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*Competition Bureau*

# INTELLECTUAL PROPERTY ENFORCEMENT GUIDELINES

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Canada



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## PREFACE

Intellectual property and intellectual property rights are increasingly important in today's knowledge-based economy. In such an environment, there has been interest in how the Competition Bureau will deal with competition issues involving intellectual property.

Accordingly, the Bureau has made it a priority to provide increased clarity on this subject. In publishing these Guidelines, the Bureau articulates how it approaches the interface between competition policy and intellectual property rights. The Guidelines describe how the Bureau will determine whether conduct involving intellectual property raises an issue under the *Competition Act*. The Guidelines also explain how the Bureau distinguishes between those circumstances that warrant a referral to the Attorney General under section 32 of the *Competition Act*, and those that will be examined under the general provisions.

These Guidelines reflect an extensive consultation process which involved two solicitations of written submissions and two series of cross country round-table discussions with interested stakeholders.



Konrad von Finckenstein  
Commissioner of Competition

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# PART 1: INTRODUCTION

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Today's economy is increasingly based on knowledge and innovation and driven by rapid advancements in information and communications technologies. New technologies create economic, cultural, social and educational opportunities for people to put ideas to work in innovative ways that increase productivity and create employment and wealth. Adequate protection of intellectual property (IP) plays an important role in stimulating new technology development, artistic expression and knowledge dissemination, all of which are vital to the knowledge-based economy.<sup>1</sup> In this context, IP becomes a valuable asset that firms can use strategically to lessen or prevent competition.

Owners of IP, like owners of any other type of private property, profit from property laws that define and protect owners' rights to exclude others from using their private property. The special characteristics of IP have made it necessary in many instances for governments to develop laws that confer property rights to IP comparable to those for other kinds of private property.

IP laws and competition laws are two complementary instruments of government policy that promote an efficient economy. IP laws provide incentives for innovation and technological diffusion by establishing enforceable property rights for the creators of new and useful products, technologies and original works of expression. Competition laws may be invoked to protect these same incentives from anti-competitive conduct that creates, enhances or maintains market power or otherwise harms vigorous rivalry among firms. Given that competition law may result in limitations on the terms and conditions under which the owners of IP rights may transfer or license the use

of such rights to others, and on the identity of those to whom the IP is transferred or licensed, Guidelines seek to clarify the circumstances under which the Bureau would consider such intervention to be appropriate and also illustrate situations that would not call for intervention under the *Competition Act*.

The Bureau has received an increasing number of requests for information on its treatment of IP under the *Competition Act*. This document, the Intellectual Property Enforcement Guidelines, sets out how the Competition Bureau views the interface between IP law and competition law. It also explains the analytical framework that the Bureau uses to assess conduct involving IP.

The Guidelines discuss the circumstances in which the Bureau, under the *Competition Act*, would seek to restrain anti-competitive conduct associated with the exercise of IP rights in order to maintain competitive markets. The approach elaborated in this document is based on the premise that the *Competition Act* generally applies to conduct involving IP as it applies to conduct involving other forms of property.

The Bureau's overall approach to the application of the *Competition Act* to IP is as follows:

- The circumstances in which the Bureau may apply the *Competition Act* to conduct involving IP or IP rights fall into two broad categories: those involving something more than the mere exercise of the IP right, and those involving the mere exercise of the IP right and nothing else. The Bureau will use the general provisions of the *Competition Act* to address the former circumstances and section 32 (special remedies) to address the latter.

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<sup>1</sup> The Canadian Intellectual Property Office (CIPO) defines intellectual property and summarizes the role of IP rights as follows:

"Ideas, designs, creativity... [that] help us [Canadians] work better, to make finer products and to compete more effectively in world trade.

A brisk and orderly exchange of ideas is as important to our economy as the flow of money or goods and services. To promote this exchange, while protecting owners' rights, the Government of Canada considers certain kinds of creative endeavors 'intellectual property.' You can receive legal recognition for these endeavors in much the same way as you receive title to a piece of land."

For more information, see the CIPO Web site ([http://strategis.ic.gc.ca/sc\\_mrksv/cipo/help/faq\\_ip-e.html](http://strategis.ic.gc.ca/sc_mrksv/cipo/help/faq_ip-e.html)).

- In either case, the Bureau does not presume that the conduct is anti-competitive, violates the general provisions of the *Competition Act* or should be remedied under section 32.
- The analytical framework that the Bureau uses to determine the presence of anti-competitive effects stemming from the exercise of rights to other forms of property is sufficiently flexible to apply to conduct involving IP, even though IP has important characteristics that distinguish it from other forms of property.
- When conduct involving an IP right warrants a special remedy under section 32, the Bureau will act only in the very rare circumstances described in this document and when the conduct cannot be remedied by the relevant IP statute.

