of the TPA are likely to be rare.

Assessing Benefits and Costs

The Council considers that the exemption has no associated benefits and minimal costs.

Benefits in terms of the exemption encouraging the development and use of standards do not exist because there is no evidence that exemption has encouraged the development and use of standards.

Benefits associated with standards generally are not attributable to the exemption because there is no evidence that exemption has encouraged the development and use of standards.

Costs in terms of the exemption restricting competition were not identified by submissions. The Council notes that standards may be used as boycotts but considers this to be extremely unlikely for standards prepared by the SAA and AGA. The costs associated with such conduct are, however, significant. The Council considers that if ever the situation arose that a standard prepared by the SAA or AGA amounts to a boycott, the costs and benefits to the public of such a standard should be subject to the authorisation process under the TPA.

B3.10 Alternative Ways of achieving the Objectives

Some submissions indicated that non-legislative alternatives would not achieve the objective of the exemption – the objective of promoting the wider development and use of recognised standards (ACTU, submission 51; SAA, submission 44; Institute of Engineers Australia, submission 71).

The Council, however, considers that there are practical non-legislative alternatives to achieving the objective of the exemption. Some of these alternatives include:

- the developments outlined in section B3.7 whereby governments are taking steps to reform the use of standards and the preparation of standards;
- the transparent and consensus based approach to the preparation of standards by the SAA and AGA;
- the establishment of the Standards Accreditation Board to accredit other bodies for the purposes of standards setting;
- increased national liaison and cooperation with industry in standards setting (Standards Australia 1998a, p. 12);
- reducing the time and cost of developing standards (Standards Australia 1998a, p. 6); and
- the electronic delivery of standards through CD Roms and the internet (Standards Australia 1998a, p. 20).

These steps contribute to the development and use of standards and their market acceptance in a more direct, transparent and effective way than a legislative exemption to Part IV of the TPA.

B3.11 State/Territory Competition Codes

The Terms of Reference required the Council to consider the "consequential effects that the exemption provisions have through the Competition Code in each State and Territory" (term 3(g)).

As discussed in Part A, the Competition Codes in the States and Territories contain provisions equivalent to section 51(2)(c). To maintain consistency these codes would need to be amended if section 51(2)(c) is repealed. This requires the Commonwealth to consult with the States.

B3.12 Conclusion

The Council considers that the exemption is not necessary. There are no benefits from the exemption because it does not promote the wider use recognised standards. There are alternative non-legislative ways to promote the development and use of recognised standards. Concerns that removal of the exemption will undermine the development of standards by the SAA and AGA, undermine the certification scheme operated by the AGA and undermine public safety are unfounded. The Council recommends that the exemption be removed from the TPA and the Competition Codes in the States and Territories.

B4 Exemption Provided by Section 51(2)(g) – Export Arrangements

B4.1 Overview

Section 51(2)(g) provides an exemption for a provision of a contract, arrangement or understanding that relates exclusively to the export of goods from Australia or to the supply of services outside Australia. The ACCC has received 216 notifications under the exemption.

Recommendation

The Council recommends that the exemption for exports in section 51(2)(g) be retained in its current form.

In making the recommendation, the Council considers that:

- the objectives of the exemption are to facilitate exports, remove uncertainty about the application of the TPA to exports, and to place Australian exporters in the same position as foreign exporters that benefit from a similar exemption;
- the exemption has no costs associated with restrictions on competition because it is unlikely to protect conduct that would otherwise breach Part IV of the TPA;
- the exemption provides benefits in terms of certainty and placing Australian exporters on an equal footing with foreign exporters;
- the exemption may have increased use in the future due to reforms in statutory marketing arrangements and growth in the services sector;
- authorisation and notification under the TPA are not practical alternatives to the exemption; and

- while non-legislative means could achieve the objective of facilitating exports, non-legislative means could not achieve the objectives of removing uncertainty about the application of the TPA to exports and placing Australian exporters in the same position as foreign exporters that benefit from similar exemptions.

B4.2 Objectives of the Exemption

The Council considers that the exemption has a number of interrelated objectives:

- to facilitate Australian exports of goods and services;
- to reduce any uncertainty associated with the application of the TPA to exports; and
- to place Australian exporters on an equal footing with foreign exporters that enjoy the same immunity from their national competition laws.

Submissions identified the purpose of the exemption as the facilitation of exports. This is supported by the historical and economic context in which trade practices legislation developed in Australia. The facilitation of exports is also the principal objective of similar exemptions in other countries (Ordover and Goldberg 1993).

Trade practices legislation in Australia developed in the 1960s at a time when Australia was experiencing high growth levels and exports were becoming an important contributor to that growth. In this context, export arrangements were seen as justified in the public interest so long as they did not injure the export business of a competitor, keep a person out of the export business or unduly lessen competition in the domestic market (Acting Attorney General 1962, pp. 3102-3113).

The existence of the export exemption may have reflected concerns about a possible negative impact on exporters arising from the generality of the legislation and the uncertainty as to how the courts would apply the legislation. A specific exemption may have been seen as a simple way to reduce any uncertainty by clarifying the application of the TPA to exports.

The exemption may have simply reflected the view that conduct in export markets was unlikely to have any adverse effects on competition in Australian markets. Heydon suggests that arrangements relating exclusively to exports are highly unlikely to have the effect of substantially lessening competition in a market in Australia (Heydon 1993).

The competition laws of most OECD countries exclude from their coverage export arrangements that relate solely to foreign markets (OECD 1996a, pp. 34-35). The principal reason for this is that national competition laws are concerned with competition and consumer welfare in the domestic market rather than competition and consumer welfare in foreign markets (Productivity Commission 1996, p. 13). In other words, competition laws are principally concerned with adverse spillover effects of export arrangements into the domestic market (Ordover and Goldberg 1993, p. 30).

The position in Australia is the same. Competition laws in Australia are concerned with enhancing the welfare of Australians and protecting the competitive health of Australian markets. This is reflected in the objectives of the TPA in section 2 and reinforced through the definition of 'market' in section 4E as a market in Australia. The Law Council of Australia suggested that Part IV is not concerned with promoting competition by Australian businesses in world markets (Law Council of Australia, submission 33, p. 6).

The existence of the exemption may also simply reflect the fact that trade practices legislation in Australia was based on similar legislation in other countries, including British legislation which had an exemption for exports. The intention may have been to place Australian exporters on the same footing as foreign exporters by providing a similar exemption for exports.

B4.3 Submissions

The Council received submissions from 12 participants addressing the exemption. The submissions fell within the following categories:

- 7 supported retention of the exemption;
- 2 suggested modification of the exemption; and

3 provided information concerning the exemption without commenting on whether or not it should be retained.

B4.4 Implications for Competition

The competitive implications of the exemption arise from the extent to which the exemption protects anti-competitive conduct that would otherwise breach Part IV of the TPA. This is principally determined by the scope of the exemption and the consequences for competition in Australian markets, foreign markets and, more generally, in international trade.

Scope of the Exemption

There are some procedural and basic aspects to the exemption with its scope ambiguous due to the requirement that a provision 'relate exclusively' to exports.

Procedural and Basic Aspects

The exemption protects the parties to the export contract, arrangement or understanding.

To obtain the exemption, information about the export provision must be furnished to the ACCC within 14 days of making the contract, arrangement or understanding. If the information is not submitted within the required 14 days, the provision will not be protected by the exemption.

The information submitted to the ACCC must satisfy the following requirements:

- the information must be full and accurate; and
- the information must include particulars of any method of price fixing but need not include particulars of prices for goods or services.

The ACCC records the information on a register under section 166 of the TPA. The register is not open to the public. The ACCC may, however, make the information available to the Treasurer or to a court. In addition, a party to the export arrangement may apply to the ACCC to obtain a certificate specifying the information submitted under the exemption and the date on which it was submitted. The certificate can be used in a court as evidence that the information in the certificate was furnished to the ACCC on the date specified.

The exemption only protects parties to an export arrangement from the application of Australian competition laws. The exemption does not provide immunity from the competition laws of another country. For example, the United States antitrust enforcement agencies may scrutinise anti-competitive conduct by foreign firms that have an effect on commerce within the United States or on the export business of firms in the United States (Federal Trade Commission 1995).

The exemption does not apply to international liner cargo shipping, which is regulated by Part X of the TPA.

Relates Exclusively to Exports

The exact scope of the exemption depends on the interpretation of when a provision 'relates exclusively' to exports. This is unclear. On the one hand, a provision that in any way relates to the domestic market is likely to fall outside the exemption. However, it is difficult to envisage a provision that deals solely with the export of goods or services and does not refer to some other aspect of the export that takes place in Australia.

In the only reported case considering section 51(2)(g), *Refrigerated Express Lines Australasia Pty Ltd v Australian Meat and Live-stock Corp (No2)*[40], Deane J noted that the exemption presents difficulties of construction. Heydon comments that:

> *[the difficulties in construing section 51(2)(g) arise from] a combination of the word "relates", which often has an extremely wide but vague and indefinite meaning, and the word "exclusively", which has a narrow and precise meaning. They also arise from the difficulty in determining whether the reference to a provision relating "exclusively" to the export of goods should be restricted to a provision dealing with actual export as such or should be construed as embracing contracts for the carriage of goods in the course of their export (Heydon 1993, p. 1667).*

Allen Allen & Hemsley noted that the exemption only applies to a provision of an agreement rather than the *whole* of the agreement. They suggested that this creates difficulties in determining whether the exemption should

40 (1980) ATPR 40-156.

be restricted to a provision dealing with the export of goods or whether it should also apply to contracts for the carriage of goods in the course of their export:

> *The wording of this section suggests that the provision in the contract must directly relate to the export of goods from Australia or the supply of services outside Australia and to no other matter. It is submitted that a provision may relate exclusively to the export of goods or the supply of services outside Australia although it includes clauses within the one provision that deal with other aspects that relate to the export but which take place in Australia. Such aspects may include the delivery of a product from the manufacturer to the point of departure from Australia and even the payment for those goods. It is difficult to envisage a provision that deals solely with the export of goods and does not refer to some other aspect of the export that takes place in Australia. It is submitted that section 51(2)(g) would not apply if these other aspects were incidental and did not relate directly to export (Allen Allen & Hemsley, submission 39, p. 8).*

Mr Steinwall suggested that the protection of the exemption should not be lost because the contract deals also with activity occurring in Australia that is necessary, but incidental to the export of goods from Australia (Mr Steinwall, submission 54, p. 8).

The ACCC has expressed the view that the exemption does not cover provisions that in any way relate to the domestic market:

> *…. if a provision of an export agreement relates to supply or pricing in the domestic market in any way, it will not fall within the exemption. For instance, if an export pricing arrangement is notified to the [ACCC] under s. 51(2)(g), any part of the arrangement that might relate to pricing on the domestic market will not relate exclusively to the export of goods and will not fall within the exemption (ACCC 1997, p. 34).*

Given the ambiguity associated with the term 'relates exclusively', it has been suggested that the exemption may potentially cover a wide variety of provisions, such as:

- exclusivity provisions between an Australian exporter and Australian upstream supplier, where the exporter is the sole exporter for the supplier;

- exclusivity provisions between an Australian exporter and foreign distributor, where the distributor is the exclusive distributor for the exporter;
- a provision in an agreement between competing Australian exporters whereby they agree not to supply their goods or services to other Australian exporters (Goldsworthy 1977, pp. 307-311);
- a provision in an agreement between a foreign manufacturer and Australian firm where the Australian firm agrees to manufacture and distribute within Australia and not sell the product in other countries in competition with the foreign manufacturer or its other licensees; and
- provisions in agreements that are ancillary or necessary to the export of goods or supply of services outside Australia. For example, a provision in an export agreement relating to the movement of goods from the point of manufacture to the point of departure from Australia (ACCC 1997, p. 34; Allen Allen & Hemsley, submission 39, p. 8; CCH 1998, par 14-285; Dr Hampton, submission 18, p. 20; Cabinet Office (NSW), submission 41, p. 7).

The ACCC has also noted that the exemption may cover a provision in a licence of Australian intellectual property that prohibits exports from Australia (Trade Practices Commission 1991, p. 33). This protection is in addition to the protection provided by the exemption in section 51(3) of the TPA for intellectual property. Such an export ban may affect the profitability of the licensee, particularly its ability to achieve scale efficiencies, and could adversely affect competition in Australian markets. The ACCC noted, however, that in most cases it would be unlikely that competition in Australia would be substantially lessened by such a provision, or that a competitor is hindered or deterred from competing (Trade Practices Commission 1991, p. 33; see also Goldsworthy 1977, pp. 307-311).

The Council considers that although the scope of the exemption is unclear, it is unlikely that the exemption protects provisions that would otherwise breach Part IV of the TPA. This is because a provision in an arrangement that breaches Part IV of the TPA is unlikely to be classified as a provision that ‘relates exclusively’ to exports. From this perspective, a provision that substantially lessens competition in an Australian market, fixes prices in an Australian market, involves third line forcing in Australia or involves a primary boycott in Australia would be unlikely to be classified as a provision that 'relates exclusively' to exports.

Australian Markets

The principal concern with the exemption is that provisions relating exclusively to exports may have competition reducing spillover effects in Australian markets. However, the Council found no evidence to suggest that the exemption harms Australian markets.

Some submissions suggested that a provision relating exclusively to exports is unlikely to substantially lessen competition in a market in Australia (Law Council of Australia, submission 33, p. 6; Allen Allen & Hemsley, submission 39, p. 7; Cabinet Office (NSW), submission 41, p. 7). This is because the definition of 'market' in section 4E of the TPA is a market in Australia and, therefore, the 'substantially lessening competition' test only applies to markets in Australia. For the same reasons, Heydon suggests that the exemption is not needed in relation to the provisions of Part IV that rely on the 'substantially lessening competition' test (Heydon 1993, p. 1667).

According to the Law Council of Australia, arrangements relating exclusively to exports are unlikely to breach the per se prohibitions in Part IV of the TPA because those prohibitions also depend on the use of the expression 'market' (Law Council of Australia, submission 33, p. 6).

The Law Council of Australia also suggested that the risk of unintended competition reducing spillover effects in domestic markets is not significant because the exemption is clear and the consequences of anti-competitive conduct in the Australian market are severe (Law Council of Australia, submission 33, p. 6). The Cabinet Office (NSW) considered that the exemption is likely to have little impact on domestic competition (Cabinet Office (NSW), submission 41, p. 7). This view accords with the Hilmer report which stated that "any impact on competition in Australia is likely to be at most indirect" (Hilmer 1993, p. 156).

The OECD has examined the anti-competitive spillover effects of export arrangements, particularly arrangements between domestic exporters (OECD 1974, 1993, 1996a and 1996b). Reports for the OECD noted potential concerns about export arrangements, including:

- exporters with no market power in the export market could use the export arrangement to increase market power in the domestic market (Ordover and Goldberg 1993, p. 19);
- exporters may use information obtained through export arrangements to fix prices in the domestic market (Ordover and Goldberg 1993, p. 53). The exchange of information on prices, costs, production lines, capacities and sales policies may influence the domestic conduct of the participating firms resulting in a restraint of domestic competition through conscious parallelism. However, the exchange of information about costs or capacity among members to an export arrangement may have beneficial effects on domestic welfare if it enables a more efficient firm, or firms, to obtain a bigger share of the domestic market (Ordover and Goldberg 1993, p. 53);
- exporters in an export arrangement are likely to seek to recoup losses in export markets in the domestic market and thereby restrain domestic competition. Losses are likely to arise because prices are usually determined on an average basis rather than the lowest price of the most efficient producer, thereby decreasing the volume of exports that may have been achieved based on the best price out of the exporting country for the product (OECD 1974); and
- export arrangements may prompt retaliatory trade measures from other countries (Ordover and Goldberg 1993).

The OECD found no solid evidence to suggest there are spillovers from export arrangements into domestic markets. It considered that the size and direction of any such spillovers is a matter of conjecture.

The ACCC expressed the following concerns about the possible spillover effects of the exemption:

- export arrangements may have spillover effects in terms of oligopoly pricing, because cooperation and exchange of information in relation to exports may facilitate coordinated pricing in domestic markets;
- membership of an exclusive export arrangement may provide members with access to certain facilities, services or other advantages, which inhibit the ability of non-members to compete effectively with them in the domestic market; and

- where spillover effects would constitute breaches of section 45, they may go undetected, or there may be insufficient evidence to satisfy a court (ACCC, submission 58).

To some extent the exemption assumes that the conduct of exporters in foreign markets does not to flow back into the domestic market. Given that the growing linkage between economies world-wide is resulting in the opening of economies, including the Australian economy, the conduct of exporters in foreign markets may have more visible effects in the domestic market than previously assumed. Recent research at the Reserve Bank of Australia suggests that within the traded goods sector, the more open is the industry, the quicker domestic prices adjust to changes in foreign prices (O'Regan and Wilkinson 1997). An implication of these results is that as the Australian economy becomes more open, the conduct of Australian exporters in foreign markets may flow through to the domestic market, especially in terms of higher prices.

The Council, overall, considers that it is unlikely that the exemption protects provisions that would otherwise breach Part IV of the TPA. The Council has not been able to find evidence to suggest that agreements protected by the exemption have had the effect of substantially lessening competition in Australian markets. The submissions have not identified any anti-competitive spillover effects into Australian markets from agreements relating exclusively to exports.

Foreign Markets and International Trade

The exemption of export arrangements from competition laws has for some time been under scrutiny in the international arena (OECD 1996a and 1996b; Ordover and Goldberg 1993). This is because export arrangements can have an adverse impact on international trade. Whilst the impact of export arrangements on international trade and foreign markets is outside the scope of this review, the Council notes some of the issues in this area.

In a report to the OECD on aspects of competition and international trade, Ordover and Goldberg note that export cartels harm international trade and world economic welfare when they constrict exports, reduce international competition and elevate prices (Ordover and Goldberg 1993, p. 18). Ordover and Goldberg suggested that while the exporting country benefits, the net result is a welfare transfer from the importing country to the exporting country. According to Ordover and Goldberg, this promotes needless international trade friction that invites retaliation (Ordover and Goldberg 1993, p. 53; see also Productivity Commission 1996, p. 13).

However, in a recent survey, the OECD suggested that export cartels are not of great concern from a competition policy perspective because there is likely to be only a few global markets where a group of national producers in a cartel will be able to raise international prices significantly (OECD 1996b).

The exemption of export arrangements from competition laws raises issues about the role and interaction of competition policy and trade policy. Under trade policy, the GATT process is removing government-imposed barriers to international trade. The exemption of export arrangements from competition laws may undermine the gains achieved through GATT. This policy fragmentation towards export arrangements has meant that they have been relatively unregulated. According to Ordover and Goldberg:

> *… the current standards for exemption from antitrust regulation are not adequate and are inconsistent with the objective of welfare maximization in both the exporting and importing countries. An export cartel should demonstrate that it will not harm competition in the home country and that it serves to overcome a genuine barrier to competition in the importing country in order to qualify for an exemption. A still better policy decision would be a worldwide repeal of cartel exemption coupled with an efficiency defense (Ordover and Goldberg 1993, p. 11).*

The OECD's current approach is a move towards prohibiting export arrangements that involve price fixing, collusive tendering, restricting output or dividing markets whilst retaining export arrangements that related to realising cost-reducing or output-enhancing efficiencies (OECD 1998). This approach recognises the increasing importance of developing competition laws to ensure open and free markets, promote competition internationally and protect consumers. The OECD has recognised that "effective application of competition policy plays a vital role in promoting world trade by ensuring dynamic national markets and encouraging the lowering or reducing of entry barriers to imports" (OECD 1998).

Australia's approach has been to actively support an exploration and educative discussion on the interaction between trade policy and competition policy as a foundation for considering how the World Trade Organisation might handle the issue in the future (World Trade Organisation 1998).

B4.5 International Experience

As in Australia, the competition laws of most OECD countries exclude from their coverage export arrangements that relate solely to foreign markets (OECD 1996a, pp. 34-35). The range of exemptions that exist are:

- United States has specific legislation for export arrangements. Exporters can obtain greater certainty about the application of the law to their activities by registering under laws that provide an explicit exemption provided that the arrangement does not have domestic anti-competitive effects and does not foreclose other United States' exporters from the export market;
- United Kingdom,[41] Germany and Japan exclude export arrangements that relate to collective action solely in foreign markets subject to an authorisation or notification procedure;
- Canada exempts export arrangements that relate to collective action solely in foreign markets.[42] The exemption does not apply to agreements that reduce the value of exports or restrict a person from entering or expanding an export business, or lessen competition unduly in the supply of services facilitating exports from Canada. No notification requirement exists;
- New Zealand has an exemption in similar terms to that in section 51(2)(g) of the TPA;[43]
- France, the European Union and the Netherlands exclude export arrangements that relate to collective action solely in foreign markets; and
- South Korea and Taiwan also have exemptions for export arrangements (OECD, 1996a, p. 34-35; Productivity Commission 1996, p. 23).

The following sections consider in more detail the exemptions in the United States, Canada and United Kingdom.

41 *Anti-Competitive Practices (Exclusion) Order 1980 (UK)*, sections 10(1)(f) and 19(1)(f) of the *Restrictive Trade Practices Act (UK)*.

42 Section 45(1) and 45(5) of the *Competition Act (Canada)*.

43 Section 44(g) of the *Commerce Act (NZ)*.

United States

The United States exempts voluntary arrangements by exporters from antitrust laws under the *Webb-Pomerene Act*[44], the *Export Trading Company Act 1982*[45] and the *Foreign Trade Antitrust Improvements Act 1982*[46] (Department of Justice and the Federal Trade Commission (US) 1995c).

The *Webb-Pomerene Act* exempts the formation and operation of associations of competing businesses to engage in collective export sales. The exemption applies only to the export of goods and not services. The exemption does not cover conduct that has an anti-competitive effect within the United States or that injures domestic competitors. To obtain the benefit of the exemption, associations must file their articles of association and annual reports with the Federal Trade Commission.

The *Export Trading Company Act 1982* covers a number of areas of export trade in goods and services, including:

- reducing restrictions on trade financing provided by financial institutions; and
- establishing a certification procedure by which exporters may obtain an export trade certificate of review.

The certificate is issued by the Secretary of Commerce with the approval of the Attorney General. The certificate provides immunity from antitrust laws for activities specified in the certificate. To obtain the certificate an exporter must show that the export conduct will not, amongst other things, have an anti-competitive effect within the United States.

The experience in the United States with the *Webb-Pomerene Act* and the *Export Trading Company Act* has been that it has not significantly promoted exports and, in particular, has not been used by small exporters (Federal Trade Commission 1967 as noted in Dr Hampton, submission 18; Immenga 1997; Nye 1993; Prozan 1988; Garvey 1983; Fugate 1982). To the extent they have been used, it seems that the export arrangements are aimed at achieving economies of scale in distribution and information gathering in order to penetrate a foreign market (Ordover and Goldberg 1993, p. 19).

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44 15 U.S.C. §§ 61-65.

45 15 U.S.C. §§ 4001-21.

46 15 U.S.C. § 6a.

Canada

The Canadian *Competition Act* in section 45(1) contains a general prohibition on anti-competitive conduct and agreements to which a specific defence is provided for in section 45(5) for conduct or arrangements that relate only to the export of products from Canada. Products are defined to include goods and services. Under section 45(6) of the *Competition Act*, the defence is not available for conduct or an arrangement that:

- has resulted in or is likely to result in a reduction or limitation of the real value of exports of a product;
- has restricted or is likely to restrict any person from entering into or expanding the business of exporting products from Canada; or
- has prevented or lessened or is likely to prevent or lessen competition unduly in the supply of services facilitating the export of products from Canada.

There is no requirement under the *Competition Act* to notify or register export arrangements.

United Kingdom

The United Kingdom *Restrictive Trade Practices Act 1976* (RTPA) creates a regime where details of restrictive agreements falling within certain criteria must be sent to the Office of Fair Trading (OFT) for registration (Office of Fair Trading (UK) 1996). Certain agreements are exempted or excluded from the RTPA or the requirement to register with the OFT. Once an agreement is registered with the OFT, it is normally referred to the court for a decision on whether the restrictions it contains are contrary to the public interest.

Agreements relating to exports of goods and services are registrable with the OFT. However, such agreements will not be contrary to the public interest if the removal of the restriction would be likely to cause a reduction in export business, when this is substantial in relation to the whole business of the particular trade or industry, or to the export business of the United Kingdom as a whole.[47]

47 Sections 10(1)(f) and 19(1)(f) of the *Restrictive Trade Practices Act (UK).*

The new *Competition Act 1998*, which comes into force on 1 March 2000 repeals the *Restrictive Trade Practices Act 1976.* The new Act seeks to place United Kingdom competition law more in-line with European Union law.

The manner in which existing exemptions will be treated under the *Competition Act* is unclear. The *Competition Act* makes provision for the regulator, the Director General of the Office of Fair Trading, to be able to exempt agreements from the prohibitions in the *Competition Act* on a case by case basis if certain criteria are met. This is similar to the authorisation and notification process under the TPA. The *Competition Act* also makes provision for 'block exemptions' for certain classes of agreement and conduct.

Conclusion

The international experience shows that many countries have exemptions from competition laws for export arrangements. The exemptions operate in different ways: some are specific standing exemptions found in competition laws requiring notification or registration of the arrangement; some are contained in separate legislation dealing with exports; and some are by way of a defence to the contravention of the competition laws.

The exemptions in the United States, Canada and United Kingdom indicate a concern that the exemption should not apply to arrangements that harm other domestic exporters. In these countries, the exemptions do not apply where arrangements:

- result in a reduction or limitation of the real value of exports of a good or service;
- restrict any person from entering into or expanding the business of exporting goods or services from the country; and
- prevent or lessen competition unduly in the supply of services facilitating the export of products from the country.

These limitations to export exemptions are considered in section B4.7, which addresses alternative means of achieving the objectives of the exemption.

B4.6 Benefits and costs

The benefits and costs of the exemption flow from the benefits and costs of facilitating collective exports by Australian exporters and the benefits and costs of any competition reducing effects in Australian markets.

Benefits

Facilitation of Exports

Submissions suggested that the exemption provides a means of facilitating exports. Professor Baxt suggested that the exemption is useful in the mining and resources sectors, for primary producers and high technology companies (Prof. Baxt, submission 16). The Department of Primary Industries and Energy (Cth) indicated that many of its portfolio industry constituents place importance on the ability to have collective bargaining arrangements for commodity exports (Department of Primary Industries and Energy (Cth), submission 24).