Circumstances will determine how the Bureau uses its enforcement discretion to respond to any alleged contravention of the *Competition Act*. Therefore, individuals contemplating a business arrangement involving IP should either consult qualified legal counsel or contact the Bureau when evaluating the risk of the arrangement contravening the *Competition Act*. The final interpretation of the law rests with the Competition Tribunal and the courts.

When developing these Guidelines, the Bureau considered the current global economic and technological environment and, in particular, the rapid rate of technological change occurring in many industries. The Bureau also took into account its past enforcement experience, Canadian case law, and

the approaches taken in the *Antitrust Guidelines for the Licensing of Intellectual Property* issued by the U.S. Department of Justice and the Federal Trade Commission in 1995, and in other jurisdictions, including the European Union.

The remainder of this document is organized into six parts:

- Part 2 discusses the purpose of IP laws and lists the various statutes that deal with IP, and reviews the purpose of competition law and lists the principal provisions of the *Competition Act* that relate to IP;
- Part 3 discusses the interface between IP law and competition law;
- Part 4 outlines the principles underlying the application of the general provisions and section 32 of the *Competition Act* to business arrangements involving IP;
- Part 5 describes the Bureau's analytical framework, which is sensitive to the particular characteristics of IP;
- Part 6 discusses the Bureau's mandate to promote competition, which may include intervening in proceedings in which IP rights are being defined, strengthened or extended inappropriately; and
- Part 7 presents a series of hypothetical scenarios to illustrate how the Bureau would apply the *Competition Act* to a wide variety of business conduct involving IP.

# PART 2: OVERVIEW OF IP LAW AND COMPETITION LAW

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## 2.1 IP Law

Intellectual property laws create legally enforceable private rights that protect to varying degrees the form and/or content of information, expression and ideas. The primary purpose of these laws is to define the scope of these rights and determine under what circumstances they have been infringed upon or violated. By protecting exclusive rights, the IP laws provide an incentive to pursue scientific, artistic and business endeavors which might not otherwise be pursued.

In the Guidelines, IP rights include rights granted under the *Copyright Act*, the *Patent Act*, the *Trade-Marks Act*,<sup>2</sup> the *Industrial Design Act*, the *Integrated Circuit Topography Act* and the *Plant Breeders' Rights Act*.

- The *Copyright Act* confers upon the creator of an original work, for a limited term, exclusive rights to reproduce or communicate that work.
- The *Patent Act* protects an inventor by granting, for a fixed term, the exclusive right to prevent others from making, selling or using an invention.
- The *Trade-Marks Act* allows the registration of distinctive marks and confers upon the owner the exclusive right to use that mark.
- Upon registration of a design, the *Industrial Design Act* confers on the owner the right to limit the production and sale of articles that incorporate the design.

- The *Integrated Circuit Topography Act* confers similar rights for a topography, which is a design for the disposition of an integrated circuit product.

The term *IP rights* also encompasses the protection afforded IP under common law and the Quebec Civil Code, including that given to trade secrets and unregistered trade-marks.

## 2.2 Competition Law

The principle underlying competition law is that the public interest is best served by competitive markets, which are socially desirable because they lead to an efficient allocation of resources. Competition law seeks to prevent companies from inappropriately creating, enhancing or maintaining market power that undermines competition without offering offsetting economic benefits. Market power refers to the ability of firms to profitably cause one or more facets of competition, such as price, output, quality, variety, service, advertising or innovation, to significantly deviate from competitive levels for a sustainable period of time.<sup>3</sup> However, a firm would not contravene the *Competition Act* if it attains its market power solely by possessing a superior product or process, introducing an innovative business practice or other reasons for exceptional performance.<sup>4</sup>

The provisions of the *Competition Act* that set out when it may be necessary for the Bureau to intervene in a business arrangement, including an

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<sup>2</sup> Although the same general competition law principles apply to trade-marks as to other forms of IP, the Guidelines are generally concerned with technology transfer and innovation related issues. Consequently, when applying its enforcement approach to trade-marks, the Bureau will additionally consider in its analysis the source and quality differentiation issues that arise in respect of trade-marks.

<sup>3</sup> *R. v. Nova Scotia Pharmaceutical Society et al.*, [1992] 2 S.C.R. (606), defines market power as “the ability to behave relatively independently of the market.” *DIR v. The NutraSweet Co.*, (1990) 32 C.P.R. (3d) 1(Comp. Trib.), defines it as the ability to maintain prices above competitive levels for a considerable period.