Over the 25 years whilst the exemption has existed the ACCC has received 216 notifications. One notification related to the export of a service, the remaining 215 relating to the export of goods. The Council has not been able to determine how many of the notifications are current. The export arrangements relate to a wide range of sectors in the economy including agriculture, mining, tourism, gas, water supply, sport, defence and petroleum (Refer to Appendix 6). This indicates, at least to some extent, that the exemption has provided a means for facilitating exports.

The exemption was frequently used in the early years of the TPA but has been much less frequently since then. Between 1974 and 1977, there were 120 notifications under the exemption and between 1990 and October 1998 there were 33 notifications, including 12 notifications in 1993 (Refer to Appendix 6).

The greater use of the exemption in the early years of the TPA may have been due to the uncertainty associated with the operation of the TPA when it was introduced. The move towards reforming statutory marketing authorities in favour of voluntary export arrangements and growth in the services sector may result in the exemption being used more in the future.

Improving the Bargaining Power of Australian Exporters in Some Export Markets

The exemption may allow Australian exporters in some export markets to improve their bargaining power. This may allow exporters to obtain higher prices, better terms, expand existing market share, enter new markets and countervail the bargaining power of domestic cartels (OECD 1993, p. 18; ACCC 1997, p. 35; Masterman & Solomon 1967, p. 358).

Realising Possible Cost and Output Efficiencies

The exemption may allow Australian exporters to realise possible cost and output efficiencies such as economies of scale in distribution, advertising and information gathering (OECD 1993, p. 18).

The OECD has found that "[w]hen an export cartel [improves bargaining power in export markets or realises cost and output efficiencies] ..., it is not detrimental to free trade: it improves resource allocation, achieves efficiency objectives and is consistent with the precepts of comparative advantage." (OECD 1993, p. 18).

Removing Uncertainty About the Application of the TPA to Exports

Some submissions refered to the exemption removing uncertainty about the application of the TPA to exports. For example, Mr MacPherson points to the stability and certainty of the exemption as important to the resources sector in the current context where there is fundamental change – market uncertainty, industrial relations adjustments, native title and competition law issues (Mr MacPherson, submission 3).

Placing Australian Exporters in the Same Position to Exporters in Other Countries That Have Similar Exemptions

Submissions indicated that the exemption places Australian exporters in the same position to exporters in other countries that have similar exemptions (Prof. Baxt, submission 16; Mr Macpherson, submission 3; Law Council of

Australia, submission 33; Cabinet Office (NSW), submission 41; Allen Allen & Hemsley, submission 39).

Costs

Competition Reducing Spillover Effects in Australian Markets

Competition reducing spillover effects in Australian markets from agreements relating exclusively to exports is a cost that is identified with the exemption (OECD 1993; Productivity Commission 1996).

The Council considered the spillover effects of the exemption in section B4.4. As noted in that section, the Council has not found any evidence that suggests that the exemption has resulted in competition reducing spillover effects in Australian markets. Submissions indicated that the costs associated with the exemption are minimal because there is little risk that export arrangements that relate exclusively to exports will harm domestic competition (Law Council of Australia, submission 33; Allen Allen & Hemsley, submission 39, Prof. Baxt, submission 16).

Conclusion

Whilst it is difficult to quantify the benefits and costs of the exemption, the Council concludes that there are benefits to the exemption without costs associated with a restriction on competition. This is because of the benefits identified for the exemption and because the exemption is unlikely to result in anti-competitive spillover effects into domestic markets.

B4.7 Alternative ways of achieving objectives

The Council considers that there are no practical alternatives to achieving the objectives of the exemption.

The alternatives must be assessed against the following objectives of the exemption identified in section B4.3:

- to facilitate Australian exports of goods and services;
- to reduce any uncertainty associated with the application of the TPA to exports; and
- to place Australian exporters on an equal footing with foreign exporters that enjoy the same immunity from their national competition laws.

Potential legislative alternatives to the exemption are:

- the authorisation or notification process where there is a concern that the export arrangement may infringe Part IV of the TPA; and
- limiting the exemption to exclude arrangements that:
  - result in a reduction or limitation of the real value of exports of a product;
  - restrict any person from entering into or expanding the business of exporting products from Australia; or
  - prevent or lessen competition unduly in the supply of the services facilitating the export of products from Australia (Cabinet Office (NSW), submission 41).
- limiting the exemption by excluding export arrangements to New Zealand.

There may be non-legislative alternatives to achieve the objective of facilitating exports. However, these could not achieve the objective of reducing uncertainty associated with the application of the TPA or place Australian exporters on an equal footing with foreign exporter who enjoy immunity from their national competition laws. The Council, therefore, considers that non-legislative means could not achieve the overall objectives of the exemption.

Authorisation or Notification

The ACCC suggested that anti-competitive spillover effects of export arrangements could be prevented by removing the exemption and requiring exporters to rely on the authorisation and notification processes (ACCC, submission 58).

However, most of the participants regarded the authorisation and notification alternative as an inappropriate and inefficient way to deal with export agreements.

The Law Council of Australia considered that given the number of transactions to which the exemptions in section 51(2) apply to, an authorisation or notification procedure would be an inefficient use of the ACCC's resources and the business community's resources (Law Council of Australia, submission 33, p. 6).

The Council considers that there are likely to be several practical disadvantages to the authorisation and notification processes for export arrangements, including:

- the time involved in obtaining authorisation or notification may cause export opportunities to be lost. Export opportunities typically arise quickly and the window of opportunity to capture them is usually short;
- the costs involved in an authorisation or notification can be substantial, quite apart from the filing fees to the ACCC;
- given that the export arrangements may be subject to scrutiny by enforcement agencies in the foreign country or other countries, the possibility of further scrutiny by the ACCC may unnecessarily increase administrative costs for Australian exporters; and
- the potential threat of a review of any authorisation pursuant to section 101 of the TPA may impose unnecessary uncertainty (Prof. Baxt, submission 16).

These disadvantages aside, in practice the circumstances in which authorisation or notification may be required will be rare because agreements relating exclusively to exports are unlikely to breach Part IV of the TPA.

The overall concern suggested in submissions is that removal of the exemption would limit the options for exporters seeking opportunities in foreign markets. Participants thought removal would delay or discourage exporters in seeking out new opportunities and would place Australian exporters at a disadvantage against foreign exporters who enjoy the same immunity from their competition laws. Exporters that are forced to make an individual entry into a foreign market may face a higher rate of failure compared to entering the market through a collaborative arrangement. This may cause export opportunities to be lost.

On balance, the Council considers that the authorisation and notification process would not achieve the objectives of the exemption as well as the current exemption.

Modification of the Exemption

The Cabinet Office (NSW) suggested that the exemption should be modified to include similar limitations to those used in Canada, namely that the exemption should not apply to arrangements that:

- ➤ result in a reduction or limitation of the real value of exports of a product;
- ➤ restrict any person from entering into or expanding the business of exporting products from Australia; or
- ➤ prevent or lessen competition unduly in the supply of the services facilitating the export of products from Australia (Cabinet Office (NSW), submission 41).

The Cabinet Office (NSW) indicated that these limitations may be worthwhile in order to reduce the scope for any current or future adverse impact on domestic competition.

The Council considers that limitations similar to those used in Canada may not reduce the scope for adverse impact on domestic competition. This is because of differences in the structure of competition laws in Australia and Canada.

In Canada, the prohibition against anti-competitive conduct applies generally with a specific defence in a prosecution for export arrangements. If the export arrangement falls within one of the limitations listed above, Canadian competition laws would catch the export arrangement.

In Australia, the prohibitions in Part IV of the TPA apply to markets in Australia. If an export arrangement fell within one of the limitations listed above it is not clear that it would have an effect on markets in Australia so as to be caught by Part IV of the TPA. Consequently, limitations similar to those used in Canada may not reduce the scope for adverse impact on domestic competition from export arrangements. In addition, as l noted in section B4.4, there is little evidence to suggest that the exemption harms Australian markets. Limitations similar to those in Canada may also increase uncertainty and would be difficult to monitor.

Overall, the Council considers that modifying the exemption to contain limitations similar to those in Canada is unlikely to have the effect of reducing spillover effects, if any, into Australian markets from arrangements relating exclusively to exports.

The ACCC suggested that if the exemption is to be retained, consideration should at least be given to excluding export arrangements to New Zealand. It stated:

> *Export cartels to New Zealand, in the context of [the Closer Economic Relations agreement with New Zealand] and the development of cross-Tasman markets, are more likely to adversely affect competition in Australian markets (ACCC, submission 58, p. 3).*

The Council considers that removal of the exemption from the TPA whilst the same exemption remains in New Zealand would be unlikely to adequately address concerns about export arrangements in the cross-Tasman context. While recognising the development of the cross-Tasman market, the Council considers that the issue raised by the ACCC is better dealt with under trade policy and in the context of the Closer Economic Relations agreement with New Zealand.

B4.8 Conclusion

Whilst the benefits of the exemption and the effect of its removal are difficult to quantify, the Council believes that on balance the exemption provides a net benefit. The Council has not found evidence to show that the exemption results in anti-competitive spillover effects in Australian markets.

The exemption is likely to have continued importance through the move to reform statutory marketing arrangements and growth in the services sector. The Council considers that there are no alternative means of achieving the objectives of the exemption. The authorisation or notification process is not a practical means of achieving the outcomes provided by the current exemption and non-legislative alternatives would not achieve the objective of reducing uncertainty about application of the TPA. Limitations to the exemption in similar terms to that in Canada are unlikely to reduce the possibility of spillover effects into domestic markets, may increase uncertainty and would be difficult to monitor.

The Council recommends that the exemption be retained.

C1 Exemption provided by Section 51(3)

C1.1 Overview

Section 51(3) of the TPA exempts certain conditions in licences and assignments[48] of intellectual property from some of the provisions of Part IV of the TPA. The section exempts conditions that 'relate to' the subject-matter of patents, registered designs, copyright, trade marks, and circuit layouts from section 45, section 45A, section 47, section 50 and 50A.[49] Section 51(3) does not exempt licensing and assignment conditions from section 46 or section 48 of the TPA.

The original objectives of section 51(3) are unclear. The Council considers that section 51(3) was most likely enacted to prevent a perceived clash between the interests of intellectual property owners and competition law. At the time the TPA was enacted in 1974, it was likely that intellectual property laws were believed to confer on the owners of intellectual property a limited economic monopoly. This led to a concern that the unrestrained application of competition law to intellectual property could undermine intellectual property rights.

The original objective is no longer relevant. It is now accepted that intellectual property laws do not create legal or economic monopolies. Intellectual property laws create property rights and the goods and services produced using intellectual property rights compete in the marketplace with other goods and services. Only in special cases will intellectual property owners be in a position to exert substantial market power or engage in anti-competitive conduct.

48 For the sake of brevity, this report will on some occasions refer only to licences or derivative terms such as licensing, licensors, and licensees. These references should be taken to include references to assignments and its derivative terms, except as otherwise indicated by the context.

49 For the sake of brevity, this report will sometimes refer to the exempted sections as 'sections 45, 47, and 50'. This should be taken to include reference to sections 45A and 50A.

In this sense, the Council agrees with the view of the US competition law authorities about the nature of intellectual property rights and their status under competition law:

> *Intellectual property law bestows on the owners of intellectual property certain rights to exclude others. These rights help the owners to profit from the use of their property. An intellectual property owner's rights to exclude are similar to the rights enjoyed by owners of other forms of intellectual property. As with other forms of private property, certain types of conduct with respect to intellectual property may have anticompetitive effects against which the antitrust laws can and do protect. Intellectual property is thus neither particularly free from scrutiny under the antitrust [i.e. competition] laws, nor particularly suspect under them (Antitrust Guidelines for the Licensing of Intellectual Property, 1995, p. 3).*

However, the Council accepts that section 51(3) has some continuing relevance in terms of providing businesses with greater certainty when engaging in licensing and assignment activity. This greater certainty can help reduce the costs associated with compliance with trade practices law and encourage more licensing activity.

The Council has examined the comparative experience in the United States, the European Union, and New Zealand.[50] The United States and the EU generally apply competition law to the types of restrictive provisions exempted in Australia under section 51(3). United States competition law does not provide any form of exemption for restrictive conditions in intellectual property licences and assignments, while the EU competition authorities have issued a block exemption for a limited range of territorial restrictions and exclusive licences but not for other restrictive conditions. Both the EU and the United States take a tough stance against price and quantity restrictions. In the United States, price and quantity restrictions are banned outright, while in the EU, agreements containing these conditions cannot benefit from the block exemption. New Zealand provides an exemption for restrictive provisions that exempts licensing and assignment conditions where those conditions are considered to fall within the scope of the rights granted under intellectual property law.

The Council examined Australia's treaty obligations under the TRIPS Agreement and intellectual property conventions. Nothing under these

50 Discussed in Chapter C3 and expanded upon in Appendix Five.

treaties impinges upon Australia's ability to apply competition law to restrictive conditions in intellectual property licences and assignments.

In reviewing section 51(3), the Council recognises the enormous benefits flowing from the commercialisation of innovation for Australia, and the increasing importance of innovation into the future. It also recognises that licensing and assignment of intellectual property is generally pro-competitive. For this reason, the Council has been careful in the course of the review to assess the impact of its recommendations on innovation and commercialisation of innovation and to explain these at length in the body of the report.

The Council recognises the commercial importance of particular types of restrictive conditions in licences and assignments of intellectual property, in particular exclusive licences, territorial restrictions, and best endeavours clauses. Despite its narrow scope and the ambiguity of the term "relates to", section 51(3) provides a measure of certainty for intellectual property licensors and licensees. Intellectual property licensing often occurs under conditions of uncertainty about the size and parameters of the market or the competitive impact of the licensed goods or services. Under these conditions, it is difficult to assess whether licensing or assignment conditions are likely at some future time to breach Part IV. Moreover, conditions such as exclusive licences, territorial restrictions, and best endeavours clauses may be necessary to allocate risk and provide incentives for the licensee to best exploit the licence or assignment.

The Council considers that section 51(3) does exempt some anti-competitive licensing and assignment practices from the operation of Part IV. Section 51(3) is likely to exempt horizontal licensing agreements (that is, arrangements between competitors), and price and quantity restrictions, which have significant potential to substantially lessen competition in the market. Other licensing conditions have some, but less, potential to substantially lessen competition.

The Council has examined possible alternatives to section 51(3) that minimise anti-competitive effects while preserving the benefits provided by section 51(3).

The Council considers that the best option is to exclude horizontal agreements, price restrictions, and quantity restrictions from the benefit of the exemption. This amendment would remove from the exemption most of the conduct that could substantially lessen competition. Section 51(3) would continue to protect exclusive licences, territorial restrictions, and best endeavours clauses in the usual situation where those conditions form part of vertical arrangements.

Additionally, the Council recommends savings provisions to ensure that restrictive provisions now in operation continue to be protected in accordance with the current exemption, and that the ACCC draft guidelines clarifying the application of Part IV to intellectual property licensing. The Council also considers that rights granted under the *Plant Breeder's Rights Act 1994 (Cth)* should be brought within the exemption, and treated in the same way as copyright, patents, and registered designs.

Recommendations

The Council recommends that the exemption in section 51(3) be amended by specifying that price and quantity restrictions and horizontal arrangements cannot benefit from the exemption.

The Council recommends amending section 51(3)(a) to extend the exemption to cover the intellectual property rights granted under the *Plant Breeder's Rights Act 1994 (Cth)* consistent with the protection provided for patents, registered designs, copyright, and EL rights.

The Council recommends amending section 51(3) to refer to the *Trade Marks Act 1995*, to the registration of services as well as goods, and to authorised users rather than registered users.

The Council recommends that saving provisions be inserted into the TPA to preserve the effect of the current section 51(3) in relation to licences and assignments entered before amendment of section 51(3).

The Council recommends that the ACCC formulate guidelines for the assistance of industry on:

- when intellectual property licensing and assignment conditions might be exempted under section 51(3);
- when intellectual property licences and assignments might breach Part IV of the TPA; and

- when conduct in relation to intellectual property that did not fall within the exemption and was likely to breach Part IV of the TPA might be authorised.

The Council recommends that the ACCC aim to release the guidelines to precede or coincide with the date of effect of the amendment of section 51(3).

The Council recommends equivalent amendments to the Competition Codes in each State and Territory to the amendments recommended in respect of the Commonwealth TPA.

C2 The Objectives behind Section 51(3)

This chapter examines the objectives behind section 51(3) within the context of the overall objectives of the TPA and the objectives of intellectual property laws.

C2.1 Objectives of TPA and Intellectual Property Laws

The overall objective of the TPA, outlined in Part A of the report, is to enhance the welfare of Australians by promoting competition, fair trading, and protecting consumer interests.

Section 51(3) relates to licensing and assignment of statutory intellectual property rights in patents, copyrights, trade marks, eligible circuit layout rights, and registered designs. Appendix Three outlines these intellectual property rights in more detail.

Intellectual property laws encourage innovation by granting statutory exclusive property rights in, among other areas:

- new inventions under the *Patents Act 1990*;
- literary, music, artistic works, dramatic works, and subject matter other than works (such as videos, sound recordings and the like) under the *Copyright Act 1968*;
- eligible layouts under the *Circuit Layouts Act 1989*;
- the right to apply a design under the *Designs Act 1902*; and
- right to use trade marks under the *Trade Marks Act 1995*.[51]

Intellectual property laws allow the owner of the intellectual property to exclude others from using the intellectual property. Without intellectual property laws, third parties might copy the goods produced through the

51 For example, see section 13 of the *Patents Act 1990 (Cth)* and section 196 of the *Copyright Act 1968 (Cth)*.

application of the intellectual property, thus reducing the incentives to create further intellectual property. As the Australian Copyright Council submitted:

> *Intellectual property rights ... confer on the owner a power to exclude free riding [copying by others without payment] and, depending on market conditions, to charge a price higher than the marginal cost of production. As a result, copyright and other intellectual property rights promote consumer welfare and technological progress by promoting investment in improvements to existing products and the development of wholly new products (Australian Copyright Council, submission 23, p. 4).*

C2.2 Possible Objectives of Section 51(3)

Little background material exists about the policy objectives originally behind section 51(3).[52] The section was carried through from the *Trade Practices Act 1965* to the *Restrictive Trade Practices Act 1971*, and then to the *Trade Practices Act 1974*.

However, it is clear that section 51(3) was not meant to provide a total exemption from the TPA for intellectual property transactions. Section 51(1)(a)(i) provides that Part IV of the TPA applies generally to intellectual property transactions. Section 51(3) then provides a limited exemption from some of the provisions of Part IV for certain types of conditions in licences and assignments of intellectual property rights.

Possible objectives of section 51(3) identified by submissions and commentators are:

- to avoid a general conflict between intellectual property law and competition law;

52 The Explanatory Memorandum to the *Trade Practices Act 1974* referred generally to the exemptions in section 51, including the intellectual property exemption, as covering "a number of specific instances of conduct to which special considerations apply" without specifying the ‘special considerations’ (Explanatory Memorandum, p. 13). The Second Reading Speech is silent on the objective of section 51(3) (House of Representatives, 25 October 1973, p. 2738).

- to avoid a practical conflict between the exercise of intellectual property rights and competition law;
- to encourage greater licensing and assignment of intellectual property; and
- to provide greater certainty for licensing and assignment of intellectual property, and reduce the TPA compliance costs associated with this activity.

These objectives overlap to some extent. For example, greater certainty and reduced compliance costs may lead to greater licensing and assignment of intellectual property.

General Conflict between Intellectual Property Laws and Competition Laws

Some submissions and commentators suggested section 51(3) resolves a perceived conflict between intellectual property laws and competition laws (Licensing Executives Society of Australia and New Zealand, submission 19; Allen Allen & Hemsley, submission 39; Heydon 1993).

Assertions of conflict between competition law and intellectual property laws arise from the use of the term ‘monopoly’ to describe intellectual property rights. Sometimes intellectual property laws are described as granting a legal monopoly in the sense of being exclusive rights free from interference from other parties. At other times, intellectual property laws are described as granting an economic monopoly in the sense of providing monopoly profits. At its simplest, the conflict is said to arise from competition laws seeking to promote competition and intellectual property laws guaranteeing protection against competition (Heydon 1993, p. 1667).

Many submissions supporting the retention of section 51(3) and all of those advocating its removal agreed that the perceived conflict between competition laws and intellectual property laws stems from a misunderstanding of "markets" and "monopolies". The existence of a monopoly depends on whether substitution between products or by producers is feasible and whether the intellectual property owner can raise prices by reducing output. Intellectual property laws do not create monopolies in markets because viable substitutes to products made using intellectual property are normally available.[53] Only in rare cases will the use of intellectual property rights through licensing, marketing or selling products result in the holder of the intellectual property rights gaining a monopoly position in a particular market.

For example, the Licensing Executives Society of Australia and New Zealand (LESANZ), considered that:

> *intellectual property regimes confer legal monopolies … but cannot be viewed as true market monopolies – that is where a single business is the sole producer of a product for which there are no close substitutes. The rights conferred do not fully preclude competition nor do they provide a barrier to the entry of new businesses. [A patent] does not prevent other businesses from continuing to innovate and produce a closely related substitute good (LESANZ, submission 19, p. 17).*

The Law Council of Australia stated that:

> *It is unlikely that any process, product or work to which any intellectual property right may relate will, by virtue of that right per se, cease to be the subject of competition from competitive goods or services (Law Council of Australia, submission 33, p. 8).*

and

> *Intellectual property laws and the regulation of anti-competitive conduct under the Trade Practices Act 1974 (Act) have been described as being inherently in conflict as intellectual property rights are incorrectly believed to confer the power of a "monopoly" on the owner. However, intellectual property rights only have a narrow application and are most unlikely to confer "monopoly power" in the economic sense (Law Council of Australia, submission 33, p. 10).*

Michael O'Bryan argued:

> *Rights of exclusivity [conferred under intellectual property laws] do not conflict with competition laws in themselves. To understand this, it is helpful to compare and contrast real and personal property rights with intellectual property rights. The*

53 The Industrial Property Advisory Committee (IPAC) came to the same conclusion: IPAC 1984, p. 24.

> *law of property is based on the concept of exclusivity. A property right is a right to exclude all others from some real or personal property. No one would suggest that this exclusive right is inherently in conflict with competition law. …. To overcome the exclusion difficulties inherent in the supply of intellectual property, it has been necessary to create statutory rights of exclusivity. In creating these rights, though, intellectual property is placed in a similar economic position to other forms of physical property (Mr O'Bryan, submission 27, p. 2).*

Similarly, the ACCC considered that there is no conflict between intellectual property rights and competition law:

> *The concepts of competition and monopoly or market power are much better understood and there is a body of case law which incorporates economic thinking on these issues. The grant of exclusive intellectual property rights are not equated with "monopoly" rights or market power; and any evaluation of the competitive effects of licensing would look to the competitive constraints operating on the parties, through substitution and market entry (ACCC, submission 31, pp. 2-3).*

The Council considers that, properly understood, intellectual property rights and competition laws are compatible and consistent. They share the same overall objective of enhancing community welfare. The Trade Practices Act seeks to enhance community welfare by creating an environment in which businesses compete by introducing new and improved goods and services, and by offering existing goods and services at lower cost to consumers. Intellectual property laws seek to enhance community welfare by encouraging innovation and invention through the grant of valuable exclusive property rights. These processes are mutually reinforcing in the sense that competition can spur innovation and invention by providing businesses with strong incentives to steal a march on their competitors by undertaking research and development and introducing new products (Hilmer 1993, p. 4). In turn, competition law takes into account the dynamic effects of innovation when assessing whether conduct affects competition in a market.

The Council considers that there is no general conflict between intellectual property laws and competition laws. The Council agrees with the view of the US competition law authorities about the nature of intellectual property rights and their status under competition law:

> *Intellectual property law bestows on the owners of intellectual property certain rights to exclude others. These rights help the owners to profit from the use of their property. An intellectual property owner's rights to exclude are similar to the rights enjoyed by owners of other forms of intellectual property. As with other forms of private property, certain types of conduct with respect to intellectual property may have anticompetitive effects against which the antitrust laws can and do protect. Intellectual property is thus neither particularly free from scrutiny under the antitrust [i.e. competition] laws, nor particularly suspect under them (Antitrust Guidelines for the Licensing of Intellectual Property, 1995, p. 3).*

Conflicts between Exercise of Intellectual Property Rights and Competition Laws

A number of submissions argued that, while there was no general conflict between competition law and intellectual property law, there may be a conflict between competition law and the way that intellectual property rights are *exercised*. These submissions argued that the exemption in section 51(3) was intended to allow intellectual property owners to fully exercise their rights as granted under intellectual property statutes (for example, the Australian Copyright Council, submission 90; LESANZ, submission 19; Institute of Patent Attorneys of Australia, submission 13; Law Council of Australia, submission 33; Telstra, submission 89; Mr De Boos, submission 95).

Some submissions in support of section 51(3) considered that there is a degree of tension in the application of competition laws to the exercise of intellectual property rights because competition laws could narrow the exploitation of intellectual property rights.

Submissions diverged about the precise point of conflict between the exercise of intellectual property rights and competition law.

For example, the Law Council of Australia argued that a tension exists between intellectual property laws and competition laws because, in the absence of section 51(3), the exploitation of an intellectual property right would be cut down by the operation of the TPA (Law Council of Australia, submission 83, p. 2).

LESANZ considered that:

> *Where the law grants to a person the exclusive right to do an act [like intellectual property laws], it should not be treated as anti-competitive for that person to license the same exclusive right to another person or persons or to impose conditions on the licence which protect the legal exclusivity (LESANZ, submission 19, pp. 1-2).*

Other submissions were concerned that the application of competition law to intellectual property law may prevent intellectual property owners from selling goods and services produced using intellectual property rights for more than the marginal costs of production.[54]

Other parties considered that intellectual property laws create exclusive rights that should be free from competition. For example, the Australian Chamber of Commerce and Industry suggested that:

> *... while intellectual property (IP) laws and competition laws can have the common objective of promoting innovation, IP rights can be claimed to guarantee protection against competition (ACCI, submission 31, p. 7).*

Finally, the Australian Copyright Council considered that the policies behind intellectual property and competition laws serve the same ends, but through different means: [55]

> *Intellectual property rights are directed to a dynamic or ex ante view. Acknowledging that competition clearly has a role to play in forcing firms to innovate, nonetheless, competition laws are still primarily directed to static efficiency. Intellectual property rights generally confer on the right owner (or licensee) an opportunity to charge prices above the marginal costs of production of the protected product or process while competition laws operate primarily by seeking to strike at that power to price above marginal cost (Australian Copyright Council, submission 90, p. 4).*

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54 The marginal costs of production are the costs associated with making one more copy of an article. These costs are lower than the costs of making the first article. For example, in the case of a book, the costs of 'making' the first book are the costs of researching and writing the first book, while the marginal costs of production are the costs of printing one more book.. Compare Lehmann 1989.

55 See also IP - Australia, commenting that the "time frames [for competition law and intellectual property law] me be different. A trade-off (some temporary restraint in competition for greater output in the long run) is in the interest of socially desirable resource allocation" (IP - Australia, submission 20, p. 9).

In a similar vein, Telstra argued that:

> *... although intellectual property and competition laws have the same ultimate goals, they are designed to achieve those goals by very different means. Intellectual property rights of their very nature involve the grant of an entitlement to charge prices above the marginal costs of production of the protected product or process. Part IV of the TPA, however, is essentially designed to restrict market power (Telstra, submission 89, p. 4).*

However, the Council does not consider that competition law conflicts with the exercise of intellectual property rights in any of these ways.

First, if these arguments are accepted, then there has already been a conflict between the exercise of intellectual property rights and competition law, because for the past twenty-five years dealings in intellectual property, with the exception of *certain* conditions in licenses and assignments of intellectual property in intellectual property, have been subject to competition law. Further, even the exemption under section 51(3) does not cover conduct that breaches section 46 (misuse of market power) or section 48 (resale price maintenance). It is clearly incompatible with the limited nature of the exemption in section 51(3) to assert that the exercise of intellectual property rights generally conflicts with competition law in such a way as to require a general exemption for intellectual property dealings from competition law.

Second, if there is a conflict between competition laws and the exercise of rights under intellectual property laws then why do intellectual property laws themselves prohibit certain types of licensing practices. For example, section 112 of the *Patents Act 1990* prohibits the owner of a patent in a licence, sale or lease of the patent from imposing conditions requiring the licensee to buy raw materials from the licensor; section 108 permits compulsory licensing of a patent where it is not being exploited; and section 144 prohibits certain exclusionary or tying conditions.

Third, the argument that one set of laws (intellectual property laws) is subject to another set of laws (competition laws) does not mean that there is a conflict between the exercise of rights under these laws. Otherwise, tax laws could be said to conflict with intellectual property laws because tax laws require intellectual property owners to pay tax on any profits they derive from their intellectual property rights. For a conflict to exist, there must be something in the nature of a conflict that prevents the exercise of intellectual property rights as envisaged by the legislators that passed the intellectual property laws.

Fourth, competition law is concerned with dynamic features of the marketplace as much as with static features. For example, competition law has a role to play in preventing anti-competitive conduct that reduces the incentives of parties to engage in innovation and research, and competition law takes into account the dynamic features of the market where assessing whether conduct has substantially lessened competition.

Fifth, competition law does not ban pricing above marginal cost. In this regard, the Council accepts the arguments of Abraham van Melle that:

> *[Pricing above marginal cost], so essential to the intellectual property schemes, is sometimes seen as conflicting with the objects of competition law in promoting competitive pricing (i.e. close to marginal cost) and hence the need for a far reaching exception to [competition laws]. This analysis is flawed. Competition law promotes "competitive" market behaviour which, when dealing with tangible products in perfectly competitive markets, is synonymous with pricing close to marginal cost. Competition policy does not serve to promote marginal cost pricing per se however. Competition law recognises the need in some industries (e.g. essential facilities or intellectual property goods) to recover fixed costs by pricing above marginal cost. The "monopoly" prices charged for intellectual property rights are not a function of market power, but rather a function of the cost structures that affect all innovators (Mr van Melle, submission 36, p. 7).*

For all these reasons, the Council considers that, as a general principle, there is not an inherent conflict between competition laws and the *exercise* of intellectual property laws, such that intellectual property licensing and assignment conditions must be exempt from competition law to enable them to be exercised effectively.

There was one other sense in which the exercise of intellectual property rights were said to conflict with competition laws. Some submissions considered that the application of competition laws may interfere with the scope of the rights granted under intellectual property laws, in particular, the right to subdivide and carve out rights from the broad intellectual property rights (for example, Mr van Melle, submission 35, p. 2). For example, a condition in a licence of intellectual property that forbids the licensee from competing outside a particular territory may appear from one perspective to be a restriction on competition (in that the licensee may not compete outside this territory) but is from another perspective merely a subdivision of the exclusive rights granted to the intellectual property owner under the relevant intellectual property statute.

This view - that intellectual property owners should be able to fully exercise their rights as granted under intellectual property statutes without interference from competition law – has been referred to as the 'scope of the grant' doctrine (Dr Hampton, submission 18). Under this doctrine, only restrictions in licences and assignments of intellectual property that seek to extend the owner's rights beyond the scope of the exclusive rights granted by intellectual property statutes are subject to competition laws.

To evaluate further the validity of the 'scope of the grant' approach and whether competition law might unjustifiably restrain the subdivision of intellectual property laws requires an understanding of the operation of the TPA and section 51(3). This is examined in Chapter C3.

Encouraging Greater Licensing and Assignment of Intellectual Property

Some submissions suggested that section 51(3) was enacted to encourage greater licensing and assignment of intellectual property because, while licences and assignments of intellectual property rights may contain some restrictions on competition, the overall effect of such activity is pro-competitive (Australian Copyright Council, submission 23; Telstra, submission 89). The Australian Copyright Council, for example, suggested that:

> *[Section 51(3)] is merely a recognition that: … the encouragement of particular dealings in intellectual property rights, particularly assignments and licensing of intellectual property rights is generally pro-competitive by encouraging the dissemination of new developments and improvements (Australian Copyright Council, submission 23, p. 5).*

However, the Council notes that section 51(3) does not generally exempt all forms of licensing and assignment conditions from the operation of Part IV, but only those that are considered to 'relate to' the subject-matter of the intellectual property rights. Therefore, while the encouragement of greater licensing and assignment activity may have been one of the objectives of section 51(3), Parliament could not have intended to encourage greater licensing and assignment of intellectual property at any price. Parliament must have considered that some forms of licensing and assignment conditions were so unacceptable from a competition law perspective that they should not be permitted, even where banning these conditions resulted in less licensing and assignment activity.

On balance, the Council considers that this objective only has continued relevance to the extent that licensing and assignment conditions are considered in some way acceptable from a competition law perspective. One way of interpreting this might be to view certain types of licensing conditions as unacceptable because they are on balance more likely to be anti-competitive, while viewing other types of licensing conditions as acceptable because on balance they are less likely to be anti-competitive.

This objective is then linked to an understanding of what types of licensing and assignment conditions might be considered acceptable or unacceptable in the eyes of competition laws. This is bound up with views about the interpretation of the words 'relates to' in section 51(3), which is discussed in Chapter C3.

Providing Greater Certainty and Reducing Compliance Costs in the Licensing and Assignment of Intellectual Property

Some submissions suggested section 51(3) reduces uncertainty surrounding the operation of Part IV in relation to common licensing and assignment conditions (for example, best endeavours clauses, exclusive licences, and territorial restrictions) This uncertainty, they argue, would in the absence of section 51(3) raise the costs of licensing and lead to less licensing (for example, LESANZ, submission 19; Law Institute of Victoria, submission 52; ANUTECH Pty Ltd, submission 46; Montech Pty Ltd, submission 64; Mendes, submission 55; WA Department of Commerce and Trade, submission 106).

Philip Mendes, for example, submitted that licensors and licensees, when executing licences of intellectual property, need to know with certainty whether particular licensing conditions breach the provisions of Part IV. Currently, section 51(3) gives them this sense of certainty. But in the absence of section 51(3), parties would need to engage in an analysis of the market, and the impact of their product on the market, before they could ascertain whether an exclusive licence breached any of the provisions of Part

IV. Importantly, this market analysis will have to be carried out at the time the exclusive licence is executed, which may be well before the release of the patented product on the market (Mendes, submission 55, p. 5).

Cooperative Research Centres, the commercialisation arms of Universities and small high technology companies all suggested that section 51(3) provides an important element of certainty in relation to intellectual property licensing (ANUTECH Pty Ltd, submission 46; Montech Pty Ltd, submission 64; CSIRO, submission 47).

However, Michael Gray in speculating on why section 51(3) was originally included in the TPA, considered that the law had developed sufficiently that there is now reasonable certainty about how competition law might treat particular intellectual property licensing and assignment transactions:

> *We can only assume that in 1974 there was a very different appreciation of the kinds of provisions in contracts, arrangements and understandings, and of the kinds of conditions of supply of goods or services, which would have the effect, or would be likely to have the effect, of substantially lessening competition in a market. With over 20 years of competition law and practice in the Australian legal system, it is now clear that the limited protection conferred by section 51(3) is unnecessary (Mr Gray, submission 11, p. 3).*

Overall, the Council considers that, to a limited extent, section 51(3) may confer greater certainty in relation to licensing and assignment of intellectual property and reduce intellectual property owners' and licensees' costs of complying with the TPA.

C2.3 Conclusion

The Council cannot be certain of the intended objectives of section 51(3). However, the Council considers it likely that section 51(3) was included in Part IV of the TPA to avoid a perceived conflict between intellectual property laws and competition laws. The Council considers this objective is no longer relevant because it is clear that these two fields of law are compatible and consistent with each other.

However, section 51(3) may have some continuing objectives in the context of:

- clarifying whether licensing conditions which have the effect of subdividing intellectual property rights may be anti-competitive; and
- providing greater certainty and reduced compliance costs in relation to the licensing and assignment of intellectual property.

The relative size and importance of these objectives is examined further in the remaining chapters of this report.

C3 Operation of the Trade Practices Act and Section 51(3)

This chapter examines:

- the operation of the TPA in relation to intellectual property;
- the operation of section 51(3); and
- comparative overseas experience.

Chapter C7 examines the effect of amending or repealing section 51(3).

C3.1 Operation of Trade Practices Act

Dealings in intellectual property are generally subject to the provisions of Part IV of the TPA. Section 51(1)(a) provides that Part IV applies to patents, trade marks, designs, and copyrights.[56] Section 51(3) operates by way of exception to this by providing an exemption for certain restrictive conditions in licences and assignments. Therefore, on a combined reading of sections 51(1) and 51(3), dealings in intellectual property are subject to Part IV unless they fall within section 51(3).

Part IV of the TPA prohibits certain types of anti-competitive conduct[57]

- anti-competitive agreements and exclusionary provisions (sections 45, 45A);
- misuse of market power (section 46);

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56 Section 51(1)(a) provides "in deciding whether a person has contravened [Part IV], the following must be disregarded: (a) anything specified in, and specifically authorised by ... an Act (not including an Act relating to patents, trade marks, designs or copyrights) .. or .. regulations made under such an Act." (emphasis added). It is possible that acts authorised under intellectual property statutes other than the ones listed in section 51(1) may be exempted from the TPA under section 51(1)(a).

57 In this context, conduct includes the imposing of particular conditions in the terms of licences and assignments of intellectual property.

- exclusive dealing (section 47);
- resale price maintenance (section 48); and
- mergers which would have the likely effect of substantially lessening competition in a substantial market (section 50).

In general, businesses will only breach these provisions where their conduct *substantially lessens competition* in a *market*.[58] The concepts of 'market' and 'substantial lessening of competition' underpin most of the analysis under Part IV.

Market

In economic terms, a market is regarded as an area of close competition. The chief consideration in defining the scope of a market is the nature and extent of 'substitution possibilities', that is the ability of consumers to obtain reasonably similar products, or the ability of other suppliers to switch production so that they can produce reasonably similar products.

This concept of market was first stated by the Trade Practices Tribunal in *Re Queensland Co-Op Milling Association Ltd. and Defiance Holdings Ltd.*:[59]

> *A market is the area of close competition between firms or, putting it a little differently, the field of rivalry between them.... Within the bounds of a market there is 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. ... 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*

58 Per se offences under Part IV do not require proof that the conduct in question has substantially lessened competition. For a discussion of per se offences see Part A. For a discussion of per se offences and intellectual property licensing and assignment activity, see Chapter C7.

59 (1976) ATPR 40-012 at 17,247.

> *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?*

There are four dimensions of substitutability within a market:

- product differentiation (what other types of product perform the same function as the product in question?);
- geographic (how far would consumers travel to find a substitute product?);
- functional market level (are parties seeking products at, for example, the innovation, manufacturing, wholesale, or retail level of a market?); and
- dynamic and temporal (what changes are occurring that over time will affect the market?).

The product substitutability and dynamic dimensions of market may be particularly important in markets employing intellectual property rights.

In terms of product substitutability, courts look broadly at the functions that a product is performing. For example, assuming that there was a market for treatment of headaches, then patented headache tablets would compete in this market with natural and alternative medicine remedies because both these 'products' relieve the symptoms of headache.

Dynamic and temporal changes that affect substitution possibilities in the market include: the introduction of new technologies; technological convergence between markets (such as between the telecommunications and audiovisual markets); and the effect of the expiration of patent protection over a particular technology.

Based on this concept of market, it is clear that most goods produced using intellectual property rights compete in broad markets, and therefore have little power to influence the state of competition in a market. For example, copyright articles such as economics textbooks and hit songs compete in broader markets (for example economics textbooks would compete with other textbooks, and hit songs would compete with other popular music).[60] In the same way, patented goods such as headache tablets and computerised manufacturing equipment compete with other headache treatments and

60 See , for example, *Tru Tone Ltd v Festival Records Retail Marketing Ltd* (1988) 2 NZBLC 103, 286 (a hit album does not occupy its own market).

manufacturing equipment. The courts have in recent times rarely found that particular products occupy highly confined or single product markets.[61]

In some rare cases, however, certain technologies and copyrighted information will have no or few close substitutes. For example, a newly discovered vaccine for a formerly incurable disease might be considered to exist in its own market. Before coming to this conclusion, the court would need to examine possible close substitutes such as: natural remedies; ameliorative treatments; or soon to be released treatments.

The application of Part IV where intellectual property rights have few or no real substitutes and therefore some power to affect the state of competition in a market is discussed further in Chapter C7.

Substantial lessening of competition

In assessing whether conduct substantially lessens competition in a market, courts examine the structure of the market, and how the conduct in question affects that market:

> *… one must look at the relevant significant portion of the market, ask oneself how and to what extent there would have been competition therein but for the conduct, assess what is left and determine whether what has been lost in relation to what would have been, is seen to be a substantial lessening of competition (Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd (1982) ATPR 40-315 at 43,887 - 43,888).*

Therefore a comparison must be made between the level of competition in the market with and without the conduct in question.

The judgment of Wilcox J in *Eastern Express v General Newspapers* made it clear that, in assessing the effect of particular conduct, one must examine the overall effect of the conduct rather than whether the conduct on its face appears to restrict competition:

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61 See *Broderbund Software Inc v Computermate Products (Australia) Pty Ltd* (1992) ATPR 41-155 (a particular software program did not occupy its own market) and *Tru Tone Ltd v Festival Records Retail Marketing Ltd* (1988) 2 NZBLC 103,286. But compare *Hugin v Commission of European Communities* (1979) 3 CMLR 345 (repair parts for Hugin cash registers did occupy their own market).

... [in making judgments about whether conduct substantially lessens competition] courts should have regard to commercial realities and normal commercial practice.

It is not difficult to think of examples of contracts which involve a substantial and long-term commitment but which would generally be considered acceptable; even desirable in promoting a competitive economy. ...

[For example, assume] that a building company, X, habitually purchases bricks from brickyard A, ordering bricks as required at current prices. It uses about 500,000 bricks each year. Promoters of a proposed brickyard, B, approach X with a proposal for a contract whereby B will supply, and X will purchase, not less than 500,000 bricks per year for five years, at prices which are specified but lower than those presently paid by the company to A. B sees such a contract as advantageous because it provides a market base justifying the incurring of establishment costs. The attraction to X is an assured supply of bricks at a known, cheaper price. The contract is made. In theory, X remains free to purchase bricks from A, or anyone else. But, in practice, it is unlikely to do so. If the contract is honoured, its likely needs will be fully met by B. Conversely, B has committed to X 500,000 bricks per year, out of its total production capacity. It is no longer free to sell those bricks elsewhere. To the extent of their obligations, the contract has lessened the ability of both parties to compete in the open market. In a direct sense, the effect of the agreement is to lessen competition in the brick market. This is a market in which X participates. So the relevant competition is "competition" within the meaning of s.45(2) of the Act. Having regard to the volume of bricks involved and the duration of the agreement, it could hardly be said that the effect was insignificant. Yet I venture to think that a court would decline to hold that the agreement was one which substantially lessened competition; but, rather, that it would be impressed with the argument that the agreement was instrumental in bringing into the market a new participant, B .... The qualitative judgment of the court, weighing its pro-competitive aspects against its anti-competitive aspects, would probably be that the agreement was not unreasonably restrictive in character and, on the whole, conducive to competition rather than the contrary (Re: Eastern Express Pty Limited v General Newspapers Pty Limited (1991) ATPR 41-128, at p. 52,907)

When considering whether conduct substantially lessens competition in a market, courts have taken the position that:

- the mere possession of market power does not substantially lessen competition - what is important is the *effect* of particular conduct;[62] and
- the effect must be substantial in respect of the whole of the defined market rather than in respect of the particular product.[63] Therefore, where a product is one of many in a market, and there is strong competition among the products, a restriction on how that particular product may be sold would not have a substantial effect on the market.[63]

In analysing the effect of conditions on competition, Courts may also examine whether the parties involved are in a horizontal or vertical relationship. A horizontal relationship is one where the parties to a deal are competitors or potential competitors to each other (for example, two grocery chains, or two manufacturers of patent articles). A vertical relationship is one where one party is a supplier of the other party (for example a wholesaler and a grocery chain, or a research body and a manufacturer working under a patent from the research body). Competition law is generally more concerned about horizontal agreements, and some provisions in Part IV (for example the exclusionary provisions in section 45) focus solely on horizontal agreements.

There are two possible frameworks for analysing the effect a licensing or assignment condition has on the state of competition within a market:

- what would the state of competition be if the licensor had *not* licensed the intellectual property rights?; or
- what would the state of competition be if the licensor had licensed the intellectual property rights but without the licence condition?

On the first view, it is clear that without licensing (albeit on restrictive conditions), there would be no more competition in the market before the licence is granted than there would be afterwards. For example, assume that a party grants an exclusive licence. Assume that there are no other

62 A business must engage in some form of conduct before it can breach the provisions of Part IV. In some cases, refusals to do things may be considered conduct for the purposes of Part IV.

63 See CCH ¶ 2,500, at p. 1,711.

circumstances combined with the grant of the licence that influence the state of competition in the market. Before the grant of the licence, the licensor by virtue of its exclusive intellectual property rights, would have been the only party with the rights to manufacture the product. After the grant of the licence, the licensee is the only party with the rights to manufacture the product. Essentially, competition has not been lessened because of the transfer of the exclusive rights from the licensor to the licensee. On this first view, the principle would be that licensing that only has the effect of transferring rights from one party to another does not substantially lessen competition because, without the licence, the licensee could not have competed in the market.

On the second view, licensing that only has the effect of transferring market power may, in some circumstances, substantially lessen competition. The question is whether, in the absence of the restrictive condition in the licence, the licensor would be able to compete with the licensee (either by itself competing or by licensing third parties), and whether this loss of competition (if any) is substantial. Take the case of the exclusive licence of a patent. An exclusive licence prevents the licensor working the patent, or licensing third parties to work the patent. On this view, without the exclusive licence condition, the licensor and the licensor's other licensees would have been able to compete with the licensee. Therefore, the effect of the exclusive licence condition is to reduce competition. If the effect of that reduction is considered substantial, then the condition may be taken to have substantially lessened competition.

The first view is consistent with the approach of the European Court of Justice in *Nungesser v Commission*,[64] (the *Maize Seed* case) and is accepted by the Council as the correct view of the operation of the test of substantial lessening of competition. The TPC in its 1991 paper also considered that, in the absence of a general right to compel parties to licence intellectual property rights, it was artificial to look at the position where rights are licensed without restriction to assess effects on competition (TPC 1991, p. 10).

The first view also receives support in the 1995 US Antitrust Guidelines for the Licensing of Intellectual Property. The Guidelines consider that exclusive licensing is only likely to raise competition law concerns if the licensor and the licensee are in a horizontal relationship (Antitrust Guidelines for the Licensing of Intellectual Property 1995, p. 18).

64 [1982] ECR 2015; discussed at TPC 1991, pp. 9 and 22.

The Council considers that the grant of an exclusive licence, without more, is unlikely to substantially lessen competition because it merely transfers exclusive rights in the licence from the licensor to the licensee without affecting the state of competition in the market by for example, reducing the number of players in the market. An exclusive license would only be likely to substantially lessen competition where it was combined with other licence conditions that had the combined effect of, for example, driving competitors out of the market, preventing potential competitors from entering the market, or dividing the market among existing competitors.

Territorial licences fit within the same framework of analysis. The 1991 TPC paper took the view that territorial restrictions, without more, did not substantially lessen competition. The paper quoted the case of *US v Crown Zellerbach Corporation*[65] that, "Territorial licences, *without more*, are a reasonable means for the patentee to secure the reward granted to him" (TPC 1991, p. 23; emphasis added).[66]

However, there may be some residual doubt about whether Courts would adopt the first or second view when analysing the effect of restrictive conditions in licensing or assignments of intellectual property rights. The potential impact of this uncertainty is examined in Chapter C7.

The next question is what other conduct or circumstances could, in combination with a restrictive condition such as an exclusive licence or a territorial restraint, have the effect of substantially lessening competition.

There are a number of situations where other factors could combine with a restrictive condition to substantially lessen competition. For example, where:

- a business agreed to grant an exclusive licence in exchange for the licensee granting a reciprocal exclusive licence over a competing product, the effect of the cross-licensing may be to reduce competition between the two products;
- the licence contains a term requiring the licensee to buy a second product from the licensor, the effect of the licence may be to reduce competition in the market for the second product; or

65 141 F. Supp 118 (1956).

66 Also see discussion by Dr Hampton on section 45 of the New Zealand *Commerce Act*, submission 18, pp. 29 – 36.

- the license restricts how the licensee may deal with the goods that it produces under licence, the effect of the licence may be to reduce competition in the market for the goods.

The Council examines this issue further in Chapter C5 when it examines the costs of conduct permitted under the exemption in section 51(3).

Anti-competitive agreements – sections 45, 45A

Sections 45 and 45A forbid the following types of anti-competitive agreements between businesses:

- agreements which have the purpose or effect of substantially lessening competition in a market, for example, market-sharing;
- agreements containing exclusionary provisions. These are agreements between persons in competition with each other which exclude or limit dealings with a particular supplier or customer or a particular class of suppliers or customers; and
- agreements to fix prices. Some joint ventures and buying groups are excluded from this provision.

Application to intellectual property arrangements

Section 45 deals with contracts, agreements, or understandings between parties that substantially lessen competition. Therefore, internal business decisions about what a business will do with its intellectual property do not breach section 45 because they are not agreements between businesses.

Section 45 might apply where two patent-holders dealing in competing goods agree to cross-licence their patents. If the effect is to substantially lessen competition then, in the absence of section 51(3), the cross-licences might breach section 45.[67] For example, in a recent US case, two companies holding competing patents to manufacture machines that could perform laser eye surgery (where neither patent blocked the other) agreed to cross-license their patents, and share the proceeds each time either machine was used.

67 TPC 1991, p.23; and Dr Hampton, submission 18, p. 27.

These cross-licences are currently under challenge by the Federal Trade Commission.[68]

Competitors may not always engage in cross-licensing for anti-competitive purposes, and cross-licensing may not always have an anti-competitive effect. For example, parties may cross-license to achieve greater efficiencies, or to resolve 'blocking' patents[69] and enable the cross-licensees to use patents that they could not otherwise have been able to use without infringing the other patent.

If section 51(3) were repealed, then in circumstances where cross-licensing was considered to substantially lessen competition the intending cross-licences would need to seek authorisation of their conduct. Authorisation is discussed in Chapter C7.

Misuse of market power – section 46

Under section 46, a business with a substantial degree of power in a market is prohibited from taking advantage of that power for the purpose of eliminating, preventing, or lessening competition in any market.

In determining whether a business has a substantial degree of market power, the court will consider the extent to which the activities of the business in a market are constrained by the conduct of its competitors or potential competitors, and by the behaviour of its suppliers or those whom it supplies. For a business to have substantial market power, that market power must be 'considerable' or 'large'. However, the business does not need to have total power within a market.

While section 46 prohibits the *misuse* of market power, it does not prohibit businesses from merely possessing that power, or exercising it in some legitimate commercial manner.

68 See Summit Technology and VISX Inc. discussed in an FTC press release at http://www.ftc.gov/opa/9803/eye.html.

69 One patent blocks another where the commercialisation of the second patent would infringe the first patent. This commonly occurs where the second patent represents an incremental improvement on the first.

Conduct which may fall within section 46 includes price discrimination, predatory pricing, and refusals to supply. Conduct that falls within sections 45 or 47 may also fall within section 46.

Section 51(3) does not protect conduct that breaches section 46.

Exclusive Dealing – section 47

In essence, a supplier engages in exclusive dealing where it supplies goods or services on *condition* that the purchaser:

- will not acquire, or will limit the acquisition of goods or services from a competitor of the supplier; or
- will not resupply, or will resupply only to a limited extent, goods to particular persons or a particular class of persons or in a particular place or places.

A supplier also engages in exclusive dealing where it refuses to deal with a party because that party has declined to accept the supply of goods on one of the above conditions.

One form of exclusive dealing is third line forcing – where a party supplies goods or services on condition that (or refuses to supply unless) the party being supplied accepts goods from a third party.

With the exception of third line forcing, section 47 only prohibits exclusive dealing which has the purpose or effect of substantially lessening competition in a market. Third line forcing breaches section 47 even where it does not substantially lessen competition. Parties that wish to rely on exclusive dealing provisions, including third line forcing, may notify these provisions to the ACCC. In essence, notified exclusive dealing provisions are protected from the operation of Part IV until the ACCC revokes the notification. The ACCC must follow certain procedures which protect the interests of the notice-giver before it may revoke notification.[70]

Exclusive dealing is *not* the same thing as exclusive licensing, since exclusive licensing does not restrict where the licensee may obtain other goods or services.