<sup>4</sup> In the Abuse of Dominance provision of the Act, subsection 79(4) provides that superior competitive performance is a consideration in determining whether a practice has an anti-competitive effect in a market.



arrangement involving IP, fall into two categories: those that cover criminal offenses and those that cover reviewable (civil) matters. Many provisions state that the Bureau must, before it intervenes show that the conduct either substantially or unduly lessens or prevents competition.

Criminal offenses include conspiracy (section 45), bid-rigging (section 47), price maintenance (section 61), price discrimination and predatory pricing (section 50), and some forms of misleading advertising and related deceptive marketing practices (sections 52 to 55).<sup>5</sup>

The provisions on reviewable (civil) matters deal with conduct that is generally pro-competitive but that may, in certain economic circumstances, significantly constrain competition. Reviewable matters include abuse of dominant position (section 79), exclusive dealing, tied selling and market restriction (section 77), refusal to deal (section 75), mergers (section 92), and misleading advertising and related deceptive marketing practices (section 74). As a rule, the Competition Tribunal may order remedies under these provisions if the conduct is likely to substantially lessen or prevent competition.<sup>6</sup>

When a court determines that a firm has contravened the criminal provisions of the *Competition Act*, it can impose fines, imprisonment and prohibition orders.<sup>7</sup> In addition, parties may bring private actions seeking damages. With respect to reviewable (civil) matters, the Competition Tribunal may issue a variety of remedial orders, some of which restrict private property rights. For example, the Tribunal has, in the past, ordered merging firms to divest themselves of

assets, including IP, when it concluded that the proposed merger was likely to substantially lessen or prevent competition, thereby overriding the rights of property owners to acquire or dispose of their private property.<sup>8</sup> Similarly, remedies under the abuse-of-dominant-position provisions have involved orders affecting IP.<sup>9</sup>

Section 32, which is in the special remedies part of the *Competition Act*, gives the Federal Court the power, when asked by the Attorney General, to make remedial orders if it finds that a company has used the exclusive rights and privileges conferred by a patent, trade-mark, copyright or registered integrated circuit topography to unduly restrain trade or lessen competition (see section 4.2 of this document for circumstances in which the Bureau may seek to have the Attorney General bring an application under section 32).

When the Federal Court determines that a special remedy is warranted under section 32, it may issue a remedial order declaring any agreement or license relating to the anti-competitive use void, ordering licensing of the IP right (except in the case of trade-marks), revoking the right or directing that other things be done to prevent anti-competitive use. This provision provides the Attorney General with the statutory authority to intervene in a broad range of circumstances to remedy an undue lessening or prevention of competition involving the exercise of statutory IP rights. In practice, the Attorney General likely would seek a remedial order under the *Competition Act* only on the recommendation of the Bureau.

<sup>5</sup> With the exception of those for conspiracy and predatory pricing, these provisions do not require proof of market power or anti-competitive effects.

<sup>6</sup> The refusal-to-deal provision (section 75) does not require proof of substantial lessening or prevention of competition. However, it does require that the person's inability to obtain adequate supply is the result of insufficient competition among suppliers.

<sup>7</sup> See DIR, Program of Compliance, Information Bulletin No. 3 (Revised), March 1993, for a detailed discussion of case resolution alternatives.

<sup>8</sup> See *DIR v. Southam Inc.* (1997), 71 C.P.R. (3d) 417 (S.C.C.), and (1995), 63 C.P.R. (3d) 67 (F.C.A.), *aff'd* (1992), 47 C.P.R. (3d) 240 (Comp. Trib.).

<sup>9</sup> See *DIR v. D&B Companies of Canada Ltd.* (1995), 64 C.P.R. (3d) 216 (Comp. Trib.) (hereafter referred to as *Nielsen*).

# PART 3: INTERFACE BETWEEN IP AND COMPETITION LAW

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## 3.1 Property Rights

Private property rights are the foundation of a market economy. Property owners must be allowed to profit from the creation and use of their property by claiming the rewards flowing from it. In a market system this is accomplished by granting owners the right to exclude others from using their property, and forcing those wishing to use it to negotiate or bargain in the marketplace for it, thereby rewarding the owner. This creates incentives to invest in developing, and leads to the exchange of, private property, thus contributing to the efficient operation of markets.