70 sections 93 – 95, TPA.

Application to intellectual property arrangements

Restrictive conditions in licences or assignments of intellectual property rights might have the effect of substantially lessening competition where they:

- leverage another market. For example, in the case of *Magill*,[71] a party refused to licence daily programming information in an attempt to prevent the licensee competing in the market for weekly TV guides (The daily and weekly TV programming information markets were considered separate markets). This conduct was considered to leverage the weekly TV guide market; or
- lock the sellers of competing products out of the market, or raising their costs of entering the market. Box C1 provides an example.

Resale Price Maintenance – section 48

Suppliers of goods or services may not specify the minimum price at which those goods or services may be resupplied.

Price specification clauses in intellectual property licences generally do not breach section 48. This is because they typically relate not to the supply of goods *from the licensor* to the licensee but rather to goods produced under licence *by the licensee*.[72]

Section 51(3) does not exempt conduct that breaches section 48.

71 *Radio Telefis Eireann and Independent Television Publications Ltd. (Intellectual Property Owners Inc. intervening) v EC Commission (Magill TV Guide Ltd. intervening)* [1995] 4 CMLR 718; [1995] All ER (EC) 416.

72 See TPC 1991, p. 24, and Dr Hampton, submission 18, p. 42.

Box C1 – SoftwareCo

Suppose SoftwareCo has a dominant position in the market for computer operating systems. It sells its operating system to computer equipment manufacturers in exchange for a licence fee for each computer on which the operating system is installed. SoftwareCo bundles an internet browser with the operating system, and charges the same licence fee to computer manufacturers whether they install the internet browser or not. If equipment manufacturers elect to install a browser from a competing browser supplier, they must pay both SoftwareCo and the competitor, while if they elect to install SoftwareCo's browser, they pay only once.

There is strong consumer demand for SoftwareCo's operating system, and consumers are reluctant to buy computer which do not have SoftwareCo's operating system installed. Consumers want an internet browser installed on their computer, but they are indifferent as to whether the browser is SoftwareCo's or by a competitor's.

In this situation, SoftwareCo is using its power in the market for operating systems to leverage the market for internet browsers. SoftwareCo is using its power in the operating system market effectively to bundle the operating system and the browser. The effect of bundling operating systems with browsers is to raise the costs for competing browser suppliers. SoftwareCo's conduct amounts to exclusive dealing.[73]

Mergers or Acquisitions – sections 50

Section 50 generally prohibits mergers or acquisitions which would have the effect or likely effect of substantially lessening competition in a substantial market for goods or services.

In determining whether a merger has this effect, courts are required to take into account a number of matters, including:

73 Compare *US v Microsoft Corp.* Civ Action No. 94-1564. See the US Department of Justice Antitrust Division website at http://www.usdoj.gov/atr/index.html.

- actual or potential import competition;
- the ease with which other businesses may enter the market;
- the availability of substitute products in the market; and
- the dynamic characteristics of the market, including growth, innovation, and product differentiation.[74]

Application to intellectual property arrangements

Where a business seeks to acquire assignments or exclusive licences of all the intellectual property in a particular market, it may breach section 50 where that acquisition has the effect or is likely to have the effect of substantially lessening competition in that market. In this context, an exclusive licence may be considered to be an acquisition.[75]

For example, if a business sought to acquire exclusive licences over all the patents in the field of digital technology with the effect that anyone who wanted to use digital technology had to deal with the business, then, assuming digital technology forms a separate market, it may breach section 50. The business's acquisition program would not be protected by section 51(3) because section 51(3) only protects *conditions* in assignments or licenses of intellectual property, and not the assignments or licences themselves.

C3.2 Operation of Section 51(3)

Section 51(3) provides an exemption from the operation of Part IV for certain types of conditions in licences and assignments of intellectual property.[76] The exemption is of limited scope.

As section 51(1) makes clear, the exemption does not apply generally to intellectual property dealings. For example, it does not apply to refusals to licence, agreements to conduct co-operative research, or to legal actions by parties alleging infringement of patent (This is not to suggest that these

74 Section 50(3).

75 See definition of 'acquire' in section 4(1), TPA.

76 For a discussion of the limitations on section 51(3), see TPC 1991, pp. 11-13; Heydon 1993, pp. 1667-1671; CCH 1998, ¶ 14-400-14-465; Corones 1994, ch. 12; and Allen Allen and Hemsley, submission 39, pp. 9-10.

activities necessarily breach Part IV, but only that they do not come within the exemption in section 51(3)).

First, section 51(3) only applies in respect of the subject matter of *existing or pending* intellectual property rights in respect of patents, registered designs, copyrights, trade marks, and EL (Eligible Layout) rights under the *Circuit Layouts Act 1989*. Therefore, it does not cover:

- the subject matter of future intellectual property. This omission is important because parties often contract in relation to intellectual property that has yet to come into existence, for example in relation to the publication rights of a book yet to be written, or in respect of payments to support research and development to discover a new patent;
- unregistered trademarks;
- confidential information such as trade secrets and know-how; and
- rights under other intellectual property statutes, most notably the *Plant Breeder's Rights Act 1994*.

Second, the exemption in section 51(3) only covers conduct that contravenes sections 45, 45A, 47 or 50. Section 51(3) does not cover conduct that breaches sections 46 or 48. This significantly cuts down the scope of the protection because conduct in breach of sections 45, 45A, 47, or 50, may also breach sections 46 or 48.

Third, section 51(3) only applies in relation to *conditions* in licences and assignments. Therefore the exemption does not cover:

- refusals to assign or grant a licence of intellectual property; or
- infringement or enforcement actions.

Four, section 51(3) only exempts conditions that "relate to" the subject matter of the intellectual property right.

Some submissions and commentators consider the term "relates to" creates uncertainty in the application of section 51(3).[77] The ACCC considered that

77 For example, Allen Allen and Hemsley, submission 39, p. 13; LESANZ, submission 19, p. 5; ACCC, submission 30, p. 3; Hilmer Review 1993, p. 150; TPC 1991, p. 12; CCH ¶ 14-425 at 8,653. However, some submissions considered that the term was reasonably certain, for example, the Law Council of Australia, submission 33, p. 8; and Australian Copyright Council, submission 23, p. 10, and supported its retention.

the decision in *Transfield v Arlo* (discussed below) "provides only limited guidance, with considerable latitude remaining for interpretation". The Hilmer Review considered that the term is "ambiguous and cause[d] section 51(3) to be uncertain".[78] LESANZ agreed with the view of the Hilmer Review (LESANZ, submission 19, p. 5). On the other hand, the Australian Copyright Council supported retention of the term, suggesting that the section was sufficiently certain to achieve its purpose (Australian Copyright Council, submission 23, p. 10).

There are a range of views about the meaning of the term.[79] On a narrow reading, a condition relates to intellectual property or the goods produced using it if it relates directly to the goods produced. On this view, a territorial restriction on where the licensee could sell would not relate to the goods, because it relates to the market for the goods rather than the goods themselves. On an intermediate reading, a condition relates to intellectual property or the goods produced using it if the condition seeks to protect and exploit the patentee's exclusive rights or to secure an advantage that is not collateral to the patentee's exclusive rights. On this view, a territorial restriction would fall within the scope of the section. On a broad reading, a condition relates to the intellectual property or goods produced using it unless it seeks to apply to an almost entirely unrelated transaction or arrangement. On this view, if there is some link between the condition and the intellectual property or the goods then it will be covered by section 51(3). On the broad view, territorial restrictions, exclusive grant-backs, and non-challenge provisions fall within the section.

The only reported case on the interpretation of "relate to", the High Court decision in *Transfield Pty Ltd. v Arlo International Limited*,[80] appears to support the intermediate view. In that case, the Court had to consider a condition in a patent licence which required the licensee (Transfield) to use its best endeavours to promote and develop a patented pole, the Arlo pole. The question for the Court was whether the best endeavours clause 'related to' either the invention or poles produced using it. Transfield submitted that the effect of the condition was to prevent it from using other poles, and therefore 'related to' the use of competing poles.

78 Hilmer Review 1993, p. 150.

79 See ACCC, submission 30, at pp. 3 – 5; and CCH ¶ 14-425 at 8,653.

80 (1980) ATPR 40-166; 144 CLR 83.

Each of the three judges who considered the point held that the condition fell within section 51(3). However, only Mason J provided reasons for his conclusion. He held that:

> *The appellant submitted that cl. 7 of the Agreement [the best endeavours clause] does not only relate to 'the invention' but it goes beyond the terms of s.51(3)(a)(iii) and relates to other products, that is, relates to not using other poles. This submission in part attributes to the word 'relates to' a meaning that is too narrow, thereby giving s.51(3) an overly restrictive operation. …*
>
> *In bridging the different policies of the Patents Act and the Trade Practices Act, s.51(3) recognises that a patentee is justly entitled to impose conditions on the granting of a licence or assignment of a patent in order to protect the patentee's legal monopoly. … sub-section 51(3) determines the scope of restrictions the patentee may properly impose on the use of the patent. Conditions which seek to gain advantages collateral to the patent are not covered by s.51(3) (p. 42,310).*

Mason J's judgment appears to support the intermediate view that a condition relates to intellectual property where it seeks to secure an advantage that could be considered within the "purpose and scope of the exclusive rights granted by the specific intellectual property regime"[81] and does not seek to gain a collateral advantage. This accords with the ACCC's interpretation of section 51(3):

> *a condition "relates" to the invention or to articles made by use of the invention if it operates in order to protect the patentee's [intellectual property rights], and that otherwise the condition will be regarded as collateral to the patent (ACCC, submission 30, p. 4).*

Nonetheless, this interpretation may give rise to problems in application. As the former TPC pointed out, the test laid down by Mason J appears in two forms: either as a positive question of whether a condition is within the purpose and scope of the intellectual property owner's exclusive rights; or as a negative question of whether the intellectual property owner is seeking an advantage collateral to his exclusive rights. The TPC argued that "a different conclusion may be reached depending on whether one asks if the condition relates to the subject matter of the licence, or whether the

81 See TPC 1991, p. 13.

condition gives the licensor an advantage collateral to his intellectual property rights".[82]

The Council considers that the interpretation of section 51(3) remains to some extent uncertain due to residual ambiguity about what types of contractual provisions might ‘relate to’ the intellectual property or the goods produced using it. This uncertainty reduces the effectiveness of section 51(3) in achieving its objectives.

The Trade Practices Commission released a paper in 1991 identifying the types of restrictive conditions that might ‘relate to’ the subject-matter of the intellectual property rights, and therefore fall within the exemption in section 51(3). These conditions are: exclusive licences and sole licences; territorial restrictions; best endeavours clauses; price restrictions; and quantity restrictions.[83] The Council does not suggest that these conditions are necessarily or even likely to be anti-competitive, but that in some circumstances they may be anti-competitive. Chapter C5 discusses the possible anti-competitive effects these conditions may have in particular circumstances.

C3.3 Overseas Experience

The Council has examined how intellectual property rights are dealt with under the competition laws of the United States, European Union, and New Zealand to gain a sense of perspective about the role and importance of section 51(3).[84]

United States competition law does not provide a specific exemption for restrictive conditions in intellectual property licences and assignments. It applies general competition laws to intellectual property arrangements. However, it takes into account the special features of intellectual property

82 See TPC 1991, p. 13.

83 Exclusive licences are licences granted to the exclusion of any other party (Sole licences are granted to the exclusion of any other party apart from the licensor). Territorial restrictions limit the geographic area within which the licensee may sell goods produced under licence. Best endeavours clauses require the licensee to devote its best endeavours to promoting the goods produced under licence. Price restrictions are limitations on the minimum price at which the licensee may sell goods produced under the licence. Quantity restrictions limit the number of goods that a licensee may produce under licence.

84 The following discussion is expanded in Appendix Five.

licensing when considering whether particular arrangements are anti-competitive in effect.

The European Union (EU) generally treats intellectual property dealings under the competition laws in the same way as other forms of property dealings. However, the EU competition authorities have issued a block exemption for a limited range of territorial restrictions in technology licences. This block exemption does not cover other types of restrictive conditions.

Both the EU and the United States take a tough stance against some of the restrictive conditions that come within section 51(3), that is, price and quantity restrictions. In the United States, price and quantity restrictions are banned outright, while in the EU, agreements containing price or quantity restrictions do not qualify for block exemption.

New Zealand provides an exemption for restrictive provisions in intellectual property agreements roughly similar in effect to the position applying in the European Union. The New Zealand counterpart of the TPA exempts conduct in respect of intellectual property rights where that conduct is considered to be within the legitimate scope of the rights granted under intellectual property laws.

United States

The United States Department of Justice and Federal Trade Commission (the US Agencies) have issued joint *Antitrust Guidelines for the Licensing of Intellectual Property* (1995a) setting out their approach when assessing whether intellectual property dealings infringe competition law.[85]

The guidelines contain three main principles:

(c) for the purpose of antitrust analysis, the Agencies [the DOJ and FTC] regard intellectual property as being essentially comparable to any other form of property;

(c) the Agencies do not presume that intellectual property creates market power in the antitrust context; and

85 In the United States, competition law is known as antitrust law.

(c) the Agencies recognize that intellectual property licensing allows firms to combine complementary factors of production and is generally procompetitive.

The first principle recognises that while intellectual property rights do have some special characteristics, these does not justify exemption from competition law. The second principle provides that while "intellectual property confers the power to exclude with respect to the *specific* product, process, or work ..., there will often be sufficient actual or potential close substitutes for such product, process, or work to prevent the exercise of market power". The third principle states that licensing of intellectual property rights is generally pro-competitive because it allows different firms (such as research organisations, manufacturers, distributors, and retailers) to combine to develop and market a product.

The US Agencies are particularly concerned about horizontal arrangements (where owners of competing technologies agree to pool the technologies or research efforts, or where one firm buys the rival's competing technology). They are also concerned where licence conditions restrict output, create or consolidate market power, increase the risk of coordinated pricing, or shut competitors out of markets or raise their costs (for example, by lifting the price of vital inputs). The Agencies are less concerned where the product produced under licence occupies less than twenty percent of a market.

Antitrust law bans outright licensing conditions that fix minimum resale prices, and agreements between parties that have the effect of fixing prices, reducing output, dividing markets or customers, or boycotting certain parties. These agreements are considered anticompetitive without the need to examine their effect on markets.

European Union

The Treaty of Rome established the EU and regulates trade between the members of the Union. The Treaty sets out the competition law to be applied within the EU.

Articles 85 and 86 are the main competition law provisions of the Treaty. Article 85 prohibits practices, decisions, or agreements "which have as their object or effect the prevention restriction or distortion of competition within the [EU], and in particular [price-fixing, production limits, market-sharing, applying dissimilar conditions in equivalent transactions with parties outside the agreement, or tie-ins of unrelated obligations]". Article 86 forbids companies from abusing a position of dominant market power.

Article 85(3) provides a limited exemption from the application of Article 85 (but not Article 86) where a practice, decision, or agreement: (1) promotes the production or distribution of goods or technical or economic progress; (2) allows consumers a fair share of the resulting benefits; (3) the restrictions are indispensable to attain these objectives; and (4) the agreement does not afford the parties "the possibility of eliminating competition in respect of a substantial part of the products in question". Restrictive conditions may come within Article 85(3) if they provide the public with significant economic benefits in the form of lower prices or higher quality.

The Directorate General IV of the EU has the power to issue block exemptions for conduct that would otherwise breach Article 85 (but not Article 86). In 1996, it issued a Technology Transfer Block Exemption[86] which applies to licences of patents and know-how, or where a licensee manufactures goods or provides services or has products or goods provided for it. The block exemption does not apply to resales, joint ventures, or patent pools.

The block exemption exempts territorial and exclusive licences associated with technology transfer that are limited to the life of the intellectual property (or 10 years in the case of pure know-how agreements) from Article 85. However, the block exemption does not apply if the licence also contains a restriction on the selling price of licensed products, the quantities to be made or sold, prohibits the licensee from dealing in competing technologies, limits the customers a licensee may compete for, or requires the licensee to licence back to the licensor any improvements on the patent.

The technology transfer block exemption does not apply generally to exempt all territorial and exclusive licences from competition law. The block exemption only applies where it is considered that the restrictive conditions are highly unlikely to be anti-competitive. For this reason, the block exemption contains a long list of exceptions to the exemption, where territorial restrictions or exclusive licences could be considered potentially anti-competitive. For example, DG IV may withdraw the exemption where the licensee's market share exceeds 40 percent; the licensee refuses without an objectively justified reason to deal; or obligations to produce a minimum

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86 See OJ L 031, 9/2/96, p. 0002

quantity or use best endeavours to promote the licensed product effectively prevent the licensee using competing technologies; or where the licence is part of a cross-licensing or joint venture (unless the product has less than 20 percent market share).

When considering intellectual property cases brought under Articles 85 and 86, the European Courts have traditionally applied the doctrine of 'the scope of the grant' to resolve the question of the appropriate interface between intellectual property law and competition law.[87] Under this doctrine, dealings considered to be within the scope of the rights granted by the relevant intellectual property statute are immune from the application of competition law, and dealings outside are fully subject to competition law. The scope of the grant was considered to cover all matters essential to the function of the intellectual property law. For example, under copyright law, one essential matter was the exclusive right to reproduce the copyrighted work. Therefore, the grant of a sole licence did not infringe competition law.

The scope of the grant approach has been criticised in recent years.[88] It is questionable whether there is a neat division between what is within the scope of the grant of intellectual property rights and what is outside.[89] This approach may not focus sufficiently on the purpose or effect of conduct engaged in by intellectual property owners, licensees, and assignees.[90]

The recent case of *Magill*[91] has cast doubt on whether the courts will continue to apply the 'scope of the grant' approach. In *Magill*, the court held that where an intellectual property owner sought to gain control of a related market by refusing to licence its intellectual property rights it may breach competition law. *Magill* represents a departure from the accepted case-law because it indicates that the European Courts are prepared to consider whether activity *within* the scope of the grant could have anti-competitive effects. If the case-law after *Magill* develops in this direction, this may mean that when applying competition law in intellectual property cases the courts will focus on whether conduct is anti-competitive or not, rather than on whether it is within or outside the scope of the grant.

87 This discussion draws on van Melle 1997, pp. 7 - 8.

88 For example, see Dr Hampton, submission 18, p. 25, footnote 53.

89 Compare Calhoun and Brown 1990, p. 438.

90 Contrast van Melle, submissions 36 and 68.

91 *Radio Telefis Eireann and Independent Television Publications Ltd. (Intellectual Property Owners Inc. intervening) v EC Commission (Magill TV Guide Ltd. intervening)* [1995] 4 CMLR 718; [1995] All ER (EC) 416.

New Zealand

The *Commerce Act* is the New Zealand counterpart of the TPA. It contains two specific exemptions for intellectual property rights: section 45(1) and section 36(2).

Section 45(1) provides that, with the exception of the provisions relating to misuse of dominant market power and resale price maintenance, the Act does not apply to provisions which authorise conduct that "would otherwise be prohibited by virtue of the existence of a statutory intellectual property right". Statutory intellectual property rights are rights that arise under the Patents, Designs, Trade Marks, Copyright, or Plant Variety Rights Acts.

Since the enactment of section 45(1) in its present form in 1988, the section has been very rarely used, and it is generally considered problematic. There are a number of views about how it might apply. One view is that section 45(1) is 'purposive', that is, it protects licensing and assignment conditions to the extent that they are seen as compatible with the appropriate or efficient use of intellectual property rights. A second, slightly broader view, advanced by Abraham van Melle, is that section 45(1) is analogous to the "scope of the right" approach under European law.[92]

Under the 'purposive' approach, section 45(1) exempts licensing conditions seen as legitimately protecting the intellectual property owner's rights. Restrictive conditions that can be characterised as having the purpose of reducing competition or extending the intellectual property owner's market power into another market are not exempt.

On Mr van Melle's interpretation, section 45(1) exempts licensing and assignment conditions that fall within the subject matter of the licence.[93] For example, it exempts agreements to: grant exclusive licences; limit licensees to particular territories or for specified periods of time; impose production quotas (but not distribution); refuse to licence (except where the refusal is part of an attempt to monopolise a second market); or place bans on resale to unauthorised distributors. However, section 45 does not exempt: exclusive cross-licensing; limiting licences as part of a tacit agreement to fix prices; requiring the licensee to buy additional non-intellectual property products from the licensor; package licensing (where the licensee is required to license other intellectual property products; restrictions on sale after the

92 van Melle, submission 36, p. 11.

93 van Melle, submission 36, pp. 12 – 15.

first sale; grantback clauses (where the licensee must grant back to the licensor any improvements); or non-challenge clauses.

Section 36(2) is quite narrow; it provides that a party does not abuse its dominant market power "by reason only that the party seeks to enforce any statutory intellectual property right within the meaning of section 45(2)".

C4 Benefits of Exemption

Possible benefits of the exemption in section 51(3) are:

- greater certainty and reduced costs of compliance;
- greater licensing of intellectual property;
- greater investment in research and development; and
- a comparative advantage for Australian research and commercialisation.

C4.1 Greater Certainty and Reduced Costs of Compliance

Submissions to the Council argued that section 51(3) provides a significant measure of certainty to licensors and licensees of intellectual property. On this view, parties can rely on the exemption in section 51(3) when they are executing licenses and assignments containing exclusive licence grants, territorial restrictions, or best endeavours clauses, without being overly concerned that such conditions may breach Part IV. The submissions considered a high degree of certainty is essential to enable such transactions to take place.

For example, the Cooperative Research Centre for Diagnostic Technologies contended that, in accepting the risks associated with the commercialisation of intellectual property, commercialising companies need absolute certainty that their exclusive licences do not breach the TPA. Repeal of section 51(3), according to this view, would require the intellectual property owner to seek authorisation on every occasion it sought to grant an exclusive licence, even where the possibility that the exclusive licence breached Part IV was very small (Cooperative Research Centre for Diagnostic Technologies, submission 80, p. 2).

Philip Mendes submitted that uncertainty about the legal validity of exclusive licences would discourage investment in research and development, exacerbating a funding gap that already exists between basic research and product development. He considered repealing section 51(3) would discourage investment in applied research because business would lose their guarantee of certainty that exclusive licences do not breach Part IV of the TPA.

In his view:

> *The consideration whether the proposed exclusive licence will contravene [Part IV] must be undertaken at a time:*
>
> 1. *Before research commences*
> 2. *When the expectation of research outcomes are highly speculative*
> 3. *When the cost of negotiating and seeking any authorisation under the Trade Practices Act for the contemplated license will be burdensome, and so burdensome in fact, as to … discourage the effort of proceeding with the transaction and the research (Philip Mendes, submission 55, p. 5).*

Submissions also argued the exemption in section 51(3) saved administrative and other costs associated with being required to pursue clarification of their arrangements or authorisation. They argued repeal of section 51(3) would create significant doubt whether restrictive licensing and assignment conditions breached Part IV, requiring parties to seek authorisation, provide notification to the ACCC, or at the least consult about the legality of their licences and assignments.

They argued that at the time licences were executed, it was often very difficult and expensive to assess whether they would at some future time substantially lessen competition. This was because the licenses often involved embryonic technology where businesses could not be sure about its uptake by the marketplace.

The Law Council of Australia considered:

> *The legal inquiry which is required to be undertaken to determine whether the entry into an agreement could substantially lessen competition is an arduous and expensive one, and the increased cost may well deter exploitation of the rights by way of licensing or assignment, especially for small to medium sized businesses (Law Council of Australia, submission 33, p. 1).*

and the CSIRO considered:

> *The inclusion of sub-section 51(3) in the TPA is one of many measures taken by Australian governments to encourage innovation. Its mere existence means that owners of intellectual property rights do not need to waste time and money on detailed competition analyses whenever they grant an exclusive licence. … in the vast majority of cases the grant of an exclusive licence will not raise competition issues and therefore it would be wasteful to impose a new analysis and cost burden on these transactions.*
>
> *Similarly it would be wasteful to create a situation where, as a prudent precaution on the part of licensors, licensees or both, every exclusive licence would have to be officially notified under the TPA (CSIRO, submission 47, p. 3).*

Submitters considered that certain types of new technology (e.g. new vaccines, leading edge photonics technology) may exist in their own markets, conferring on these technologies strong market power, and making dealings in these technologies particularly vulnerable to breaching Part IV. This meant that parties would often need to seek authorisation, or provide notification of their licensing agreements, driving up costs significantly. The Cooperative Research Centre for Black Coal argued that parties would be reluctant to incur the expense of authorisation in relation to new high technology products:

> *Technology licensing is a very different activity from other forms of trade agreement, where the costs of [authorisation] can be readily evaluated against relatively certain benefits from a successful outcome (Cooperative Research Centre for Black Coal, submission 92, p. 1).*

The Council accepts that if section 51(3) were repealed there may be some degree of uncertainty about the circumstances in which exclusive licence terms and other licensing conditions are likely to breach Part IV, particularly in light of the undeveloped nature of the markets in which licensing may take place. The greater certainty provided by section 51(3) may not only protect licensing and assignment agreements that substantially lessen competition, but also confer greater certainty where agreements fall into a 'grey' area where it is *possible* they may breach the Act.

Having said that, uncertainty or compliance costs may not increase to this extent because:

- some of the uncertainty only exists because of the view that intellectual property creates an economic or legal monopoly. As discussed in Chapter C2, it is now recognised that the market power of an intellectual property holder must be assessed according to the market in which the goods or services produced using the intellectual property compete;
- there will be some compliance costs in checking whether activity comes within the exemption, and whether activity breaches sections 46 or 48 (which fall outside the scope of the exemption);
- there is already some residual uncertainty about the meaning and extent of the exemption;[94] and
- overseas, the absence of an equivalent to section 51(3) has not discouraged investment in applied research.

Overall, the Council considers that section 51(3) may confer some limited benefits in terms of greater certainty and reduced costs of compliance for licensors and licensees of intellectual property.

C4.2 Exemption Encourages Greater Licensing

Submissions to the Council argued the exemption provided by section 51(3) assists in promoting the licensing and assignment of intellectual property. For example, Toyota submitted that "these exemptions facilitate the effective commercialisation of intellectual property rights and benefits both licensors and licensees of those rights" (Toyota, submission 10, p. 5).

Intellectual property owners may not wish to licence unless they can impose licensing conditions that breach Part IV. However, the Council considers that, where licensing conditions breach Part IV, there are likely to be net costs in permitting the licensing to occur on restrictive conditions. The benefits of any greater licensing and assignment activity must be offset against the costs arising from the existence of anti-competitive restrictions

94 Compare ACCC, submission 30, p. 5.

in licences and assignments that would not have been there in the absence of section 51(3). The social benefits of licensing that proceeds on restrictive conditions may be less than where the licensing proceeds without such restrictions.

Moreover, it will not always be worthwhile to encourage licensing where it would only occur on anti-competitive conditions. In the absence of the licence, the licensee may decide to invest in research and development or otherwise compete with the licensor:

> *a person who accepts a licence from another corporation might, in the absence of the licence, have been a competitor of the corporation. Apart from any restrictive terms contained in the licence, the licence itself may reduce competition between the corporation and the licensee (TPC Background Paper, 1991, p. 10).*

Submitters also argued that repealing section 51(3) would not only discourage licensing and assignment where the licensing and assignment conditions breach Part IV. They argued that there will be many cases falling into a grey area where it is unclear whether licensing conditions will breach Part IV (for example, see Mr De Boos, submission 95, p. 2). In these cases, the cost and trouble of clarifying whether licensing or assignment conditions breach Part IV would discourage licensors from entering negotiations to license, and would discourage investors from investing in research.

The Council considers that, to the extent that section 51(3) confers greater certainty and reduces compliance costs for licensors and licensees of intellectual property (discussed above), then the continued presence of section 51(3) may encourage greater licensing activity.

C4.3 Encourages Greater Innovation

There was a view in submissions that the application of competition law to intellectual property licensing and assignment activity might interfere with commercial pricing practices in the markets in which goods and services produced under intellectual property rights are sold.

Submissions argued that, if section 51(3) were repealed, intellectual property owners and licensees would not be able to earn monopoly (or "super") profits they may currently be able to earn under the exemption, thus driving investment away from innovation:

> *If super profits are earned this will attract competitors so that in time those super profits are reduced to normal profits. The amount of the super profits which can be made by virtue of the intellectual property right will relate directly to the height of innovation (Law Council of Australia, submission 83, p. 3).*

This view assumes that the purpose of intellectual property laws is to enable intellectual property owners to earn monopoly profits. However, as discussed in Chapter C2, the purpose of intellectual property laws is to create exclusive property rights rather than the right to earn monopoly profits.

Another concern expressed by submissions was that, in the absence of section 51(3), competition law might treat any price charged by intellectual property owners in excess of the marginal cost of production[95] as anti-competitive. Submissions noted that intellectual property rights are typically characterised by high initial costs of discovery but low costs of production. In these circumstances, intellectual property owners need to charge more than the marginal costs of production on each article produced or they would not be able to recoup their original investment in discovery. A related concern was that competition law was primarily concerned with price competition, while intellectual property laws were designed to encourage greater innovation, leading to greater competition in the long run (for example, WA Department of Commerce and Trade, submission 106, p. 2).

These submissions assume there is a dichotomy between competition law, which is focussed on near-term competition, and intellectual property law, which fosters competition in the long run. However, the Council does not accept this characterisation of competition law.

As discussed in Chapter C2, competition law is concerned with dynamic aspects of competition rather than just short term price competition. For example, when assessing whether conduct substantially lessens competition, competition law examines whether horizontal agreements reduce incentives for dynamic competition. When assessing mergers, competition law requires

95 The marginal cost of production is the cost of producing one more copy of the intellectual property article.

an analysis, among other matters, of "the dynamic characteristics of the market, including growth, innovation and product differentiation".[96] Therefore it can be said that competition law is concerned both with proscribing anti-competitive agreements that reduce innovation, and with ensuring that dynamic competitive forces are taken into account when assessing the true extent of competition in a market.

C4.4 Provides comparative advantage to Australian research

Some submissions argued section 51(3) acted to encourage investment in intellectual property. To the extent that Australia favoured intellectual property investment over other nations, for example through the exemption in section 51(3), this could encourage companies to carry out research and development activities in Australia. Allen Allen and Hemsley considered that, "In terms of attracting emerging industries that rely heavily on IP, the exemption may be an advantage to Australia" (Allen Allen and Hemsley, submission 39, p. 11), and the ACCI considered:

> *the proportion of private sector turn-over dedicated to R&D remains well below the OECD average, despite some improvement over the past decade. Any diminution of the capacity to obtain a return from genuine IP woul worsen Australia's competitive position in this regard. … Any major watering down or repeal of Section 51(3) would put Australian industry at a disadvantage relative to overseas competitors (Australian Chamber of Commerce and Industry, submission 31, p. 7).*

The counterpart of this argument is that removing the exemption in section 51(3) will tend to drive research and licensing of intellectual property offshore. A number of bodies made this contention, for example, ANUTECH, and the Cooperative Research Centre for Diagnostic Technologies (ANUTECH, submission 46, p. 1; CRC for Diagnostic Technologies, submission 80, p. 2).

96 section 50(3)(g)

There are a number of problems with these arguments:

- favourable competition law treatment would only be one of a large number of factors that would influence decisions about where to invest in innovation. At best, it would be a minor factor. Other factors such as, for example, tax treatment of the costs of innovation, and the market conditions facing the firm, would be far more important factors;
- the OECD countries examined in Chapter C3 generally applied competition law more rigorously to conditions in licences and assignments of intellectual property. For example, the US, by far the largest source of innovation, has significantly stricter regulation of innovation. This makes it difficult to argue that the repeal of section 51(3) would place Australian industry at a disadvantage; and
- where licenses are executed in respect of markets in Australia, then notwithstanding where they were executed, Australian competition laws will apply to them. Moreover, where licenses are executed in respect of overseas markets, the competition laws of those countries will apply to them. Therefore, removing the exemption in section 51(3) is unlikely to affect where research and licensing take place.

C4.5 Conclusion

The Council considers that section 51(3) may provide some benefits in terms of greater business certainty. This greater certainty may, in turn, assist parties to reduce their costs of compliance and encourage greater licensing of intellectual property rights.

A comparison of the costs and benefits of section 51(3) in undertaken in Chapters C7 and C8.

C5 Costs of Exemption

This chapter examines the costs imposed on the Australian community by section 51(3). First, it examines the types of market relationships under which conduct exempted under section 51(3) may substantially lessen competition. Then it examines the types of conditions exempted under section 51(3) and their potential to substantially lessen competition.

Some submissions argued there is no evidence that conduct exempted under section 51(3) is damaging the Australian economy, for example the submissions from the Law Council of Australia, ANUTECH, CSIRO, and the Law Institute of Victoria. The submission from CSIRO contended that section 46 applies to much of the conduct that might otherwise have been of concern (CSIRO, submission 47, p. 3).

While the Council agrees that the majority of licensing conditions do not substantially lessen competition, the Council considers that *some* of the conduct exempted under section 51(3) does have the effect of substantially lessening competition. The Council shares the ACCC's concern that this conduct is exempted without any balancing of public benefits against anti-competitive detriment.[97]

The Council considers that two types of conduct exempted under section 51(3) *may in some circumstances* substantially lessen competition:

- horizontal arrangements such as cross-licences or other agreements or understandings between competitors; and
- horizontal and vertical arrangements that have the effect of substantially lessening competition, but where it cannot be established that the conduct has one of the proscribed purposes in section 46 (i.e., to diminish, eliminate, or prevent competition).

The Council also considers that, in particular markets, conduct exempted under section 51(3) may reduce incentives to innovate, leading to less investment in research and development.

97 ACCC, submission 30, p. 2

C5.1 Horizontal Agreements

Typically, licences and assignments of intellectual property rights are vertical in nature, that is, they are between two parties at different functional levels of a market. However, sometimes, licenses and assignments can have a horizontal element, for example, where the licensee and licensor produce competing goods, or where a licensor enters vertical licensing arrangements with a number of licensees on the tacit understanding that the licensees will not compete with each other.

The exemption in section 51(3) does not distinguish between horizontal and vertical agreements. This means that horizontal licensing arrangements such as patent pools, exclusive cross-licenses, or price restraints executed between competitors, are protected in the same way as vertical licensing arrangements.[98]

Licensing conditions may have a horizontal element where the licensor and licensee are direct competitors, or where the licensor and licensee would have been likely to compete except for the licence conditions. In these circumstances, the conditions exempted under section 51(3) may assist parties to reach collusive market-sharing arrangements. For example:

- where direct competitors exclusively cross-licence their intellectual property rights in circumstances where those licensees face few or no substitutes for their products (unless, without the cross-licences, the intellectual property rights would block each other);
- quantity and/or price restrictions in license agreements among competitors may restrict output of particular products and help them to fix prices;
- territorial restrictions in exclusive cross-licences among competitors may help them to allocate territories to each other, and reduce competition within those territories.

Box C2 and C3 provide examples of where exclusive licensing arrangements might substantially lessen competition.

98 Compare Dr Hampton's discussion of the former NZ provisions, which may have been based on the Australian section 51(3): Dr Hampton, submission 18, p. 27, and footnote 58.

Box C2 – Exclusive Cross-Licensing

Scenario: Two of the leading manufacturers of a consumer electronic product hold patents that cover alternative circuit designs for the product. The manufacturers exclusively licence their patents to a separate corporation wholly owned by the two firms. That corporation licences the right to use the circuit designs to other consumer product manufacturers and establishes the license royalties. Neither of the patents is blocking; that is, each of the patents can be used without infringing a patent owned by the other firm. The different circuit designs are substitutable in that each permits the manufacture at comparable cost to consumers of products that consumers consider to be interchangeable.

Discussion: In this example, the manufacturers are competitors in the goods market for the consumer product and in the related technology markets. The competitive issue with regard to a joint exclusive licence of patent rights is whether the exclusive licences have an adverse impact on competition in technology and goods markets that is substantial. To the extent that the patent rights cover technologies that are close substitutes, the joint determination of royalties likely would result in higher royalties and higher priced goods than would result if the owners licensed or used their technologies independently.

Where the effect on competition in the goods market is considered substantial, the exclusive cross-licence to the joint venture is likely to breach section 45. In the absence of evidence establishing efficiency-enhancing integration from the joint exclusive licence of patent rights, or that the patents are blocking, the arrangements are unlikely to be authorised by the ACCC (adapted from Example 9 in Antitrust Guidelines for the Licensing of Intellectual Property 1995, p. 23).

Box C3 – The *du Pont* Case

In the 1950s, du Pont took a patent infringement action against another company in relation to its patent in cellophane. The defendant, as part of the settlement of the action, agreed to limit "its sales of moistureproof cellophane to 20 percent of the combined sales of the two companies". This agreement effectively divided up the market for cellophane and like products between du Pont and the defendant, and substantially lessened competition in that market.[99]

In 1988 New Zealand amended their equivalent of section 51(3) (section 45 of the *Commerce Act*) because it had the effect of exempting horizontal licensing agreements from competition law. The amendment followed a review of section 45 by the Department of Trade and Industry which had found that:

> *Section 45 … is framed in such a way as to confer protection upon both vertical and horizontal agreements. … section 45 potentially protects anti-competitive arrangements made between competitors which of the face of it "relate to" the use, licence, or assignment of any right conferred by virtue of any copyright, patent, protected plant variety, registered design, or trademark, but which when examined closely in fact have anti-competitive effects not required to give effect to the strict exercise of the right conferred (NZ Department of Trade and Industry 1988, p. 41).*

C5.2 Where purpose cannot be established

Where a business with substantial market power engages in conduct has the effect of substantially lessening competition, and it can be proved that the conduct had the purpose of reducing competition in a market, the business is in breach of section 46. However, where the purpose of the conduct cannot be proved, or the purpose of the conduct is to facilitate collusion between

99 *US v du Pont* 351 US 377 (1956) discussed at TPC 1991, p. 25, fn. 81.

competitors (rather than to drive a competitor from the market), then the conduct arguably does not breach section 46. In these circumstances, the conduct may be exempted by section 51(3) from breaching sections 45 or 47.

Tom and Newberg nominate the *Pilkington* case,[100] described in Box C4 as an example of how restrictive licensing conditions may facilitate collusion between competitors. The *du Pont* case, described above, is another example.

Box C4 – The *Pilkington* Case

"In the 1930s Pilkington … developed a process for making sheet glass by floating molten glass on a molten metal bath. It was a revolutionary process, and it eventually became the dominant technology for making sheet glass. Pilkington licensed its technology by giving its licensees exclusive sales territories.

Sixty years later, Pilkington's basic patents had long since expired, but the exclusive territories persisted. Although Pilkington still asserted trade secrets, most of the related know-how had become publicly known, so that Pilkington did not actually possess any intellectual property rights of significant value. The arrangement was partly vertical, … . But in this case, the arrangement was partly horizontal because, [without the territorial restrictions], there would by now likely be competition among some or all of these firms using their own glass technology or technology that was in the public domain. The territorial restrictions in the license significantly inhibited this competition because Pilkington vigorously attempted to enforce them against all of its competitors' glass-making activities."[101]

In this case, Pilkington's enforcement proceedings may have breached section 46. However, it was clear that the vertical territorial restrictions in the licences between Pilkington and its licensees facilitated what in effect was a horizontal collusive arrangements among the licensees not to compete with each other across the borders of their respective territories

100 *United States v Pilkington plc* Civ. No. 94-345 (D. Ariz., filed May 25, 1994).

101 Tom and Newberg 1997, pp. 205 – 206.

On the other hand, a strictly vertical arrangement, where restrictive conditions were inserted to protect the interests of the licensor, would generally not breach Part IV. See Box C5.

Box C5 - NewCo

Scenario: NewCo, the inventor and manufacturer of a new flat panel display technology, lacking the capability to bring a flat panel display product to market, grants BigCo an exclusive licence to sell a product embodying NewCo's technology. BigCo does not currently sell, and is not developing (or likely to develop), a product that would compete with the product embodying the new technology and does not control rights to another display technology. Several firms offer competing displays, BigCo accounts for only a small proportion of the outlets for distribution of display products, and entry into the manufacture and distribution of display products is relatively easy. Demand for the new technology is uncertain and successful market penetration will require considerable promotional effort. The licence contains an exclusive dealing restriction preventing BigCo from selling products that compete with the product embodying the licensed technology.

Discussion: This example illustrates both types of exclusivity in a licensing arrangement. The licence is exclusive in that it restricts the right of the licensor to grant other licenses. In addition, the licence has an exclusive dealing component in that it restricts the licensee from selling competing products.

NewCo and BigCo are in a vertical relationship since they are not actual or likely potential competitors in the manufacture or sale of display products or in the sale or development of technology. Hence, the grant of the exclusive licence does not affect competition between the licensor and licensee. The exclusive licence may promote competition by encouraging BigCo to develop and promote the new product by rewarding BigCo if its efforts lead to large sales. Although the licence bars the licensee from selling competing products, this exclusive dealing aspect is unlikely in this example to harm competition by anticompetitively foreclosing access, raising competitors' costs of inputs, or facilitating anticompetitive pricing because the relevant market is not concentrated, the exclusive dealing restraint affects only a small proportion of the outlets for distribution of display products, and entry is easy (adapted from Example 8, Antitrust Guidelines for the Licensing of Intellectual Property 1995, pp. 19 – 20).

C5.3 Reduced Incentives to Innovate

Competition law is sometimes considered to be concerned with price competition, while intellectual property law is thought to increase competition through innovation. However, as discussed in Chapter C2, this view overlooks the role competition plays in encouraging greater innovation.

Competition can spur innovation and invention by providing incentives to undertake research and development (Hilmer 1993, p. 4). Under conditions of competition, firms will seek ways to improve their product to gain an edge over rivals. If particular licensing and assignment practices are exempted from competition, the anti-competitive licensing and assignment practices protected by them can reduce the competitive pressure on licensors and licensees to innovate.[102]

If a licence is granted on restrictive conditions, the licensee will have less incentive to innovate because the potential value of an improvement will be limited by the restrictions. For example, the value of an improvement will be reduced if restrictive conditions limit the territory in which the improvement can be marketed, or restrict output. If the improved product can be considered a competitor of the licensed product, then by promoting it the licensee may risk breaching its obligations under a best endeavours clause to use its best endeavours to promote the licensed product.

Tom and Newberg consider that competition can increase the pressure to innovate and bring new products on to the market.[103] They point to the US telephony market, where fibre optic cables were only introduced after the market was opened up to competition (Tom and Newberg 1997, pp. 201-202). Moreover, at the Federal Trade Commission's 1995 Global Competition Hearings:

> *A 3M representative noted that market pressures had led 3M to increase its target rate of innovation, and Hewlett-Packard's CEO observed that competition forces Hewlett-Packard to invest*

102 In Re Queensland Co-Op Milling Association Ltd and Defiance Holdings Ltd (1976) ATPR ¶ 40-012 at p. 17,246, the Trade Practices Tribunal (as it then was) stated that: "Competition is a dynamic process; but that process is generated by market pressure from alternative sources of supply and the desire to keep ahead".

103 Compare Dunford 1986, pp. 127 – 129; and Bureau of Industry Economics 1994, p. 7 and p. 45.

continuously in technology. Similarly, an Eastman Kodak representative noted that competition led Kodak to spend $3 billion over the past fifteen years on research and development directed toward electronic imaging. Other witnesses suggested a similar relationship between competition and innovation in automobiles, steel, financial services, and grocery products (Tom and Newberg 1997, p. 203, footnotes omitted).

They conclude:

to the extent that potential rival innovators can be prevented from becoming effective competitors, a dominant firm may feel less competitive pressure to innovate, whereas in the absence of such exclusion, the dominant firm may be forced to innovate simply to maintain its position. … giving freer rein to anticompetitive conduct would dampen innovation (Tom and Newberg 1997, pp. 199 - 200).

Box C6 provides an example of where conduct that is likely to be exempted under section 51(3) reduces incentives to innovate and substantially lessens competition:

Box C6 – Alpha and Beta

Siuation: Firms Alpha and Beta independently develop different patented process technologies to manufacture the same off-patent drug for the treatment of a particular disease. Before the firms use their technologies internally or license them to third parties, they announce plans jointly to manufacture the drug, and to exclusively licence their manufacturing processes to the new manufacturing venture. The two processes developed by Alpha and Beta enable manufacture of the drug far more cheaply than any existing method of manufacture. There are no other processes for manufacture close to development which come near in terms of efficiency to the methods developed by Alpha and Beta.

Discussion: The competitive effects of the proposed joint venture would be analysed by first defining the relevant markets in which competition may be affected and then evaluating the likely competitive effects of the joint venture in the identified markets. In this example, the structural effect of the joint venture in the relevant goods market for the manufacture and distribution of the

Box C6 cont...

drug is unlikely to be significant, because many firms (in addition to the joint venture) compete in that market. The joint venture might, however, increase the prices of the drug producing using Alpha or Beta's technology by reducing competition in the relevant market for technology to manufacture the drug. Just as importantly, the cross-licences may reduce competitive pressure on Alphas and Beta to further improve their process technologies (adapted from Example 2 in Antitrust Guidelines for the Licensing of Intellectual Property 1995, p. 9).

The Council considers that in some cases restrictive conditions in licences and assignments of intellectual property can reduce the competitive pressures on licensors to innovate. Restrictive conditions can also reduce licensees' incentives to innovate by reducing the rewards available from successful innovation.

C5.4 Types of Restrictive Conditions within Section 51(3)

In 1991, the TPC issued a background paper which considered that five types of restrictive conditions fall within the exemption in section 51(3):[104]

- exclusive licence grants (where the licensor agrees to grant a sole licence to the licensee over the whole of the intellectual property or within a particular territory, to the exclusion of any other licensee or the licensor);
- territorial restrictions (where the licensor restricts the licensee to selling goods produced under licence within a particular territory);

104 See TPC 1991, pp. 21 – 30. The paper came to different conclusions in respect of trade marks because of the more limited exemption in relation to certification and other trade marks contained in 51(3)(b) and (c). In assessing whether the clauses came within section 51(3), the paper mainly concentrated on whether the clauses 'related to' the intellectual property or the goods produced using it, and whether their use would fall outside sections 46 or 48.

- best endeavours clauses (where the licensor requires the licensee to use its best endeavours to promote the licensed product, sometimes to the exclusion of competing products); and
- price restrictions (where the licensee is required to charge a particular price for the goods produced under license); and
- quantity restrictions (where the licensor restricts the number of goods that the licensee may produce under licence).

Submissions generally accepted the views expressed in this paper (for example, LESANZ, submission 19, pp. 20 - 28, ACCC, submission 30, p. 5, Allen Allen and Hemsley, submission 39, pp. 13 - 14).

Other types of restrictive conditions are not likely to fall within section 51(3) because, either they do not breach any of the provisions of Part IV (for example, provisions specifying minimum quality standards), or they do not relate to the intellectual property or products produced using it (for example, provisions requiring the licensee to grant back to the licensor on exclusive terms any improvement in the licensed product).

Exclusive Licence Grants and Territorial Restraints

Exclusive licence grants may potentially lessen competition by reducing competitive pressure on the licensee to increase output or lower the price of the licensed product to match competitors' prices. This will generally only occur where the licensed product has few or no substitutes. Where a large number of goods compete with the licensed product, the licensee will not be able to reduce output or raise prices, and in these cases an exclusive licence is unlikely to lessen competition.

Territorial restrictions may reduce the competitive pressure a licensee can exert outside its sales territory. The result might be that the licensor or its other licensees may earn higher profits on reduced output in those areas. If the territorial restriction is combined with exclusive rights within the territory, it can protect the licensee from competition to the detriment of consumers within the territory.

On the other hand, exclusive licences and territorial restrictions can be pro-competitive.[105] For example, in the words of Toyota, exclusive licensing may

105 Compare Department of Justice and Federal Trade Commission (US) 1995a, p. 5, and Technology Transfer Block Exemption 1996, recital (10).

provide "an incentive for the licensee to undertake significant capital expenditure and incur commercial risks in the use and exploitation of the licensed rights, particularly if the licensed product or process licensed is new" (Toyota, submission 10, p. 5).

A large number of submissions to the Council, particularly from the University research and commercialisation sector, emphasised that in many circumstances investors were only prepared to fund applied research or marketing of patents where they could be guaranteed an exclusive licence (for example, Mendes, submission 55). Investors required an exclusive licence to justify the high risks involved in supporting the launch of new technology.

The European Union's technology transfer block exemption in respect of patent licences (Technology Transfer Block Exemption 1996) recognises the pro-competitive effects of territorial restrictions and exclusive licences by granting them a block exemption in limited circumstances. However, the technology transfer block exemption may not apply, for example, where the licensee's market share exceeds 40 percent of the relevant market in which the licensed product competes.

The Council considers that territorial restrictions and exclusive licences often have pro-competitive effects that offset anti-competitive effects. However, exclusive licences and territorial restrictions may be of some concern where the licensee thereby acquires strong power in a market.

Best Endeavours Clauses

Best endeavours clauses may give the licensor confidence that the licensee will invest adequate resources in promoting the licensed product, and thereby expand the market for it to the benefit of the licensor and other licensees.

On the other hand, best endeavours clauses may effectively prevent the licensee selling competing products, potentially making it difficult for competing products to find distributors in markets where there are few distributors.

The Council considers that best endeavours clauses are unlikely to be anti-competitive unless the product has significant market power and there are only a limited number of distributors in the market.[106]

Price Restrictions and Quantity Restrictions

Price restrictions prevent licensees from reducing their prices to gain market share from the licensor or other licensees. Price restrictions may be imposed by licensors to "ensure that the licensor's profit is not undermined by having to compete with its licensee who sells the licensed product at a lower price" (TPC 1991, p. 24). The effect of price restrictions is likely to be that consumers pay higher prices.[107]

Quantity restrictions can have a similar effect. By limiting supply, quantity restrictions can artificially raise prices, and therefore raise prices. Additionally, quantity restrictions may oblige the licensee to maintain higher prices because the licensee is unable to obtain "efficiencies in production and distribution".[108] These higher prices can protect the price charged by the licensor from competition.

The Council can see few justifications for price and quantity restrictions. The United States generally bans price and quantity restrictions per se, while the European Union has withdrawn the benefit of the technology transfer block exemption where licences contain price or quantity restrictions.[109]

Overall, the Council considers that price and quantity restrictions, particularly in cross-licences, have a high potential to be anti-competitive.

106 Compare TPC 1991, p. 28, and the judgment of Wilson J in *Transfield v Arlo* at p. 42,313.

107 TPC 1991, p. 25.

108 TPC 1991, p. 25.

109 Articles 3 (1) and 3 (5). Quantity restrictions may be allowed in very limited circumstances: see Articles 1 (8) and 2 (1) (13).

C5.5 Conclusion

The Council considers that the exemption in section 51(3) carries costs in terms of its potential to permit conduct that substantially lessens competition. Almost all of this anti-competitive conduct consists of:

- horizontal arrangements (e.g. *du Pont*); or
- vertical arrangements that facilitate tacit horizontal agreements (e.g. *Pilkington*).

Exclusive licences, territorial restrictions, best endeavours clauses, price restrictions and quantity restrictions may in some circumstances facilitate anti-competitive conduct. The Council recognises that exclusive licences, territorial restrictions, and best endeavours clauses more commonly have pro-competitive benefits. However, price restrictions and quantity restrictions are unlikely to have pro-competitive benefits.

C6 Does section 51(3) achieve its objectives?

In Chapter C2, the Council stated that possible objectives of section 51(3) are to achieve greater certainty and save trade practices compliance costs for licensors and licensees of intellectual property rights.

The Council has examined three aspects of section 51(3) to determine whether it is meeting these objectives:

- the scope of section 51(3);
- its practical effect on conduct in the domestic marketplace; and
- its effect on overseas markets.

C6.1 Scope of section 51(3)

Chapter C3 discussed the scope of section 51(3) and the types of restrictive conditions that might be exempted under it. The discussion relied on a 1991 paper issued by the TPC (as it then was), and on the sole reported decision on the interpretation of section 51(3), *Transfield v Arlo*.