## 3.2 IP Law

IP has unique characteristics that make it difficult for owners to physically restrict access to it and, therefore, exercise their rights over it. The owner of physical property can protect against its unauthorized use by taking appropriate security measures, such as locking it away, but it is difficult, if not impossible, for the creator of a work of art to prevent his or her property from being copied once it has been shown or distributed. This is exacerbated because IP, while often expensive to develop, is often easy and inexpensive to copy. IP is also typically non-rivalrous — that is, two or more people can simultaneously use IP. The fact that a firm is using a novel production process does not prevent another firm from simultaneously using the same process. In contrast, the use of a physical property by one firm prevents concurrent use by another.<sup>10</sup>

Accordingly, IP laws confer on an IP owner the right to unilaterally exclude others from using that property. While each IP statute grants this right to varying degrees

and the right may be subject to limitations that vary across statutes, it allows the owners of the IP to maximize its value through trade and exchange in the marketplace. This claim on the rewards flowing from IP enhances the incentive for investment and future innovation in IP as it does for other forms of private property. With the exception of the protections afforded unregistered trade-marks and other common law rights, the legal protection of IP is a function of and does not exist outside the ambit of IP statutory regimes.

## 3.3 Competition Law

Since the right to exclude, which is the basis of private property rights, is necessary for efficient, competitive markets, the enforcement of the *Competition Act* rarely interferes with the exercise of this basic right. Enforcement action under the *Competition Act* may be warranted when anti-competitive conduct creates, enhances or maintains market power.

## 3.4 Interface

IP and competition laws are both necessary for the efficient operation of the marketplace. IP laws provide property rights comparable to those for other kinds of private property, thereby providing incentives for owners to invest in creating and developing intellectual property and encouraging the efficient use and dissemination of the property within the marketplace. Applying the *Competition Act* to conduct associated with IP may prevent anti-competitive conduct that impedes the efficient production and diffusion of goods and technologies and the creation of new products. The promotion of a competitive marketplace through the application of competition laws is consistent with the objectives underlying IP laws.

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<sup>10</sup> In order to enforce common law property rights, it must be possible to identify the property's owner and to clearly delineate the boundaries of the property. Both tasks can prove problematic in the case of IP. For other kinds of private property, possession can generally be seen as an indication of ownership. However, since many individuals can possess IP simultaneously, it may be difficult to establish the identity of the original creator and true owner of the IP. Furthermore, since IP is generally intangible, it is often difficult to clearly delineate the boundaries of the property. Without a legal delineation of these boundaries, IP owners may have difficulty showing that others have infringed on their property.

# PART 4: APPLYING THE COMPETITION ACT TO CONDUCT INVOLVING IP

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## 4.1 Overview

In general, the Bureau's analysis for determining whether competitive harm would result<sup>11</sup> from a particular transaction or type of business conduct comprises five steps:

- identifying the transaction or conduct;<sup>12</sup>
- defining the relevant market(s);
- determining if the firm(s) under scrutiny possess market power by examining the level of concentration and entry conditions in the relevant market(s), as well as other factors;
- determining if the transaction or conduct would unduly or substantially lessen or prevent competition in the relevant market(s); and,
- considering, when appropriate, any relevant efficiency rationales.

This analysis applies to all industries and all types of business transactions and conduct, and is sufficiently flexible to accommodate differences among the many forms of IP protection, as well as between IP and other types of property. For example, the Bureau takes differences among the various forms of IP protection into account when defining the relevant market and determining whether a firm has market power. In addition, although IP rights to a particular product or process are often created and protected by statute and are thus different from other forms of property rights, the right to exclude others from using the product or process does not necessarily

grant the owner market power. It is only after it has defined the relevant market and examined factors such as concentration, entry barriers and technological change that the Bureau can conclude whether an owner of a valid IP right possesses market power. The existence of a variety of effective substitutes for the IP and/or a high probability of entry by other players into the market (by “innovating around” or “leap-frogging over” any apparently entrenched position) would likely cause the Bureau to conclude that the IP has not conferred market power on its owner.

The Bureau's analysis may reveal that an IP owner does indeed have market power. In general, to violate the *Competition Act* a firm must engage in anti-competitive conduct that creates, enhances or maintains market power. Again, consistent with its approach with respect to all forms of property, the Bureau does not consider an owner of IP to have contravened the *Competition Act* if it attained market power solely by possessing a superior quality product or process, introducing an innovative business practice or other reasons for exceptional performance.

Licensing is the usual method by which the owner of IP authorizes others to use it. In the vast majority of cases, licensing is pro-competitive because it facilitates the broader use of a valuable IP right by additional parties.<sup>13</sup> In assessing whether a particular licensing arrangement raises a competition issue, the Bureau examines whether the terms of the license serve to create, enhance or maintain the market power of either the licensor or the licensee. The Bureau will

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<sup>11</sup> For ease of discussion, and unless otherwise indicated, competitive harm is prospective. Note, however, that in many cases competitive harm may be occurring at the time the Bureau is conducting an investigation or may have occurred sometime in the past.