A number of submissions to the Council argued that section 51(3) was too unclear for licensors and licensees of intellectual property rights to rely on it. They cite the ambiguity of the words 'relates to' in determining what types of conditions might be exempted under section 51(3). For example, Stephen Stern argued that section 51(3) was "particularly unclear" (Stern, submission 69, pp. 1-2) while the ACCC considered that:

> *Even where parties may consider their conduct to be protected by s.51(3), its interpretation by the Courts is uncertain and they are exposed to both Commission enforcement and private action. In these circumstances, many parties already apply for authorisation or notify conduct to safeguard themselves against others interpretation of s.51(3). For example, APRA's application for authorisation was prompted by a FACTS private action (ACCC, submission 58, p. 4).*

However, other submitters argued that the operation of section 51(3) was sufficiently clear to rely on, and in particular covered common conditions in licences of intellectual property, such as exclusive licence conditions and territorial restrictions (for example, Australian Copyright Council, submission 23, p. 10).

The Council considers that the interpretation of the "relates to" provision in section 51(3) is open to some doubt. The Council would expect that parties in major deals, where considerable sums of money are invested would be likely to take measures to alleviate this uncertainty by seeking authorisation under Part VII of the Trade Practices Act. In less major deals, the Council expects parties might take the risk that their interpretation of section 51(3) would be accepted, might limit themselves to the types of conditions identified in the 1991 TPC paper as likely to be exempt under section 51(3), namely, exclusive licences, territorial restrictions, best endeavours clauses, price restrictions, and quantity restrictions.

Overall, the Council considers that, while there is some doubt about the operation of section 51(3), (due to the different views about the interpretation of the words ‘relates to’) section 51(3) does have some effective operation in terms of giving parties a degree of certainty that conditions such as exclusive licence conditions and territorial restrictions are exempted.

C6.2 Practical Effect in Domestic Marketplace

Submissions from the ACCC, Michael Gray, and Stephen Stern considered that section 51(3) has little practical effect. For example, Stephen Stern, commenting on his experience as a practitioner specialising in intellectual property law, argued:

> *… the application of section 51(3) has been purely theoretical and has not been of any practical impact on any of the wide ranging matters in which I have been involved.*
>
> *… at no stage [in almost 20 years of practice in the Intellectual Property area] have the exemptions contained in section 51(3) been relevant to any of those [Intellectual Property] licences (Stern, submission 69, p. 1).*

The reasons cited for the limited practical effect of section 51(3) are:

- it is narrow in scope; and
- most forms of intellectual property rights, in particular copyrights, design rights, trade mark rights, and EL rights rarely give rise to sufficient market power to raise anti-competitive concerns.

The scope of the exemption in section 51 (3) is narrowed by the fact that it does not exempt conduct that breaches section 46 of the Trade Practices Act. This is because in many cases where conduct breaches section 45, 47, or 50, it also breaches section 46. However, the Council accepts that there is a significant amount of conduct that may breach section 45 or 47 without breaching section 46.

Section 46 has two elements which are not shared by sections 45 and 47:

- the party engaging in the conduct must have a substantial degree of power in a market; and
- conduct must have the *purpose* of preventing, eliminating, deterring, or substantially damaging competition in a market.

As the 1991 TPC paper observes, licensors in general insist on conditions such as best endeavours clauses or territorial restrictions to protect their interests in the exploitation of the intellectual property rights rather than to eliminate competition in a market.[110] For this reason, their conduct is unlikely to be held to have the purpose of preventing, eliminating, or deterring competition as required for a breach of section 46 even where it has the effect of substantially lessening competition. Moreover, where the licensor does not have a substantial degree of power in a market, then it will not breach sections 46, even though it may have sufficient power in a market in order to substantially lessen competition in that market. For these reasons, the Council considers that while the exemption does not cover conduct that breaches section 46, it still has some effective operation.

It has also been argued that intellectual property rights rarely give rise to sufficient market power that they could be exercised in such a way as to substantially lessen competition.

110 For example, see TPC 1991, pp. 22, 23, and 28.

The Patents Act grants the broadest protection of the intellectual property statutes. The Patents Act protects not only the form in which ideas are expressed but also the underlying ideas. For example, a patent over a machine to manufacture a product would 'protect' the machine, the product, and the innovative ideas embodied in the machine. This broad protection permits patent owners to exercise market power in some cases.

By contrast, the Copyright Act only protects the form in which ideas are expressed, rather than the ideas themselves. For example, in a detective novel, copyright law protects the words of the novel, but not the plot ideas. Due to the more limited protection afforded under copyright law, it is more difficult for a copyright holder to exercise market power in respect of individual copyrighted articles – without protection of the ideas behind the form of expression, it is generally possible for competitors to produce similar works. A copyright owner will most likely to hold market power where:

- there is no substitute for the information contained in the work (for example, a telephone directory, computer software program, or meteorological information);[111] or
- the owner controls a substantial library of copyright articles in the same market (for example, a collecting society that has licence over a wide range of contemporary music).

The *Designs Act 1906* protects only the appearance of made objects; it does not protect their principles of construction or prevent others from making products that serve functionally equivalent purposes. For example, a firm may protect the design of a teapot, but competitors are free to manufacture other teapot designs. Therefore, it is less likely that a firm could acquire substantial market power from the ownership of a design.

Trade mark protection relates to the fixing of marks to products. The exemption under section 51(3) only extends to the "kinds, qualities, and standards" of goods that may be produced using the trade mark. It is difficult to see how a condition of this kind could be anti-competitive. Consequently, repeal of section 51(3) would be unlikely to have any real impact on trade mark licensing or assignment.

111 Telstra recently gave the ACCC an undertaking to license the use of its telephone directory on reasonable terms to enable competition in the market for the publication of directories (ACCC 1997, "Telephone Directory data now accessible by all", press release at http://www.accc.gov.au/). In another case, the Bureau of Meteorology settled a case brought by the ACCC by agreeing to supply meteorological information to competitors to assist them to compete in the market for the supply of such information to the public (ACCC 1997, "Weather court case settled", press release at http://www.accc.gov.au/).

EL rights under the Circuit Layouts Act comprise the right to make an integrated circuit in accordance with the layout (i.e. a three-dimensional copy of the layout) and to exploit the layout commercially in Australia, as well as the right to copy the layout, directly or indirectly, in a material form. These rights are unlikely to confer market power where there are a number of competing circuit layouts.

Overall, the Council considers that patent owners, and to a lesser extent, copyright owners, may have sufficient market power that section 51(3) has some, but limited, practical effect in relation to their activity. However, the exemption has little practical effect in relation to designs, trade marks, and EL rights because these intellectual property rights rarely, if ever, give rise to sufficient market power that parties could engage in activity that substantially lessens competition.

C6.3 Effect in Overseas Markets

The Council has considered the relevance of the exemption in section 51(3) in the context of the trend to the worldwide exploitation of intellectual property.

Much intellectual property tends to be exploited worldwide through licensing and other deals. Where intellectual property licences contain restrictive conditions exempted under section 51(3) but not exempted under foreign competition laws, the overseas exploitation of these licences will not be protected by section 51(3). To the extent that Australian developed intellectual property is licensed in the EU, the United States, or in New Zealand, the exploitation of that intellectual property will need to take account of the competition laws applying in those places.

The regimes currently applying in the US and Europe are significantly different from the position in Australia under the present form of section 51(3). The US and EU regimes give their competition authorities greater freedom to examine intellectual property licensing practices than Australia. As discussed above, in the US, all licensing practices are open to examination by the antitrust authorities to assess whether they are anti-competitive. In Europe, practices are exempt from competition law review unless they fall within a block exemption that is different in nature and considerably narrower than section 51(3).

As discussed in Chapter C6, section 51(3) exempts licensing conditions only in respect of licenses confined solely to the Australian market. For this reason the exemption in section 51(3) is of little use when licensors intend to licence intellectual property worldwide.

For example, where two multinational competitors execute worldwide cross-licences, those cross-licences must be assessed under the competition laws in each country in which the licences are being exploited. Even if the cross-licences are executed in Australia, they will not be protected under the laws applying in the United States.

Given the small size of the Australian market, increasing international licensing of intellectual property rights trade in intellectual property rights, and increasing trade in goods and services produced using intellectual property rights, the Council expects the domestic reach of section 51(3) will reduce its relevance over time.

C6.4 Conclusion

The Council considers section 51(3) partly achieves its objectives. In particular, section 51(3) provides some certainty in relation to the use of exclusive licences, territorial restrictions, best endeavours clauses, price restrictions, and quantity restrictions in patents and copyright licences.

C7 Impact of repealing section 51(3) and international considerations

In this chapter, the Council examines the practical implications of repealing section 51(3), concerns raised by parties, and whether Australia's international treaty obligations constrain its ability to apply competition law to intellectual property licensing and assignment activity.

C7.1 Impact of repealing section 51(3)

Repealing section 51(3) would open restrictive conditions exempted under section 51(3) to the operation of Part IV of the TPA. On the most likely interpretation of section 51(3), these restrictive conditions would be exclusive licences, territorial restrictions, best endeavours clauses, price restrictions, and quantity restrictions.

In most cases, the repeal of section 51(3) would not affect the use of these restrictive conditions in licences and assignments of intellectual property. This is because it would be relatively rare for these conditions to have the effect of substantially lessening competition or breach the per se provisions of Part IV.

As discussed in Part A and Chapter C3, the TPA consists of:

- offences that require proof that conduct has substantially lessened competition; and
- per se offences, where it is not necessary that conduct has substantially lessened competition.

In relation to the offences that require proof of a substantial lessening of competition, it is clear that in most cases, intellectual property licensors or licensees do not possess sufficient market power that their conduct could substantially lessen competition. Even in cases where there is sufficient market power attached to the exercise of the intellectual property rights to substantially lessen competition, often the restrictive conditions would not of themselves substantially lessen competition.

The per se provisions of sections 45 and 47 cover exclusionary agreements, price-fixing agreements, and third line forcing.

Licensing and assignment conditions are unlikely to infringe the provisions against exclusionary agreements or price-fixing agreements, because, while most licensing and assignment agreements are vertical in nature, exclusionary agreements and price-fixing agreements relate to horizontal arrangements. In some cases, licensing and assignment agreements may have an horizontal element, for example in the context of a cross-license of intellectual property, or where competitors selling goods or services protected by intellectual property rights reach some tacit understanding about how they will market their competing goods or services (see Box C4 discussed in Chapter C3). However, where licensing and assignments *are* part of horizontal arrangements between competitors, then Chapter C5 identified that there was significant likelihood that the conduct was anti-competitive.

CSIRO expressed concern that the activities of Cooperative Research Centres (CRCs) might be exposed to the exclusionary provisions in section 45 if section 51(3) were repealed. CRCs are typically joint ventures between different research bodies that investigate particular technologies. CSIRO was concerned at the prospect that CRC agreements might be construed as exclusionary agreements, and banned per se if section 51(3) were removed (CSIRO, submission 47, p. 4). However, section 51(3) does not exempt joint research agreements, but only licensing and assignment conditions that relate to intellectual property, so its repeal would have no effect on cooperative research agreements.

The issue of third line forcing arises in relation to licence or assignment conditions that require the licensee to buy particular goods or services to be used in the manufacture of goods produced under patent or trade mark. For example, a trade mark owner may license the trade mark on condition that the licensee buys certain goods from a specified third party to ensure that the quality of the goods manufactured under trade mark reach a particular quality standard.

Businesses have only limited ability to include third line forcing provisions in patent licences because most such provisions infringe section 144 of the Patents Act (section 51(3) does not provide an exemption from section 144).

Moreover, as Michael Gray notes, firms that wish to engage in third line forcing can seek to protect themselves by notifying the ACCC of the provision, whereupon the notified behaviour will be protected from breaching Part IV unless and until the ACCC revokes the notification.[112] Before it can revoke notification, the ACCC must follow procedures that protect the interests of notifying parties.[113] Therefore, repeal of section 51(3) would have a minimal impact on the ability of firms to rely on third line forcing provisions in intellectual property licences and assignments.

Moreover, where trade mark and patent licensors consider that requiring licensees to buy from third parties would breach the third line forcing provisions in section 47, they may redraft the contract to specify the particular quality standard of the goods to be used in the manufacture of the licensed goods and services. Specifying quality standards would not breach section 47 or Part IV generally.

Role of Authorisation

If section 51(3) were to be repealed, then conduct that breached Part IV would need to be authorised (or notified) if the parties wished to engage in it.

Conduct that breaches Part IV may be authorised (or in some cases notified) where the public benefits of that conduct outweigh the anti-competitive costs.[114]

Submissions to the Council expressed concern that the authorisation process could be expensive and time-consuming.[115] For example, the Australian Copyright Council argued:

> *The authorisation process and to a lesser extent the notification process is expensive. Filing fees, particularly for authorisation, are high. The costs of preparing applications is far, far higher (often running into the order of $50,000-$100,000). This is an*

112 Mr Gray, submission 11, p. 2.

113 See sections 93 and 95, TPA.

114 See Part VII of the TPA. The authorisation and notification processes are described in greater detail in Appendix Four.

115 For example, see ANSTO, submission 5, p. 1; Australian Copyright Council, submission 23, p. 10; Toyota, submission 10, p. 9.

> *unwarranted burden on business in the absence of properly assessed anti-competitive effects (Australian Copyright Council, submission 23, p. 9).*

The Cooperative Research Centre for Black Coal Utilisation submitted that it was more difficult to estimate the benefits of authorisation of intellectual property licences compared to other forms of property dealings:

> *Technology licensing is a very different activity from other forms of trade agreement, where the costs of certification can be readily evaluated against the relatively certain benefits from a successful outcome (Cooperative Research Centre for Black Coal Utilisation, submission 92, p. 1).*

While the Council accepts that it may be difficult to predict the profitability of commercialisation of intellectual property, similar levels of unpredictability apply in many other areas of business activity.

The presence of section 51(3) will not always avoid the need for authorisation of conduct. In some cases parties will need to seek authorisation of their conduct despite the existence of the exemption in section 51(3). In particular, authorisation may need to be sought where conduct breaches section 46[116] or 48.

For example, collecting agencies, such as the Phonographic Performance Company of Australia (PPCA), have sought authorisation in relation to their copyright collection schemes on behalf of composers and music publishers because they are unclear about whether their conduct was exempted under section 51(3) or whether it breached section 46.[117]

The Council is recommending (in Chapter C8) that the ACCC issue guidelines on the circumstances where authorisation or notification of conduct may be required. These guidelines should assist parties to make judgments about the need to seek authorisation or provide notification, and thus reduce the costs of complying with the TPA.

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116 The authorisation provisions do not provide for authorisation of conduct that breaches section 46. However, where conduct is authorised in respect of possible breaches of sections 45, 47, or 50 (although not section 48), then it is protected from an action brought under section 46: see section 46(6).

117 For the text of the authorisation of the collecting scheme administered by the PPCA, see *EMI Records (Australia) Limited* (1985) ATPR (Com) 50-096. Compare *Phonographic Performance Company of Australia Ltd.*, (1990) ATPR (com) 54,335. These cases are discussed in Appendix Four, and by Puri 1992, pp. 110 – 112, and Puri 1991, p. 417 – 418.

The Council notes that authorisation decisions of the ACCC are subject to rehearing by the Australian Competition Tribunal (and by the courts on questions of law). This provides intellectual property licensors and licensees with an avenue of appeal where conduct is not authorised by the ACCC.

Concerns raised in Submissions

Submissions raised a number of areas of concern about how Part IV might apply to intellectual property licensing if section 51(3) were repealed:

- where goods produced under intellectual property rights have no close substitutes, and have strong market power;
- the view that it would often be necessary to seek authorisation in respect of exclusive licences, territorial restrictions, and best endeavours clauses; and
- the flowback effect on innovation and research agreements.

First, some submitters, most notably the Cooperative Research Centres (CRCs), were concerned about the application of Part IV to technologies with strong market power. Philip Mendes argued that the research conducted by the University CRCs "concern innovative technologies aimed at introducing new products, in relation to which there will not be any competing products" (Mendes, submission 55, p. 3; also Australian Vice-Chancellors' Committee, submission 50, p. 2). These products, when introduced onto the market, could be expected to face few substitutes, and acquire a strong position in their relevant markets.

Second, submissions were also concerned that if section 51(3) were repealed, parties wishing to use particular types of restrictive conditions, especially exclusive licences, would always or nearly always need to seek authorisation.

The argument was put succinctly by the Cooperative Research Centre for Diagnostic Technologies:

> *In the diagnostics arena, the R&D to translate a patent concept into a single product, involves a very high degree of risk and can often cost more than a million dollars. Depending on the type of product, clinical trials, regulatory approvals and product promotional material can easily add a further million dollars or more. In the therapeutic arena, to get a single product to market*

> *will cost in excess of one hundred million dollars. Such an expense is completely outside the funding ability of the CDT or any other research institution in the greater majority of cases and must be [borne] by the commercialising entity.*
>
> *In accepting such risk and expense, the commercialising entity would necessarily demand an exclusive licence to the IP and if the exemption in Section 51(3) was repealed, their due diligence process would also demand absolute certainty that such an exclusive licence would not breach the TPA. We believe that the CDT would have to obtain a ruling in each case and bear the cost and that this additional expense would severely limit our ability to protect our IP (Cooperative Research Centre for Diagnostic Technologies, submission 80, pp. 1 – 2).*

In essence, the argument is that parties would almost always need to authorise licensing agreements in order to provide the degree of certainty demanded by investors that exclusive licence conditions were not in breach of the TPA.

The Australian Copyright Council argued authorisations can be costly, ranging between $50,000 and $100,000. Other costs would need to be taken into account, for example, the administrative costs borne by the ACCC in considering applications for authorisation, and the delay experienced by the parties (Australian Copyright Council, submission 23, p. 10).

Third, submissions were concerned that repealing section 51(3) could reduce innovation:

- by raising the costs of commercialisation and therefore making research and development less attractive (for example, Law Council of Australia, submission 83, p. 3; Mr De Boos, submission 95, p. 1); and
- by requiring parties to incur significant trade practices compliance costs at an early stage of their research before it was not clear whether the research would led to a product with strong market power (Mendes, submission 55, p. 5).

CRCs sometimes agree to provide, in exchange for research funding, exclusive licences to the investors over any patents that may be developed as a consequence of the research. The concern is that, in the absence of the exemption in section 51(3), these exclusive licence agreements might breach Part IV. Moreover, where the agreement is entered prior to the discovery of a patentable invention, it is almost impossible for the parties to gauge whether at some future time the licence will substantially lessen competition. As the WA Department of Commerce and Trade argued:

> *IP license agreements are often negotiated before a product's development is complete and before any substantial market research or testing has been possible. Knowing the market and the potential impact on that market of a new product at the time a licence agreement is negotiated will often be problematic if not impossible and much more difficult than when dealing with physical assets or the provision of services (WA Department of Commerce and Trade, submission 106, p. 3).*

C7.2 Australia's International Treaty Obligations

The Council has reviewed the Trade Related Aspects of Intellectual Property Rights (TRIPS) Agreement, and other intellectual property treaties signed by Australia, to assess whether Australia has assumed any obligations under these treaties that affect its ability to apply competition law to intellectual property.

Australia signed the TRIPS Agreement in 1994 as part of the Uruguay Round of the General Agreement on Tariffs and Trade.[118] The TRIPS Agreement provides for the international recognition of intellectual property rights. The TRIPS agreement contains provisions to internationally recognise and harmonise the treatment of intellectual property. The TRIPS agreement incorporates the definitions of intellectual property set out in earlier Intellectual Property Conventions (such as the Berne and Paris Conventions), and supplements these in areas where the earlier conventions were silent or too weak.

Australia met its obligations under the TRIPS Agreement by amending domestic intellectual property statutes to incorporate the principles of the TRIPS Agreement where they were not already part of Australian domestic law.

118 For the text of the agreement see the World Trade Organisation homepage at http://www.wto.org/.

The TRIPS Agreement contains two specific provisions dealing with the interface between competition law and intellectual property regulation, Articles 31 and 40. Article 31 confers a limited right on government to require the compulsory licensing of patents, and is not relevant to the Council's considerations.

Articles 40 (1) and (2) provide:

> 1. *Members agree that some licensing practices or conditions pertaining to intellectual property rights which restrain competition may have adverse effects on trade and may impede the transfer and dissemination of technology.*
>
> 2. *Nothing in this Agreement shall prevent Members from specifying in their legislation licensing practices or conditions that may in particular cases constitute an abuse of intellectual property rights having an adverse effect on competition in the relevant market. As provided above, a Member may adopt, consistently with the other provisions of this Agreement, appropriate measures to prevent or control such practices, which may include for example, exclusive grantback conditions, conditions preventing challenges to validity and coercive package licensing, in the light of relevant laws and regulations of that Member. ….*[119]

The Australian Copyright Council contended that Article 40 imposes restrictions on Australia's freedom to amend or repeal section 51(3):

> *[Article 40 of TRIPS] permits competition law to override intellectual property rights only in particular cases where the practice or condition constitutes an abuse of intellectual property rights and has an adverse effect on competition in a relevant market. … This provision clearly recognises, therefore, the primacy of intellectual property rights generally.*
>
> *A requirement that the validity of licences be subject to an authorisation or notification process, however, [which would apply if section 51(3) were repealed] would not appear to be consistent with the TRIPS Agreement as the prohibition would operate generally (subject to the possibility of authorisation or notification), not in particular cases (Australian Copyright Council, submission 23, p. 7).*

119 For a brief history of the drafting of Article 40, see Blakeney 1996, para 11.01.

This view was supported by the submission from the Law Institute of Victoria.

However, the submission from IP - Australia took the view that nothing in the TRIPS Agreement constrains Australia's ability to apply competition law to intellectual property:

> *It is up to each country to decide what are 'appropriate measures' for controlling anti-competitive IP licensing practices, subject to appeals from other TRIPS signatories. Because TRIPS is not directive on this matter, both retaining and repeal of s.51(3) exemptions seem consistent with art. 40 of TRIPS (IP – Australia, submission 20, p. 12).*

The Law Council of Australia also took this view:

> *art 40 … expressly acknowledges the right of member countries to regulate such practices … [and] does not appear in any way to require specific exemptions of the kind provided in Section 51(3) (Law Council of Australia, submission 33, p. 10).*[120]

In support of these views, the Attorney-General's Department stated:

> *The Branch agrees with the NCC, and with the submissions of IP Australia and the Law Council of Australia, that Australia is not constrained in how it might apply competition law to copyright and EL rights, if not other intellectual property rights, by virtue of being a signatory to a number of intellectual property treaties, including the Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement (Attorney-General's Department, submission 67, p. 6).*

The Council considers the repeal of section 51(3) would not impose a general requirement on intellectual property licensors and licensees to seek authorisation of licences. Licence conditions would only require authorisation where they breached Part IV.

The Council also considered Australia's obligations under earlier intellectual property treaties.

120 Markus 1997, p. 14, considered, "Article 40 of TRIPS provides wide latitude for competition policies".

Discussing these treaties, the Law Council of Australia considered that:

> *In general, it cannot be said that these exemptions [in section 51(3)] are necessary for the purposes of compliance with Australia's international obligations. … there is nothing in the Berne Convention to prevent the application of other measures, such [as] those under Part IV of the Trade Practices Act 1974, and it is to be assumed that the same is true of the other principal intellectual property conventions such as the Paris Convention …*
>
> *… these conventions do not mandate the exemptions in Section 51(3), which could therefore be removed without breaching Australia's obligations under them (Law Council of Australia, submission 33, p. 9).*

This view was supported by the Attorney-General's Department:

> *… it is internationally understood that there is nothing in the Berne Convention to prevent member countries from taking all necessary measures to restrict possible abuses of monopoly provided this is the genuine purpose behind the measure and not a pretext for abridging rights which countries are obliged to protect under the Convention. … (Attorney-General's Department, submission 67, p. 6).*

The Council concludes that Australia's treaty obligations do not constrain how it might choose to apply competition law to intellectual property rights.

C7.3 Weighing Up Costs and Benefits of Section 51(3)

The Council accepts the concerns raised by parties about the need for certainty, and the considerably higher Trade Practices compliance costs that could flow if parties could not be reasonably sure about whether their licensing conditions breached provisions in Part IV.

On the other hand, the Council is concerned about the costs of the exemption, particularly where parties are engaged in horizontal arrangements, or in the case of price and quantity restrictions. Price and quantity restrictions, unlike exclusive licences, territorial restrictions, and best endeavours clauses would rarely, if ever, be justified as commercially necessary to protect the interests of licensors or licensees. [121]

In the next Chapter, the Council explores options to retain the benefits provided by the exemption in section 51(3) while minimising the costs of anti-competitive conduct exempted by section 51(3).

121 Compare McGonigal 1981, and Mr van Melle, submission 36, p. 5.

C8 Options and Recommendations

This chapter examines options for retaining the benefits of section 51(3) while minimising possible anti-competitive costs.

The Council has considered a number of possible options:

- retaining section 51(3) as is;
- expanding section 51(3) to make it more certain and effective;
- replacing section 51(3) with a 'bright-line' exemption that exempts conduct considered to be within the scope of the rights granted under intellectual property law;
- reducing the scope of section 51(3) to remove from the exemption conduct considered most likely to be anti-competitive;
- repealing section 51(3) and replacing it with a notification system, under which parties notify the ACCC of licensing and assignment agreements that might breach Part IV. Unless the ACCC objects to a notified agreement it would be exempted;
- replacing section 51(3) with a revocable block exemption; and
- repealing section 51(3) and having the ACCC issue guidelines outlining its approach to licensing and assignment of intellectual property rights.

The Council has evaluated these options against the following criteria:

- reducing the potential for anti-competitive conduct;
- minimising uncertainty;
- minimising compliance and regulatory costs; and
- practicality of implementation.

C8.1 Retaining section 51(3)

Retaining section 51(3) as it currently stands would carry forward the benefits and costs identified in Chapters C4 and C5.

The Council considers that the cost of the present exemption are significant. It is possible that other options may provide a lower cost way of achieving the objectives of section 51(3) while minimising the potential for anti-competitive conduct.

C8.2 Expanding section 51(3) to make it more certain

LESANZ recommended extending section 51(3) to cover know-how and confidential information, other forms of intellectual property such as plant breeders' rights, to cover conduct that falls within section 46, and to replace the term "relates to" with a clearer provision (LESANZ, submission 19, pp. 5, 8, 12, 14-15). However, few other submissions called for the expansion of section 51(3).

If section 51(3) is expanded to help it more effectively achieve its objectives, then it is likely to exempt more anti-competitive conduct than it currently does, at higher costs to the Australian community.