<sup>12</sup> Some of the transactions and conduct that could involve IP include mergers, pooling of licenses, setting standards for products, tied selling and exclusive dealing.

<sup>13</sup> Licensing is a means by which owners trade IP, and it signals the willingness of IP holders to participate in the marketplace. This ability of owners to exchange and transfer IP can enhance the IP's value and increase the incentive for its creation and use. Licensing arrangements also promote the efficient use of IP by facilitating its integration with other components of production, such as manufacturing and distribution.

not consider licensing agreements involving IP to be anti-competitive unless they reduce competition substantially or unduly relative to that which would have likely existed in the absence of the license.

## 4.2 Enforcement Principles

Specific reference is made to IP rights in a number of provisions of the *Competition Act*.<sup>14</sup> The circumstances in which the Bureau may apply the *Competition Act* to anti-competitive conduct involving IP or IP rights fall into two broad categories: those involving anti-competitive conduct that is something more than the mere exercise of the IP right, and those involving the mere exercise of the IP right and nothing else. The general provisions of the *Competition Act* address the former, while section 32 (special remedies) addresses the latter. The Bureau's approach is consistent with subsection 79(5), which acknowledges that the mere exercise of an IP right is not an anti-competitive act,<sup>15</sup> while acknowledging the possibility that under the very rare circumstances set out in section 32 the mere exercise of an IP right might raise a competition issue.<sup>16</sup>

### 4.2.1 General Provisions

The mere exercise of an IP right is not cause for concern under the general provisions of the *Competition Act*. The Bureau defines the mere exercise of an IP right as the exercise of the owner's right to unilaterally exclude others from using the IP. The Bureau views an IP owner's use or non-use of the IP also as being the mere exercise of an IP right.

The unilateral exercise of the IP right to exclude does not violate the general provisions of the *Competition Act* no matter to what degree competition is affected.

To hold otherwise could effectively nullify IP rights, impair or remove the economic, cultural, social and educational benefits created by them and be inconsistent with the Bureau's underlying view that IP and competition law are generally complementary.

The Bureau applies the general provisions of the *Competition Act* when IP rights form the basis of arrangements between independent entities, whether in the form of a transfer, licensing arrangement or agreement to use or enforce IP rights, and when the alleged competitive harm stems from such an arrangement and not just from the mere exercise of the IP right and nothing else.

Applying the *Competition Act* in this way may limit to whom and how the IP owner may license, transfer or sell the IP, but it does not challenge the fundamental right of the IP holder to do so. If an IP owner licenses, transfers or sells the IP to a firm or a group of firms that would have been actual or potential competitors without the arrangement, and if this arrangement creates, enhances or maintains market power, the Bureau may seek to challenge the arrangement under the appropriate section of the *Competition Act*.<sup>17</sup> Part 7 of this document provides a series of hypothetical examples to illustrate how the Bureau would examine the licensing, transfer or sale of IP under the *Competition Act*.

This approach is consistent with the Competition Tribunal's decisions in both *Tele-Direct*<sup>18</sup> and *Warner*<sup>19</sup> in which the Tribunal held that the mere exercise of the IP right to refuse to license a complainant was not an anti-competitive act. In its decision in

<sup>14</sup> Refer to sections 32, 61, 77, 79 and 86.

<sup>15</sup> Subsection 79(5) reads: "For the purpose of this section, an act engaged in pursuant only to the exercise of any right or enjoyment of any interest derived under the *Copyright Act*, *Industrial Design Act*, *Integrated Circuit Topography Act*, *Patent Act*, *Trade-marks Act* or any other Act of Parliament pertaining to intellectual or industrial property is not an anti-competitive act."

<sup>16</sup> The remedies in section 32 are more extensive than those under the general provisions.

<sup>17</sup> This analysis would use the concept of a relevant market as discussed in section 5.1.

<sup>18</sup> *DIR v. Tele-Direct (Publications) Inc. and Tele-Direct (Services) Inc.* (1997), 73 C.P.R. (3d).

<sup>19</sup> *DIR v. Warner Music Canada Ltd.* (1997), 78 C.P.R. (3d) 321.

*Tele-Direct*, the Tribunal indicated that competitive harm must stem from something more than just the mere refusal to license.<sup>20</sup>

Underlying this enforcement approach is the view that market conditions and the differential advantages IP provides should largely determine commercial rewards flowing from the exploitation of an IP right in the market to which it relates. If a company uses IP protection to engage in conduct that creates, enhances or maintains market power as proscribed by the *Competition Act*, then the Bureau may intervene.

When joint conduct of two or more firms lessens or prevents competition, the competitive harm clearly flows from something more than the mere exercise of the IP right to refuse. To the extent that conduct such as conspiracy,<sup>21</sup> bid-rigging, joint abuse of dominance, market allocation agreements and mergers restricts competition among firms actually or potentially producing substitute products or services, the presence of IP should not be a mitigating factor. Such conduct would be subject to review under the appropriate general provision of the *Competition Act*.

A transfer of IP rights that lessens or prevents competition is a further example of a situation in which competitive harm results from something more than the mere exercise of the IP right to refuse. Two examples of this are when a licensor ties a non-proprietary product to a product covered by its IP right, and when a firm effectively extends its market power beyond the term of its patent through an exclusive contract. In either case, if the conduct

leads to the creation, enhancement or maintenance of market power so as to substantially lessen or prevent competition, the Bureau may intervene.

Sometimes upon examination, what appears to be just a refusal to license or to grant others access to a firm's IP rights turns out to have included conduct which goes beyond such a refusal. The conduct which goes beyond the unilateral refusal to grant access to the IP could warrant enforcement action under the general provisions of the *Competition Act*. For instance, if a firm acquires market power by systematically purchasing a controlling collection of IP rights and then refuses to license the rights to others, thereby substantially lessening or preventing competition in markets associated with the IP rights, the Bureau could view the acquisition of such rights as anti-competitive and review the matter under either section 79 (abuse of dominance) or section 92 (mergers) of the *Competition Act*. Without the acquisitions, the owner's mere refusal to license the IP rights would have been unlikely to cause concern (see example 7).

#### 4.2.2 Matters Outside the General Provisions — Section 32<sup>22</sup>

Only section 32, in the special remedies part of the *Competition Act*, contemplates the possibility that the mere exercise of an IP right may cause concern and result in the Bureau seeking to have the Attorney General bring an application for a special remedy to the Federal Court.

<sup>20</sup> In *Tele-Direct* the Competition Tribunal stated that, "The Tribunal is in agreement with the Director that there may be instances where a trade-mark may be misused. However in the Tribunal's view, something more than the mere exercise of statutory rights, even if exclusionary in effect, must be present before there can be a finding of misuse of a trade-mark."

<sup>21</sup> The *Copyright Act* provides that section 45 of the *Competition Act* not apply to any royalties or related terms and conditions arising under certain collective agreements filed with the Copyright Board.

<sup>22</sup> The special remedies provided for under section 32 include declaring any agreement or license relating to the challenged right void, ordering licensing of the right (except in the case of trade-marks), revoking a patent, expunging or amending a trade-mark, or directing that other such acts be done or omitted as deemed necessary to prevent the challenged use.

The Bureau will seek a remedy for the unilateral exercise of the IP right to exclude under section 32 only if the circumstances specified in that section are met and the alleged competitive harm stems directly from the refusal and nothing else. Such circumstances require the Federal Court to balance the interests of the system of protection for IP (and the incentives created by it) against the public interest in greater competition in the particular market under consideration. Generally, the Bureau would recommend to the Attorney General that an application be made to the Federal Court under section 32 when, in the Bureau's view, no appropriate remedy is available under the relevant IP statute.

Enforcement under section 32 requires proof of undue restraint of trade or lessened competition. The Bureau expects such enforcement action would be required only in certain narrowly defined circumstances. The Bureau determines whether the exercise of an IP right meets this threshold by analyzing the situation in two steps.

In the first step, the Bureau establishes that the mere refusal (typically the refusal to license IP) has adversely affected competition to a degree that would be considered substantial in a relevant market that is different or significantly larger than the subject matter of the IP or the products or services which result directly from the exercise of the IP. This step is satisfied only by the combination of the following factors:

- i) the holder of the IP is dominant in the relevant market; and,
- ii) the IP is an essential input or resource for firms participating in the relevant market — that is, the refusal to allow others to use the IP prevents other firms from effectively competing in the relevant market.

In the second step, the Bureau establishes that invoking a special remedy against the IP right holder would not adversely alter the incentives to invest in research and development in the economy. This step is satisfied if the refusal to license the IP is stifling further innovation.

If factors i) and ii) are present then the IP is the source of dominance in a relevant market and other competitors would be able to participate in the relevant market only by having access to that IP. If the refusal is stifling further innovation then the Bureau would conclude that incentives to invest in research and development have been harmed by the refusal and a special remedy would help realign these incentives with the public interest in greater competition.