For example, where section 51(3) was expanded to cover conduct that would otherwise breach section 46, then parties with strong market power would be able to use licensing conditions with the specific purpose of driving competitors out of the market.

Alternatively, where the scope of section 51(3) was expanded to cover a broader range of licensing conditions, such as exclusive dealing arrangements, then licensors with strong market power could, as a precondition for granting a licence, require licensees to buy unrelated products at higher than market prices (compare Box C1 discussed in Chapter C3).[122]

The Council considers however, that, if some form of exemption is retained for intellectual property rights, there is justification for bringing intellectual property rights granted under the *Plant Breeder's Rights Act 1994 (Cth)* into line with the protection of other forms of intellectual property.[123]

122 Subject, in the case of patents, to section 144 Patents Act.

123 See CSIRO, submission 47, p. 5.

There is also a case for updating the references in section 51(3) in relation to trade marks. Section 51(3)(b) and (c) currently refers to the *Trade Marks Act 1955*. This Act has been repealed and replaced by the *Trade Marks Act 1995*. The reference to the Act should be updated. Additionally, sections 51(3) should be amended to reflect changes in the law with respect to trade marks. The reference to registered trade marks should refer to registration of services as well as goods; and the reference to registered users should be changed to a reference to authorised users.[124]

The Council does not consider that the exemption in section 51(3) should be extended to know-how, confidential information, and trade secrets. The Council agrees with the argument advanced by the CSIRO that this information should not be exempted because, unlike the information in patents, it is not in the public domain and is not limited in the duration of its protection, and therefore lacks many of the pro-competitive aspects of patents (CSIRO, submission 47, p. 5).

C8.3 Bright-Line Exemption

One approach to amending section 51(3) is the so-called 'bright line' exemption approach advocated by Abraham van Melle. Mr van Melle proposed redrafting section 51(3) to exempt conduct considered to be within the scope of the grant of intellectual property rights, an approach similar to that adopted in New Zealand in 1988 (Mr van Melle, submissions 36 and 68).

Under this proposal, the exemption would cover licensing conditions that permitted the licensee to do something that they would otherwise be unable to do without infringing the intellectual property rights of the licensor. However, the exemption would not cover situations where the licensing conditions go beyond the scope of the exclusive rights.

To illustrate the effect of the bright line exemption, take the example of an exclusive licence, a licence requiring the licensee to buy certain other products from the licensor (a tying condition), and a licence requiring the licensee to grant back to the licensor an exclusive licence of the intellectual property rights over an improvements the licensee makes in the licensed product (an exclusive grant back condition).

124 See Michael Gray, submission 11, p. 3.

Under the bright line exemption, an exclusive licence would be exempted because the "licensor is merely passing on the exclusivity already inherent in the intellectual property right" analogous to a contract for the sale and purchase of tangible property (Mr van Melle, submission 36, p. 12). A tying provision would not be exempted because it "restricts the ability of the licensee to purchase unrelated goods elsewhere and is not a restriction that exists by reason of the intellectual property right" (Mr van Melle, submission 36, p. 14). An exclusive grant back condition would also fall outside the exemption because it imposes a restriction on the licensee unrelated to the intellectual property rights (Mr van Melle, submission 36, p. 15).

However, the Council can see some limitations with the bright-line approach.

In examining the bright-line approach, the Council is conscious of the comments made by the Minister for Manufacturing Industry when introducing the Trade Practices Act in 1974:

> *Legislation of this kind is concerned with economic considerations. There is a limit to the extent to which such considerations can be treated in the legislation as legal concepts capable of being expressed with absolute precision. Such an approach leads to provisions which are complex in the extreme and give rise to more problems than they remove ... It is of course desirable that uncertainty be kept to the minimum in this as in any other law. But it is questionable whether detailed drafting leads to more certainty (Mr Enderby, Minister for Manufacturing Industry, House of Representatives Hansard, 16 July 1974, pp. 227 and 228).*

The Council considers that the bright line exemption may not be as clear and infallible as it may appear, and may not successfully isolate anti-competitive conduct from pro-competitive conduct.

First, the Council considers that the exemption is not necessarily clearer than either the present section 51(3) or the position if section 51(3) were repealed without replacement. This is because it is not always easy to identify what could be considered within the scope of the grant of intellectual property rights.[125] The case of *Magill*, for example, held conduct to be anti-competitive that had formerly been considered within the scope of the grant.

125 Compare Calhoun and Brown 1990, p. 438.

Second, the Council is not convinced that the bright-line exemption would be confined to vertical agreements, and not exempt horizontal licensing agreements.

Third, the trend under European law may be to move away from the scope of the rights approach (that the bright line exemption is arguably based on) because it focusses to much on an analysis of the nature of intellectual property rights and too little on the effects of conduct on competition.

C8.4 Removing conduct considered most likely to be anti-competitive

Under this option, section 51(3) would be amended to remove from the exemption the conduct considered most likely to have an anti-competitive effect.

Chapter C5 identified the conduct most likely to be anti-competitive as:

- horizontal agreements; and
- price and quantity restrictions, which have fewer pro-competitive justifications than exclusive licence conditions, territorial restrictions, and best endeavours clauses.

The Law Institute of Victoria supported the idea of excluding price and quantity restrictions from section 51(3) (Law Institute of Victoria, submission 52, p. 4).

The Council considers that the above areas of conduct could be removed from the scope of section 51(3) through the use of clear and unambiguous language without disturbing the present level of certainty provided by section 51(3). Horizontal agreements could be excluded from the scope of section 51(3) using language such as "agreements between parties who are competitors".

The exemption would still remain ambiguous to the extent that the words "relates to" are uncertain. However, if these words are retained, the judgement in *Transfield v Arlo* will remain relevant. The Council considers that it would be a difficult task to replace the words "relates to" with words of greater certainty, while at the same time retaining the same basic scope for section 51(3). There is a risk that replacing "relates to" with other words may result in more confusion about the interpretation of section 51(3).

The Council considers that the amendments would not strip section 51(3) of its current benefits. The concerns raised by parties (discussed in Chapters C4 and C7) relate chiefly to the use of exclusive licence, territorial restrictions, and best endeavours clauses. Further, these licences would typically be used in vertical arrangements between research/development bodies and manufacturing/marketing bodies. Excluding price restrictions, quantity restrictions, and horizontal arrangements from the exemption will not affect most licensing arrangements. Where licenses or assignments contain price restrictions, quantity restrictions, or have a horizontal element, *and* these arrangements substantially lessen competition or otherwise breach Part IV, the arrangements may still be authorised where the public benefits of the arrangements outweigh the anti-competitive costs.

One problem with this proposal is that, in some very rare circumstances, conduct exempted by the amended section 51(3) could substantially lessen competition.

C8.5 Notification Process

Under this option, section 51(3) would be repealed and replaced with a notification system under which parties would advise the ACCC of their licence and assignment agreements where they were concerned that these agreements might breach Part IV. Unless the ACCC objected to the agreements within a particular period, for example four months, the agreements would be taken to be valid under Part IV, and the ACCC (and third parties) would not be able to subsequently object to the agreement.

This notification process would be separate from the process that currently operates under Part VII for notifying exclusive dealing provisions.

The Council foresees a number of practical problems with this process. First, the process might encourage a climate of over-compliance. Parties might tend, as part of their process of due diligence, to notify licence and assignment agreements even though these agreements could not on any reasonable interpretation, breach Part IV (Sugden, submission 63, p. 1). Second, evaluating large numbers of agreements within a short timeframe would place a heavy administrative burden on the ACCC. If the ACCC responded to this by charging fees for the evaluation process then the notification process might not achieve its overall purpose of assisting parties to reduce compliance costs. Third, if the notification process prevented third parties from objecting to conditions in licences and assignments, then it would need to be conducted in public. A public process would be unlikely to conclude within a reasonable timeframe to meet the commercial requirements of the parties conducting the licence or assignment negotiations.

For these reasons, the Council considers that a notification process would not be feasible.

C8.6 Revocable Block Exemption

Under this option, section 51(3) would be repealed and replaced with a block exemption issued by the ACCC that exempts specified conduct.

The advantage of a block exemption is that it is much more flexible than a standing exemption in legislation. Where the ACCC decided that particular conduct should no longer come within the scope of the block exemption, it could revoke the exemption in respect of that conduct. Upon revocation, the conduct would either no longer be protected, or it would be protected for its lifetime while similar future conduct would no longer be eligible to receive the protection of the block exemption.

A block exemption would have the advantage over guidelines issued by the ACCC in that it would bind the regulator, although whether it could bind the courts is less clear.

This model is similar to the block exemption process operating in the EU. Under that system, Directorate-General IV of the Commission of the European Communities has the power to issue block exemptions in respect of conduct that could be considered to come within Art 85(3).[126] The EU block exemption may be revoked in specified circumstances by the regulator, and may cease to apply when the party seeking the protection of the block exemption grows to occupy more than 40 percent of the market.[127]

126 See OJ No 36, 6.3.1965, p. 533/65, and headwords of Technology Transfer Block Exemption.

127 See Recital 27 and Article 7.

Some submissions to the Council considered the EU block exemption works well (Mendes, submission 55, p. 10) while others considered that it was cumbersome and overly bureaucratic (Sugden, submission 63, p. 1; Australian Copyright Council, submission 23, p. 9; Australian Copyright Council, submission 90, pp. 10 - 11).

The Council considers a block exemption would be unlikely to increase certainty and reduce compliance costs. Unless the block exemption bound the courts it would not provide much certainty. In particular, where it could be revoked in relation to conduct already on foot, parties would be unsure whether their licensing agreements could be undone at some future time. In these circumstances, a block exemption might actually reduce certainty. Compliance costs would still be incurred by parties in drawing their agreements to come within the scope of the block exemption, and consulting the ACCC on the interpretation of the block exemption.

C8.7 Repeal and issue of Guidelines

Under this option, section 51(3) would be repealed and in its place the ACCC would issue guidelines (after due public consultation) discussing where intellectual property licensing and assignment conditions would be likely to breach Part IV, and the judgments the ACCC would make when deciding whether conduct should be authorised.

The ACCC has indicated it would be willing to publish guidelines in this area, and more generally on the application of Part IV to intellectual property dealings (ACCC, submission 58, p. 4).

Mr van Melle considered that ACCC guidelines may have some shortcomings:

> *The ACCC by drafting guidelines in the absence of a statutory exception would have something of a conflict of interest as it would both make and enforce the law. Such guidelines would be likely to be conservatively drafted, so that while some extreme practices would be likely to be outlawed per se, many will be defined as practices that might be offensive depending on the market context. In other words, it would be recommended in all but extreme cases that authorisation be applied for, raising*

> *compliance costs for businesses considerably (Mr van Melle, submission 68, p. 2).*

The Australian Copyright Council submission considered that ACCC guidelines would be of limited usefulness because they would only reflect the views of the staff currently in charge at the ACCC and might change regularly. They were also concerned the guidelines might not increase certainty because they would not bind the courts (Australian Copyright Council, submission 23, p. 10).

The Council does not agree the ACCC would face a conflict of interest in issuing guidelines on its views about the application of Part IV to intellectual property licensing and assignment activity. As a practical matter, guidelines issued by any other party (e.g. legal practitioners) about how the ACCC should apply Part IV would carry far less weight than guidelines issued by the ACCC itself.

The Council accepts that guidelines cannot provide absolute certainty to parties dealing in intellectual property rights, or eliminate compliance costs. They can only provide parties with some idea of the ACCC's approach to the application of Part IV and authorisation. Intellectual property owners can and should obtain legal advice in appropriate circumstances as to their obligations under the Trade Practices Act. Overall, the Council considers that guidelines can go a considerable way to clearing up doubts about the application of the Trade Practices Act to intellectual property.

The Council accepts that repealing section 51(3) would increase to some extent uncertainty about the validity of those licensing conditions currently exempted under section 51(3), and that this increased uncertainty could increase compliance costs.

C8.8 Preferred Option

The Council considered each of the options against the four criteria of: reducing the potential for anti-competitive conduct; minimising uncertainty; minimising costs; and practicality of implementation.

The Council considers that the best option is to amend section 51(3) to remove price restrictions, quantity restrictions, and horizontal arrangements from the scope of the exemption. In conjunction with this, the

Council considers that it is appropriate to extend the exemption to cover rights conferred under the *Plant Breeder's Rights Act 1994* (Commonwealth), and modernise the references to the Trade Marks Act.

This option retains or enhances the certainty provided by the current form of section 51(3) while removing from the scope of the exemption conduct considered more likely to be anti-competitive. The option strikes a reasonable balance between exempting conduct that may potentially be anti-competitive, and ensuring that licences and assignments of intellectual property can be executed with a reasonable degree of certainty about the validity of the conditions used in them. The Council also considers that this option is practical to implement, and retains the benefits of the limited case-law and legal commentary in this area.

The Council considers that retaining the current section 51(3) exemption, while providing some level of certainty, has greater potential to exempt anti-competitive conduct from the operation of the TPA. The option of expanding section 51(3), while increasing the level of certainty, increases the potential for anti-competitive conduct.

The Council considers that the notification and block exemption options may not be practical to implement. While these options may reduce the potential for anti-competitive conduct, they would also reduce the level of certainty provided by a statutory provision.

Repealing section 51(3) would remove the potential that anti-competitive conduct could be exempted from the operation of the TPA. However, the Council accepts that repeal would impose some uncertainty and costs on parties in checking that their agreements do not breach Part IV, particularly in cases where it is difficult to assess the market potential of intellectual property rights or the boundaries of the markets in which the intellectual property rights might be commercialised at some future date. Guidelines may not be sufficient to fully alleviate this uncertainty, particularly in circumstances where investors need absolute certainty about the validity of licensing conditions before they may proceed to invest in research and development.

On the other hand, if section 51(3) is amended to remove price and quantity restrictions, and horizontal arrangements from the scope of the exemption, the costs of the exemption (in terms of anti-competitive conduct exempted from the operation of the TPA) would be reduced.

On balance, the Council considers that, if section 51(3) is amended to remove price and quantity restrictions and horizontal arrangements from the scope of the exemption, then the costs of the exemption are less than the benefits provided by the exemption, and the benefits cannot be achieved by means other than legislative exemption from some provisions of Part IV of the TPA.

C8.9 Recommendations

The Council has reviewed the objectives of section 51(3), determined the costs and benefits of the current method of meeting these objectives, and examined the costs and benefits of alternative methods of meeting these objectives.

After a careful assessment of the costs and benefits of section 51(3), and of alternatives, the Council recommends the amendment of section 51(3) remove price and quantity restrictions and horizontal arrangements from the scope of the exemption.

Additionally, the Council recommends amending section 51(3)(a) to extend the exemption to cover the intellectual property rights granted under the *Plant Breeder's Rights Act 1994 (Cth)* consistent with the protection provided for patents, registered designs, copyright, and EL rights.

The Council recommends amending section 51(3) to refer to the *Trade Marks Act 1995*, to the registration of services as well as goods, and to authorised users rather than registered users.

Recommendation

The Council recommends that the exemption in section 51(3) be retained, but amended to remove protection of price and quantity restrictions and horizontal agreements.

The Council recommends amending section 51(3)(a) to extend the exemption to cover the intellectual property rights granted under the *Plant Breeder's Rights Act 1994 (Cth)* consistent with the protection provided for patents, registered designs, copyright, and EL rights.

The Council recommends amending section 51(3) to refer to the *Trade Marks Act 1995*, including references to the registration of services as well as goods, and to authorised users rather than registered users.

If these recommendations are accepted, the Council considers that licences and assignments entered into before the amendment of section 51(3) should continue to be exempted for their lifetime in accordance with the provisions of section 51(3) as it currently stands. This will protect the integrity of arrangements entered into in reliance on the current exemption provisions.

Recommendation

The Council recommends that saving provisions be inserted into the TPA to preserve the effect of the current section 51(3) in relation to licences and assignments entered before amendment of section 51(3).

In order to clarify the operation of the TPA in relation to intellectual property, minimise uncertainty, and minimise compliance costs, the Council recommends that the ACCC formulate guidelines for the assistance of business on:

- when intellectual property licensing and assignment conditions might be exempted under section 51(3);
- when intellectual property licences and assignments might breach Part IV of the TPA; and
- when conduct in relation to intellectual property that did not fall within the exemption and was likely to breach Part IV of the TPA might be authorised.

Parties, in discussions with the Council, stated that it would be helpful if the ACCC could release the guidelines before or at the same time as the amendments to section 51(3) become effective.

Recommendation

The Council recommends that the ACCC formulate guidelines for the assistance of industry on:

- when intellectual property licensing and assignment conditions might be exempted under section 51(3);
- when intellectual property licences and assignments might breach Part IV of the TPA; and
- when conduct in relation to intellectual property that does not fall within the exemption and is likely to breach Part IV of the TPA might be authorised.

The Council recommends that the ACCC aim to release the guidelines to precede or coincide with the date of effect of the amendment of section 51(3).

C8.10 Possible Related Changes to TPA

The Council recommended above to include rights granted under the *Plant Breeder's Rights Act 1994 (Cth)* within the scope of the section 51(3).

This raises the issue of possible ambiguity in the interpretation of section 51(1). At present section 51(1)(a)(i) exempts anything authorised by an Act *not including Acts relating to patents, trade marks, designs, or copyrights.*

Parliament may wish to consider amending section 51(1)(a)(i) to include Acts relating to plant breeder's rights and EL rights. This would ensure section 51(1) was not interpreted to the effect that, because Acts relating to plant breeder's rights and EL rights are not specifically excluded from section 51(1), the exercise of rights under these Acts comes within the exemption in section 51(1).

C8.11 Consequential Changes to Competition Codes

The Terms of Reference asked the Council to consider the "consequential effects that the exemption provisions have through the Competition Code in each State and Territory" (term 3(g)).

As discussed in Part A, the Competition Codes in the States and Territories contain provisions equivalent to section 51(3). To maintain consistency these codes would need to be amended if section 51(3) were amended. This requires the Commonwealth to consult with the States.

Submissions did not refer to any particular reason why the Competition Codes in the States and Territories should not be amended if section 51(3) is amended. The Council can see no reason to maintain the exemption in its present form in the Competition Codes of the States and Territories if the exemption is amended in the Commonwealth TPA.

Recommendation

The Council recommends equivalent amendments to the Competition Codes in each State and Territory to the amendments recommended in respect of the Commonwealth TPA.

Appendix One: Sections 51(2) and 51(3) of the TPA

Section 51(2)

51(2) [Regard not to be had to certain contractual provisions] In determining whether a contravention of a provision of this Part other than section 45D, 45DA, 45DB, 45E, 45EA or 48 has been committed, regard shall not be had:

(a) to any act done in relation to, or to the making of a contract or arrangement or the entering into of an understanding, or to any provision of a contract, arrangement or understanding, to the extent that the contract, arrangement or understanding, or the provision, relates to, the remuneration, conditions of employment, hours of work or working conditions of employees;

(b) to any provision of a contract of service or of a contract for the provision of services, being a provision under which a person, not being a body corporate, agrees to accept restrictions as to the work, whether as an employee or otherwise, in which he may engage during, or after the termination of, the contract;

(c) to any provision of a contract, arrangement or understanding, being a provision obliging a person to comply with or apply standards of dimension, design, quality or performance prepared or approved by the Standards Association of Australia or by a prescribed association or body;

(d) to any provision of a contract, arrangement or understanding between partners none of whom is a body corporate, being a provision in relation to the terms of the partnership or the conduct of the partnership business or in relation to competition between the partnership and a party to the contract, arrangement or understanding while he is, or after he ceases to be, a partner;

(e) in the case of a contract for the sale of a business or of shares in the capital of a body corporate carrying on a business - to any provision of the contract that is solely for the protection of the purchaser in respect of the goodwill of the business; or

(f) (Omitted)

(g) to any provision of a contract, arrangement or understanding, being a provision that relates exclusively to the export of goods from Australia or to the supply of services outside Australia, if full and accurate particulars of the provision (not including particulars of prices for goods or services but including particulars of any method of fixing, controlling or maintaining such prices) were furnished to the Commission before the expiration of 14 days after the date on which the contract or arrangement was made or the understanding was arrived at, or before 8 September 1976, whichever was the later.

Section 51(3)

51(3) [Inclusion of certain conditions not to be taken as a contravention of some provisions] A contravention of a provision of this Part other than section 46, 46A or 48 shall not be taken to have been committed by reason of:

(a) the imposing of, or giving effect to, a condition of:

(i) a licence granted by the proprietor, licensee or owner of a patent, of a registered design, of a copyright or of EL rights within the meaning of the *Circuit Layouts Act 1989*, or by a person who has applied for a patent or for the registration of a design; or

(ii) an assignment of a patent, of a registered design, of a copyright or of such EL rights, or of the right to apply for a patent or for the registration of a design;

to the extent that the condition relates to:

(iii) the invention to which the patent or application for a patent relates or articles made by the use of that invention;

(iv) goods in respect of which the design is, or is proposed to be, registered and to which it is applied;

(v) the work or other subject matter in which the copyright subsists; or

(vi) the eligible layout in which the EL rights subsist;

(b) the inclusion in a contract, arrangement or understanding authorising the use of a certification trade mark of a provision in accordance with rules applicable under Part XI of the *Trade Marks Act 1955*, or the giving effect to such a provision; or

(c) the inclusion in a contract, arrangement or understanding between:

(i) the registered proprietor of a trade mark other than a certification trade mark; and

(ii) a person registered as a registered user of that trade mark under Part IX of the *Trade Marks Act 1955* or a person authorised by the contract to use the trade mark subject to his becoming registered as such a registered user;

of a provision to the extent that it relates to the kinds, qualities or standards of goods bearing the mark that may be produced or supplied, or the giving effect to the provision to that extent.

Appendix Two: Submissions and Meetings

List of Submissions

#	Submitter
1	John P McAuley
2	Tasmanian Department of Treasury and Finance
3	Neville J MacPherson
4	Standards Australia
5	Australian Nuclear Science and Technology Organisation
6	Newsagents Association of South Australia Ltd
7	Australian Dental Association Inc
8	Howie & Maher
9	Australian Chamber of Commerce and Industry
10	Toyota Motor Corporation Australia Ltd
11	Michael Gray
12	The Australian Gas Association
13	Institute of Patent Attorneys of Australia
14	Federation of Australian Commercial Television Stations
15	Australian Council of Trade Unions
16	Robert Baxt
17	Withdrawn
18	Lindsay Hampton
19	Licensing Executives Society Australia and New Zealand
20	IP - Australia

21	A I Tonking
22	Andrew Stewart
23	Australian Copyright Council (joint submission)
24	Commonwealth Department of Primary Industries and Energy
26	Queensland Treasury
27	Michael O'Bryan
28	Pharmacy Guild of Australia
29	Small Retailers Association of SA Inc.
30	Australian Competition and Consumer Commission
31	Australian Chamber of Commerce and Industry
32	Australian Industry Group
33	Law Council of Australia
34	Stephen Stern
35	Australian Competition and Consumer Commission
36	Abraham van Melle
37	National Occupational Health & Safety Commission
38	ACT Chief Minister's Department
39	Allen Allen & Hemsley
40	Law Institute of Victoria
41	NSW Cabinet Office
42	Australian Chamber of Commerce and Industry
43	Newsagents Association of South Australia Ltd
44	Standards Australia
45	Flinders Technologies Pty Ltd
46	ANUTECH Pty Ltd
47	CSIRO
48	Unisearch Ltd

49	Macquarie Research Ltd
50	Australian Vice-Chancellors' Committee
51	Australian Council of Trade Unions
52	Law Institute of Victoria
53	Rodney De Boos
54	Ray Steinwall
55	Philip Mendes
56	Australian Chamber of Commerce and Industry
57	Licensing Executives Society of Australia and New Zealand
58	Australian Competition and Consumer Commission
59	Institute of Patent and Trade Mark Attorneys of Australia
60	Australian Gas Association
61	James Cook University
62	Leif Gamertsfelder
63	Paul Sugden
64	Montech Pty Ltd
65	WA Department of Productivity and Labour Relations
66	Council of Small Business Organisations of Australia Ltd
67	Commonwealth Attorney-General's Department
68	Abraham van Melle
69	Freehill Hollingdale & Page
70	WA Office of Energy
71	Institution of Engineers, Australia
72	Cooperative Research Centre for Catchment Hydrology
73	Withdrawn
74	Cooperative Research Centre for Intelligent

	Manufacturing Systems & Technologies Ltd
75	BresaGen
76	Cooperative Research Centres Association, Inc.
77	Australian Biotechnology Association
78	Cooperative Research Centre for Waste Management and Pollution Control Limited
79	Pig Research and Development Corporation
80	Cooperative Research Centre for Diagnostic Technologies
81	Australian Cooperative Research Centre for Renewable Energy Ltd
82	Australian Geodynamics Cooperative Research Centre
83	Law Council of Australia
84	Premium Quality Wool Cooperative Research Centre
85	Commonwealth Department of Communications Information Technology and Arts
86	Australian Photonics Pty Ltd
87	Commonwealth Department of Employment Workplace Relations and Small Business
88	Vertebrate Biocontrol Cooperative Research Centre
89	Telstra Corporation Limited
90	Australian Copyright Council
91	Australian Council of Trade Unions
92	Black Coal Utilisation Cooperative Research Centre
93	Cooperative Research Centre for the Cattle and Beef Industry
94	Cooperative Research Centre for Robust and Adaptive Systems Ltd
95	Rodney De Boos
96	Cooperative Research Centres Association, Inc

97	Law Council of Australia
98	Cooperative Research Centre for Cochlear Implant, Speech & Hearing Research
99	Centre for Legumes in Mediterranean Agriculture
100	Commonwealth Department of Agriculture, Fisheries and Forestry - Australia
101	NSW Cabinet Office
102	Ray Steinwall
103	Australian Chamber of Commerce and Industry
104	WA Department of Productivity and Labour Relations
105	Australian Academy of Technological Sciences and Engineering
106	WA Department of Commerce and Trade
107	Allen Allen & Hemsley
108	Ralph Clarke, Member of SA Parliament
109	National Occupational Health and Safety Commission
110	Australian Industry Group

Parties the Council Met

ANUTECH Pty Ltd.

Australian Academy of Technological Sciences and Engineering

Australian Chamber of Commerce and Industry

Australian Competition and Consumer Commission

Australian Copyright Council

Australian Gas Association

Australian Nuclear Science and Technology Organisation

Australian Photonics Cooperative Research Centre

Australian Photonics Pty Ltd.