The Bureau recognizes that only in very rare circumstances would all three factors be satisfied. A case in which they could arise is in a network industry,<sup>23</sup> when the combination of IP protection and substantial positive effects associated with the size of the network could create or entrench substantial market dominance. In such a situation, IP rights and network externalities can interact to create *de facto* industry standards. Standardization means that the protected technology is necessary for a competitor's products to be viable alternatives. IP protection can effectively exclude others from entering and producing in the market.<sup>24</sup> However, the Bureau still would have to be satisfied that a refusal is stifling further innovation and not simply preventing the replication of existing products before seeking to recommend that the Attorney General bring an application for a special remedy to the Federal Court (see Example 8).

<sup>23</sup> A network industry is an industry that exhibits network effects. These effects exist when the value or benefit derived from using a product increases with the number of other users. For example, fax machines exhibit network effects because the value of owning a fax machine clearly depends on the number of compatible fax machines in use.

<sup>24</sup> This does not suggest that markets subject to network effects will inevitably be monopolized. Often, firms form alliances and make a new technology "open" to gain acceptance and build an installed base. These activities tend to be procompetitive if firms that participate in the standard-setting process freely compete with each other in the market.

### 4.2.3 *Matters Outside the Competition Act*

An illegitimate extension of an IP right could include anti-competitive behavior. This might involve a patent holder claiming that its patent covers products that are not within the scope of its patent. Alternatively, the Bureau may receive complaints that infringement of a legitimate IP right should be justified on competition grounds. Such disputes are best resolved by the appropriate IP authority under the appropriate IP statute (see Example 1).

As outlined in section 4.1 above, the Bureau's analytical approach is sufficiently flexible to accommodate the specific characteristics of IP and the differences in the scope and length of protection extended to different IP rights. The following information highlights how the Bureau takes these factors into account when analyzing a transaction or business conduct involving IP.

# PART 5: THE ANALYTICAL FRAMEWORK IN THE CONTEXT OF IP

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## 5.1 Relevant Markets

Relevant markets provide a practical tool for assessing market power.<sup>25</sup> When the anti-competitive concern is prospective (that is, the conduct is likely to have a future anti-competitive effect),<sup>26</sup> relevant markets are normally defined using the hypothetical monopolist test.<sup>27</sup>

When the anti-competitive concern is retrospective<sup>28</sup> (that is, the conduct has already had an anti-competitive effect), applying the hypothetical monopolist test could lead to erroneous conclusions about the availability of substitutes and the presence of market power. Accordingly, the Bureau takes into account the impact of any alleged anti-competitive conduct that may have preceded the investigation when determining the relevant market. In this context, the Bureau analyzes market definition and competitive effects concurrently (see Example 2).

For transactions or conduct involving IP, the Bureau is likely to define the relevant market based on one of the following: the intangible knowledge or know-how that constitutes the IP, processes that are based on the IP rights, or the final or intermediate goods resulting from, or incorporating, the IP.

Defining a market around intangible knowledge or know-how is likely to be important when IP rights are separate from any technology or product in which the knowledge or know-how is used. For example, consider a merger between two firms that individually license similar patents to various independent firms that, in turn, use them to develop their own process

technologies. Such a merger may reduce competition in the relevant market for the patented know-how if the two versions of that know-how are close substitutes for each other, if there are no (or very few) alternatives that are close substitutes for the know-how and if there are sufficient barriers that would prevent the development of conceptual approaches that could replace the know-how of the merging firms. This last condition may hold if the scope of the patents protecting the merging firms' know-how is sufficiently broad to prevent others from "innovating around" the patented technologies, or if the development of such know-how requires specialized knowledge or assets that only the two merging firms possess and that potential competitors could not develop or obtain in less than two years.

In cases involving the licensing of IP, the Bureau generally treats the license as the terms of trade under which the licensee is entitled to use the IP. The Bureau does not define a relevant market around a license, but rather focuses on what the legal rights granted to the licensee actually protect.

The Bureau does not define markets based on research and development activity or innovation efforts alone. The Bureau usually concentrates on price or output effects. Conduct that directly reduces the innovation effort of the firms under scrutiny or restricts or prevents the innovation efforts of others may be anti-competitive. The appropriate relevant market definition or definitions will depend specifically on the knowledge or know-how, process, or final or intermediate good toward which the innovation effort is directed.

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<sup>25</sup> The market definition exercise focuses primarily on demand substitution factors (i.e., possible consumer responses). The Bureau considers the potential constraining influence of firms that can participate in the market through a supply response (i.e., a possible production response) after it has defined the relevant market.

<sup>26</sup> This is generally the case with mergers.

<sup>27</sup> See sections 3.2 and 3.3 of the Competition Bureau's Merger Enforcement Guidelines.