Australian Technology Park

Australian Vice-Chancellors' Committee

Cooperative Research Centre for Advanced Computational Systems

Cooperative Research Centre for Eye Research and Technology

Cooperative Research Centre for Waste Management

Copyright Agency Ltd.

CSIRO

Department of Industry, Science, and Tourism

IP – Australia

Law Institute of Victoria

Law Council of Australia

Licensing Executives Society of Australia and New Zealand

Macquarie Research Ltd.

Montech Pty Ltd.

National Occupational Health and Safety Commission

Paul Sugden

Philip Mendes, Solicitor

Pig Research and Development Corporation

Premium Quality Wool Cooperative Research Centre

PriceWaterhouseCoopers

Screenrights

Standards Australia

Telstra R&D Management Pty Ltd.

The University of Newcastle Research Associates Ltd.

Thrombogenix Pty Ltd.

Unisearch Ltd.

Appendix Three: Types of Intellectual Property

Patents

Patent rights are conferred under the *Patents Act 1990 (Cth)* (Patents Act). A patent gives the patentee the exclusive rights to exploit his or her invention for a period of 20 years from the date of the patent in Australia. The invention may be either a product or a process of manufacture. Patent protection is granted to inventions that are novel and useful. Patents protect an invention from copying or independent creation. Patent protection is obtained through a registration process where the details of the patent are placed on a public record.

So called 'use it or lose it' provisions exist in Section 133 of the Patents Act whereby compulsory licences may be granted or a patent revoked if the patentee fails to exploit the patent.

Section 144 of the Patents Act makes a condition in a sale, lease or licence of a patent void in certain circumstances - in particular if the effect of the condition is to prohibit the use of a product or process (whether patented or not) supplied by a third party or to require the acquisition of a product not protected by the patent from the patentee or his or her nominee.

Copyright

Copyright is conferred under the *Copyright Act 1968 (Cth)* (Copyright Act). Copyright gives the copyright owner a number of exclusive rights, including the right to reproduce, publish, perform, broadcast, transmit and adapt the work for a period provided for in the Act. In contrast to patents, copyright only protects original expressions in material form, not underlying ideas. The materials protected by copyright are 'works' (literary, dramatic, musical or artistic works) and 'subject matter other than works' (films, sound recordings, broadcasts and published editions).

Trade Marks

Trade marks may obtain statutory protection through registration under the *Trade Marks Act 1995 (Cth)* (Trade Marks Act). A trade mark is a sign such as a word, brand, label or other symbol used to distinguish the goods or services of a person from the goods of services of others in the course of trade. Trade marks may be registered under the Trade Marks Act as trade marks, certification trade marks, collective trade marks, or defensive trade marks.

A certification trade mark is a sign that distinguishes goods or services from others in relation to quality, accuracy, origin, material, mode of manufacture or some other characteristic. Part of the registration process for a certification trade mark requires the ACCC to approve the application. The ACCC must be satisfied that the applicant is competent to certify the goods and/or services and that the rules governing the use of the certification trade mark would not be to the detriment of the public and are satisfactory having regard to prescribed criteria.

Subsection 51(3) refers to the 1955 Act rather than the 1995 Act. The 1955 Act has been repealed and replaced by the 1995 Act. Two important differences between the 1995 Act and the 1955 Act are :

- The registration procedure under the 1995 Act for certification trade marks did not exist in the 1955 Act.
- The 1995 Act does not refer to 'registered users' but refers to 'authorised use'. There is no system for registering a person as an 'authorised user' of a mark. Under the 1995 Act, the use of a trade mark by a user is an 'authorised use' only to the extent that the user uses the trade mark 'under the control' of the owner of the trade mark.

EL Rights

Eligible circuit layout rights, referred to as EL rights, are granted under the *Circuit Layouts Act 1989 (Cth)* (Circuit Layouts Act). EL rights comprise the right to make an integrated circuit in accordance with the layout (ie a three-dimensional copy of the layout) and to exploit the layout commercially in Australia, as well as the right to copy the layout, directly or indirectly, in a material form.

Section 51(1)(a) of the TPA allows an Act of the Commonwealth (other than an Act relating to patents, trade marks, designs or copyrights) to exempt conduct from Part IV of the TPA if it is specified in and specifically authorised by the Act. Consequently, the Circuit Layouts Act can exempt conduct from Part IV of the TPA if it specifies the conduct and specifically authorises the conduct. Currently the Circuit Layouts Act does not contain exemptions under section 51(1)(a) of the TPA.

Registered Designs

Design protection is granted under the *Designs Act 1906 (Cth).* Design protection is granted over the appearance of articles but does not include protection of a method or principle of construction. Design protection is gained through a registration process and is only available to new or original designs. Design registration gives the owner the exclusive right to apply the design to the registered articles. Design rights are conferred for an initial period of one year, renewable yearly for a maximum period of 16 years.

Other Intellectual Property Rights

The exemption in section 51(3) does not apply to non-statutory intellectual property rights such as unregistered trade marks and confidential information. Unregistered trademarks are protected at general law by an action for passing off or an action under section 52 of the TPA for misleading or deceptive conduct. Confidential information or 'know-how' is protected at general law by an action for breach of confidence.

The *Plant Breeder's Act 1994 (Cth)* (Plant Breeder's Act) provides protection for new plant varieties, except for trees and vines, for a period of 20 years. In the case of trees and vines the period is 25 years. The Plant Breeder's Act provides for the granting of exclusive proprietary rights to breeders of certain new varieties of plants and fungi. The owner of a plant variety that is registered under the Plant Breeder's Act has the exclusive rights to produce, sell, import and export the plant. The Plant Breeder's Act reflects the Government's obligations under the International Convention for the Protection of New Varieties of Plants.

The exemption in section 51(3) does not apply to the exclusive rights granted under the Plant Breeder's Act. However, section 51(1)(a) of the TPA allows an Act of the Commonwealth (other than an Act relating to patents, trade marks, designs or copyrights) to exempt conduct from Part IV of the TPA if it is specified in and specifically authorised by the Act. Consequently, the Plant Breeder's Act can exempt conduct from Part IV of the TPA if it specifies the conduct and specifically authorises the conduct. Currently the Plant Breeder's Act does not contain exemptions under section 51(1)(a) of the TPA.

Appendix Four: Authorisation and Notification

Under section 88 of the TPA, the ACCC may authorise some conduct that would otherwise breach provisions of sections 45, 47, 48, and 50. Section 90 provides that the ACCC may not authorise arrangements that might breach section 45, 47, 48, or 50 unless it is satisfied in all the circumstances that the proposed conduct or agreement has a public benefit which outweighs the detriment to the public from any lessening of competition.

Conduct which might breach the exclusive dealing provisions of section 47 may be notified under section 93. Under the notification procedure, a corporation advises the ACCC in writing of the proposed conduct. The effect of notification is that the corporation immediately gains protection for the proposed conduct from the provisions of section 47 (except in relation to the third line forcing provisions of section 47). The ACCC may then consider whether the likely benefit to the public from the conduct outweighs the likely detriment to the public from the conduct. If the ACCC decides that the proposed conduct does not satisfy this test, it may give the corporation a written notice to this effect. The notification ceases to protect the proposed conduct 31 days after the notice is given. In relation to the practice of third line forcing, the ACCC may postpone the coming into effect of the notice until after it has examined the proposed conduct. In this case the notification does not come into effect unless and until the ACCC determines that the conduct meets the net benefit test.

Conduct which might breach section 46 (misuse of market power provision) cannot be authorised or notified. However, section 46(6) provides that conduct authorised in relation to sections 45, 45B, 47, and 50, (not section 48) is exempt from the operation of section 46. In this way, conduct may that breaches section 46 may indirectly be authorised.

The Trade Practices Commission (TPC), the forerunner to the ACCC, was involved in assessing two major applications for authorisation of intellectual property arrangements. In 1985, the Phonographic Performance Co of Australia Ltd. (PPCA) sought authorisation from the TPC to set up a collecting society in relation to sound recordings. In 1990, the PPCA sought a similar authorisation in relation to music video clips. Under the proposed arrangements, copyright owners would license their intellectual property rights to the proposed collecting society, which would then collect royalties on their behalf. The PPCA sought authorisation because there was a concern that the arrangements would breach section 45 of the TPA by reducing competition between copyright owners of sound recordings and music video clips. In both applications, the PPCA contended that, in any event, the licensing arrangements were protected by section 51(3). The TPC responded that it was not appropriate for it to make a decision about whether the exemption in section 51(3) covered the conduct.

The TPC decision balanced the benefits and costs of approving the authorisation applications. In the sound recording case the TPC authorised the proposed arrangements. It considered that, in view of the volume of licence transactions that would otherwise be required, the proposed collective arrangements were the most efficient way of collecting royalties. Further, it considered that the arrangements facilitated more effective policing of copyright. The TPC took the view that these benefits outweighed the costs flowing from reduced competition between licensors. In the subsequent music video clip case, the TPC rejected the application for authorisation because, due to the smaller size of the market, the justification for collective arrangements was less compelling.

Appendix Five: International Experience of Intellectual Property

United States

The interface between competition law and intellectual property has changed over the past thirty years. Until the 1960s and 70s, the US adopted an approach similar to that prevailing in the European Communities, based on the notion that intellectual property laws conferred exclusive monopoly rights on the owner that entitled it to deal freely in relation to matters within the scope of the grant. However, if the intellectual property owner attempted to impose restrictions that were considered to be outside the scope of the grant, then the restriction was subject to competition law, and to an action based on the doctrine of patent misuse that could result in the loss of the patent.

In the late 1970s and the 1980s, the approach gradually changed to a position where restrictions in licence and other intellectual property arrangements began to be analysed on the basis of their effect on competition.

In 1995, the United States Department of Justice (DOJ) and the Federal Trade Commission (FTC) issued joint 'Antitrust Guidelines for the Licensing of Intellectual Property'. These guidelines set out the approach that these competition law regulators would take when investigating allegations that intellectual property dealings infringed competition law.

The guidelines contain three main principles. These are:

(a) for the purpose of antitrust analysis, the Agencies [the DOJ and FTC] regard intellectual property as being essentially comparable to any other form of property;

(b) the Agencies do not presume that intellectual property creates market power in the antitrust context; and

(c) the Agencies recognize that intellectual property licensing allows firms to combine complementary factors of production and is generally procompetitive.

The first principle is that intellectual property is comparable to other forms of property. The Agencies consider that while intellectual property does have some special characteristics, these do not differentiate it from other forms of property for the purposes of competition law analysis. For example, the Guidelines recognise that intellectual property is relatively risky and expensive to develop but is usually cheap to copy, which renders it more vulnerable to misappropriation than other forms of property. However, rather than meaning that a different type of analysis of intellectual property arrangements should occur, the Agencies consider that these characteristics should be taken into account in evaluating the conditions of the market in which the transactions involving the intellectual property occur.

The second principle is that the Agencies do not presume that intellectual property creates market power in an antitrust context. This is because the Agencies do not consider that intellectual property automatically represents a monopoly over a particular market, although in certain circumstances it may. The Agencies consider that although "the intellectual property confers the power to exclude with respect to the specific product, process, or work ..., there will often be sufficient actual or potential close substitutes for such product, process, or work to prevent the exercise of market power". The Agencies consider that the correct approach is to assess the market power of the intellectual property holder in the circumstances of the market.

The third principle is that licensing of intellectual property is generally pro-competitive because it allows firms to combine complementary resources. Different firms may contribute manufacturing capability, distribution facilities, workforces, and intellectual property. The Guidelines consider that licensing may often be the most efficient way to combine these different resources in order to harness the intellectual property and produce a finished product. Moreover, licensing can assist in coordinating control of intellectual property when it is necessary to combine different intellectual property rights in order to produce a product.

The Agencies consider that the pro-competitive benefits of licensing need to be balanced against anti-competitive costs when considering whether to approve a particular licensing arrangement. Licenses which contain restrictions such as field-of-use or territorial licenses may enable the licensor to "exploit its property as efficiently and effectively as possible". This is because the restrictions "can be used to give a licensee an incentive to invest in the commercialisation and distribution of products embodying the licensed intellectual property and to develop additional applications for the licensed property".

After enumerating the three basic principles, the Guidelines discuss which intellectual property transactions could infringe competition law, how the Agencies define the relevant market, and their approach to specific types of intellectual property transactions.

The Guidelines state that the Agencies will have concerns about arrangements where firms which would otherwise compete in a market using different technologies reach an agreement under which they pool the technologies, where firms merge their research and development efforts, and some cases where a firm acquires the intellectual property of a potential competitor. License arrangements will also be scrutinised closely where it appears that the arrangements could restrict output, create or consolidate market power, shut competitors out of markets or raise their costs by lifting the price of vital inputs, or increase the risk of coordinated pricing. The Agencies will particularly focus on the effects on whether the arrangements affect competition between firms in actual or potential competition with each other, and will place less emphasis on restrictions in licensing arrangements in where one of the firms supplies the other.

In identifying the relevant market in which competition takes place, the Guidelines canvas the possibility that arrangements could potentially affect competition three types of markets: goods markets; technology markets; and innovation markets. Goods markets are the markets in which the goods produced using intellectual property are sold. Technology markets are the markets in which different technologies compete by producing goods that can substitute for each other. Where competing technologies produce substitutes, the market will include all the competing technologies. Innovation markets are the markets in which research and development occur. The Guidelines consider that the concept of the innovation market covers situations where arrangements affect incentives to innovate, for example where an arrangement reduces a firm's incentives to improve goods or invent new goods that could compete with existing goods.

The Agencies apply the concept of 'safety zones' when analysing intellectual property arrangements. If arrangements fall within the safety zones, they will be considered acceptable and will not be investigated. The safety zones relate to dealings where the parties do not control more than small percent of the market, or there are four or more competitors in the relevant market.

Certain arrangements are treated as illegal per se without the need for extensive investigation of their effects on competition. These arrangements include where the sellers of goods produced using intellectual property attempt to fix the minimum resale price in the hands of the distributor, price fixing, agreements by competitors to divide markets or customers between them, agreements to reduce output, and certain group boycotts. (Some of these arrangements would fall within section 51(3).)

It remains to be seen whether the Courts approach cases involving the application of competition law to intellectual property consistent with the Department of Justice and Federal Trade Commission guidelines. The Courts are not bound by the guidelines.

European Union

The Treaty of Rome, which established the European Economic Community (now renamed the European Union (EU)), regulates trade between the members of the Community. The treaty sets out the competition law to be applied between the members of the EU. Since the primary purpose of the Treaty is to create a free internal market, the competition laws contained in the Treaty apply to anti-competitive practices that have the potential to affect free trade between the members of the European Union. The domestic law of the member countries applies to anti-competitive activity within each country that would only affect trade within that country.

Articles 85 and 86 are the main competition law provisions in the Treaty. Art 85 declares void concerted practices, decisions, or agreements "which have as their object or effect the prevention restriction or distortion of competition within the [EU], and in particular [price-fixing, production limits, market-sharing, applying dissimilar conditions in equivalent transactions with parties outside the agreement, or tie-ins of unrelated obligations]". Art 86 forbids a party from abusing a position of dominant market power. In particular, Art 86 is aimed against practices such as imposing unfair prices or trading conditions, limiting production, applying dissimilar conditions in equivalent transactions with other parties, and tie-ins of unrelated obligations. Apart from these Articles, Art 36 permits Member States to retain quantity-based restrictions on imports where this is necessary to protect intellectual property.

Art 85(3) provides a limited exemption from the application of Art 85 where an agreement or practice (1) promotes the production or distribution of goods or technical or economic progress, (2) allows consumers a fair share of the resulting benefits; (3) the restrictions are indispensable to attain these objectives; and (4) the agreement does not afford the parties "the possibility of eliminating competition in respect of a substantial part of the products in question". Thus it is open to a defendant to an action under Art 85(1) or (2) to plead under Art 85(3) that the practice, decision, or agreement in question provided significant economic benefits, some of which were captured by the public through lower prices or higher quality.

Directorate General IV (DG IV) of the EU is responsible for enforcing competition law. DG IV has the power to issue detailed regulations under the Treaty clarifying the scope of competition law, including the power to issue block exemptions from the provisions of Art 85(1) and (2). It does not have the power to issue block exemptions in relation to conduct that might breach Art 86. Where conduct or arrangements are not exempted under the block exemptions, they may still be exempt under Art 85(3).

In 1996, DG IV issued a Technology Transfer Block Exemption. This exemption replaced the previous block exemptions in relation to Patent Licensing (1984) and Know-How Licensing (1989).

The technology transfer block exemption applies only in the case of patents and know-how, and in situations where a licensee manufactures goods or provides services or has products or goods provided for it. It does not apply to resales, joint ventures, or patent pools. It does not apply to trade marks, copyright or other forms of intellectual property.

The block exemption specifies three types of clauses: a white list of provisions which are granted exemption; a grey list of provisions whose inclusion in an agreement does not affect its eligibility to be exempt; and a black list of provisions which if included in an agreement take it outside the block exemption. The White List (Art 1) includes exclusive licences and territorial restrictions associated with technology transfer that are limited to the life of the intellectual property (or 10 years in the case of pure know-how agreements). The Grey List (Art 2) includes obligations to keep know-how secret, not to grant sublicenses, to terminate agreements where licensees challenge the validity of the licensor's intellectual property rights, and to use best endeavours to manufacture and market the licensed product. The Black List (Art 3) includes restrictions on the selling prices of licensed products (resale price maintenance), restrictions on the quantities to be made or sold, bans on competing technologies, customer restrictions between competing manufacturers, obligations to grant-back improvements, and territorial restrictions for a duration longer than as provided under the White List.

The rationale for the White List block exemption is that territorial restrictions and exclusive licences can be considered "to improve the production of goods and promote technical progress" by making "holders of patents and know-how more willing to grant licenses", and licensees "more inclined to undertake the investment to manufacture and put a new product on the market". This greater willingness to invest can lead to more effective competition by the licensed product with other products in the marketplace. For example, the territorial restrictions in a fast food franchise may help a franchised fast food store compete more effectively against other fast food stores.

Under Art 7 of the technology transfer block exemption, the competition regulator has power to withdraw the benefit of the exemption where it finds that an exempted agreement has certain anti-competitive effects. Examples of where the competition regulator will be especially vigilant include: where the licensee's market share exceeds 40 percent; where the licensee refuses without an objectively justified reason to deal with others; and where the obligations to produce a minimum quantity or use best endeavours to promote the licensed product have the effect of preventing the licensee from using competing technologies.

Under Art 4, there is provision for an opposition procedure. A party may lodge proposed arrangements with the competition regulator. The regulator then has four months to oppose the arrangements (by deciding that they fall outside the block exemption) or the arrangements gain the benefit of the block exemption.

Apart from the technology transfer block exemption, there are a number of other block exemptions covering intellectual property dealings. In particular, the block exemption in relation to franchise agreements (see OJL 359, 28.12.1988, p. 46) exempts conduct that might otherwise breach Art 85. The franchise block exemption covers: territorial restrictions; obligations on a franchisee to use the goods of a franchisor in the franchised business; not to sell competing goods where the goods 'form the essential subject-matter of the franchise'; and clauses which preserve the common identity and reputation of the network or prevent know-how from benefiting competitors. The exemption does not extend to clauses which, for example, share markets between competing manufacturers, unduly limit the franchisee's choice of supplies or customers, or restrict (beyond issuing recommended prices) a franchisee's power to set prices.

The block exemption process does not cover activity which breaches Art 86. It would be likely that if an intellectual property holder held a dominant position in a particular market, then its licensing practices would be closely scrutinised to see if they breached Art 86.

When considering intellectual property cases brought under Arts 85 and 86, the European Courts have traditionally applied the doctrine of 'the scope of the grant' to resolve the question of the appropriate interface between intellectual property law and competition law. Under this doctrine, dealings considered to be within the scope of the rights granted by the relevant intellectual property statute are immune from the application of competition law, and dealings outside are fully subject to competition law. The scope of the grant was considered to cover all matters essential to the function of the intellectual property law. For example, under copyright law, one essential matter was the exclusive right to reproduce the copyrighted work. Therefore, the grant of such exclusive rights in a sole licence did not infringe competition law. A refusal to licence was also within the scope of the grant.

Abraham van Melle has noted the artificiality of this approach:

> *The difficulty with [the scope of the grant] approach was that it was confined to simply characterising conduct as either absolutely exempt from, or subject to, competition law without appraisal of the market context in which the conduct occurred. … exclusivity is the cornerstone of an intellectual property right, but there may be circumstances (such as where an intellectual property rights holder is dominant) where the refusal to licence may permit the gaining of unreasonable anti-competitive advantages not anticipated by the intellectual property law conferring the right (Mr van Melle, 1997, p. 8).*

The recent case of Magill casts doubt on the traditional 'scope of the grant' approach. The Court in this case held that in certain circumstances a refusal to licence would breach competition law. This might occur when the refusal was motivated by the intellectual property owner's desire to use the market power in the intellectual property to control a related market. In Magill, the Court held that the refusal by three TV stations to licence the copyright in their TV program listings was an attempt to control the market for comprehensive weekly TV guides, and breached Art 86.

Magill represents a departure from the accepted case-law because it indicates that the European Courts are prepared to consider whether activity within the scope of the grant could have anti-competitive effects. If the case-law after Magill develops in its logical direction, this may mean that when applying competition law in intellectual property cases the Courts will focus on whether conduct is anti-competitive or not rather than on whether it is within or outside the scope of the grant.

New Zealand

The *Commerce Act* is the New Zealand counterpart of the TPA, and proscribes certain types of anti-competitive behaviour. In relation to intellectual property, it contains two specific exemptions: section 45(1) and section 36(2).

Section 45(1) of the *Commerce Act* provides that, with the exception of the provisions relating to misuse of dominant market power and resale price maintenance, the competition law provisions of the Act do not apply to the entering into of agreements which contain provisions authorising acts that "would otherwise be prohibited by virtue of the existence of a statutory intellectual property right". Section 45(2) defines statutory intellectual property rights as "rights, privileges, and entitlements" arising under the Patents, Designs, Trade Marks, Copyright, and Plant Variety Rights Acts. Section 45(3) extends the definition to cover the rights of parties who have applied for and are awaiting the grant of rights in relation to patents, designs, trademarks, or plant variety rights under the relevant Acts (there is no need to apply for copyright protection; it arises automatically on the creation of the copyright work).

Since it was enacted in 1988, the section has been very rarely used, and it is generally considered problematic. There are a number of views about how it might apply. One view is that section 45(1) is ‘purposive’, that is, it protects licensing and assignment conditions to the extent that they are seen as compatible with the appropriate or efficient use of intellectual property rights. A second, slightly broader view, advanced by van Melle, is that section 45(1) is analogous to the "scope of the right" approach under European law.

Under the ‘purposive’ approach, section 45(1) exempts licensing conditions seen as legitimately protecting the intellectual property owner’s rights. Restrictive conditions that can be characterised as having the purpose of reducing competition or extending the intellectual property owner’s market power into another market are not exempt.

Van Melle considered that the effect of section 45 is:

> *if a licensing term permits the licensee to do something that they would otherwise not be entitled to do because of the exclusive rights of the intellectual property right, then to this extent the term is exempt from the Commerce Act.*
>
> *The basic rule is that the "existence" of an intellectual property right is not challengeable, but the manner in which it is exercised is challengeable (Abraham van Melle, submission 36, p. 11).*

Under this approach:

> *Permissive licensing provisions which divide, licence, or assign the intellectual property as the owner sees fit, and for a price they determine, should remain immune from competition law scrutiny. Only if a licensor attempts to lredeeverage the market power obtained from the intellectual property right (if market power exists) into other markets should competition law intervene (Abraham van Melle, submission 36, p. 7).*

In van Melle's view, section 45 would permit an intellectual property owner to: (1) grant exclusive licences; (2) limit licensees to particular territories or for specified periods of time; (3) impose production quotas (but not distribution); (4) refuse to licence (except where the refusal is part of an attempt to monopolise a second market); and (5) place bans on resale to unauthorised distributors. However, section 45 does not exempt: (1) exclusive cross-licensing; (2) limiting licences as part of a tacit agreement to fix prices; (3) requiring the licensee to buy additional non-intellectual property products from the licensor; (4) package licensing (where the licensee is required to license other intellectual property products; (5) restrictions on sale after the first sale; (6) grantback clauses (where the licensee must grant back to the licensor any improvements); or (7) non-challenge clauses.

Section 36(2) constitutes a special exception to the 'use of dominant market power' provisions in section 36(1). Section 36(1) forbids the use of dominant market power for certain specified anti-competitive purposes, and is broadly equivalent to section 46 of the TPA. Section 36(2) provides that a party is not in breach of section 36(1) "by reason only that the party seeks to enforce any statutory intellectual property right within the meaning of section 45(2)". The limited exception in section 36(2) excepts parties that seek 'only' to enforce intellectual property rights from an allegation of use of dominant market power. It is possible that where the enforcement is motivated by an anti-competitive purpose, for example to delay a competitor's entry into a market while the case is pending, then it will not come within section 36(2).

Appendix Six: Export Notifications

The number of notifications received by the ACCC per year under section 51(2)(g) are:

Year	Number of Notifications
1974	15
1975	69
1976	29
1977	7
1978	4
1979	6
1980	4
1981	7
1982	6
1983	8
1984	13
1985	4
1986	Nil
1987	6
1988	3
1989	2
1990	1
1991	1
1992	1
1993	12
1994	5
1995	7
1996	2
1997	2
1998*	2
Total	**216**

* To 15 October 1998

The sectors of the economy to which the notifications under section 51(2)(g) relate are:

Agriculture

Alcohol

Automotive

Brewing

Chemical

Clothing Manufacturing

Confectionery

Construction

Cosmetics

Dairy

Defence

Electrical Appliances

Financial Services

Fishing

Food

Furniture Manufacturing

Gas

Health

Heavy Machinery

Horticultural

Industrial Equipment

Livestock

Logging

Medical Equipment

Metals

Milling

Mining

Petroleum

Plastics

Power Supply

Recreation

Refrigeration

Sanitation

Scrap Metal

Service

Sport

Stationery

Stevedoring

Sugar

Telecommunications

Textiles

Timber

Tobacco

Tourism

Veterinary Medicine

Water Supply

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