<sup>28</sup> This is generally the case with alleged abuse of dominant position or conspiracy.



## 5.2 Market Power

Whether a transaction or conduct involving IP results in an increase in market power in the relevant market depends on a number of factors, including the level of concentration, entry conditions, the rate of technological change, the ability of firms to “leap-frog over” seemingly entrenched positions and the horizontal effects, if any, on the market.<sup>29</sup> The order in which the Bureau assesses these factors may vary depending on the section of the *Competition Act* under which the Bureau is examining the transaction or conduct and on the circumstances of the relevant market.

### 5.2.1 Market Concentration

The Bureau examines the degree of market concentration to get a preliminary indication of the competitiveness of the relevant market. In general, the more firms there are in the relevant market, the less likely it is that any one firm acting unilaterally, or any group of firms acting cooperatively, could enhance or maintain market power through the transaction or conduct being examined. However, a high degree of concentration is not enough to justify the conclusion that the transaction or conduct will create, enhance or maintain market power. This is particularly true of industries with low barriers to entry, a high rate of technological change and a pattern of firms “innovating around” or “leap-frogging over” technologies that had previously controlled a dominant share of a market.

To measure concentration in markets for intermediate or final goods, the Bureau typically calculates the market shares of the firms identified as actual participants in the relevant market. These include the firms identified as offering products that are demand substitutes as well as those that represent potential supply substitutes (i.e., firms that are likely to respond to a price increase in the relevant market within one year with minimal investment).<sup>30</sup> Firms that are unable to respond within one year or whose entry requires significant investment are not considered to be part of the relevant market for purposes of defining the relevant market and assessing market concentration. That said, the potential competitive influence of such firms may be considered as part of the assessment of whether the conduct in question is likely to lessen or prevent competition substantially.

The Bureau generally does not challenge the conduct of a firm (or a group of firms acting together) that possesses less than a 35 percent market share. (Market shares of more than 35 percent are not considered evidence of market power or anti-competitive effect, but merely of circumstances that may warrant further review.) Market share may be calculated based on the firms’ entire actual output, total sales (dollars or units) or total capacity (used and unused).<sup>31, 32</sup> However, some of these factors may be difficult to assess in cases involving IP. Accordingly, the Bureau’s assessment of market power is likely to focus on qualitative factors such as conditions of entry into the relevant market, whether IP development is resulting in a rapid pace of technological change, the views of buyers and market participants, and industry and technology experts.

<sup>29</sup> Part 4 of the Merger Enforcement Guidelines provides a list of other factors the Bureau considers when it assesses market power. These include foreign competition, business failure and exit, the availability of acceptable substitutes, effective remaining competition, removal of a vigorous and effective competitor, and change and innovation.

<sup>30</sup> The following factors are relevant to determining when a firm will divert sales within one year in response to a price increase: the cost of substituting production in the relevant market for current production (i.e., switching costs), the extent to which the firm is committed to producing other products or services, and the profitability of switching from current production.

<sup>31</sup> If the actual participants in the market include firms that, within one year, represent potential sources of supply for the market, then market shares, even in terms of production capacities, may be difficult to accurately estimate. Accordingly, it must be recognized that the market shares attributed to firms whose products are actually sold within the relevant market will overstate the relative market position of these firms in such circumstances.

<sup>32</sup> The Competition Tribunal stated in *DIR. v. Laidlaw Waste Systems Ltd.* (1992), 40 C.P.R. (3d) 289 (Comp. Trib.) (hereafter *Laidlaw*), that market share calculations based on sales may overstate market power when the market is characterized by excess capacity.

### 5.2.2 Ease of Entry

The Bureau also examines how easily firms can enter the relevant market to determine whether new entrants have the ability to restrain any creation, enhancement or maintenance of market power that may result from a transaction or conduct involving IP. When assessing effects in markets involving IP, conditions of entry are often more important than market concentration. For instance, evidence of a rapid pace of technological change and of the prospect of firms being able to “innovate around” or “leap-frog over” an apparently entrenched position is an important consideration that may, in many cases, fully address potential competition law concerns.

The Bureau also considers the extent to which the transaction or conduct itself erects or has erected barriers to entry or, alternatively, induces or has induced competitors to exit the market (see Examples 3.2 and 4).<sup>33</sup> Entry into markets in which IP is important may be difficult because of the sunk costs associated with developing assets that comprise specialized knowledge. Additionally, IP rights can serve to increase barriers to entry independent of any conduct.<sup>34</sup>

### 5.2.3 Horizontal Effects

In evaluating the competitive effects of conduct that involves an IP right, whether it is a merger transaction, licensing arrangement or other form of contractual arrangement, the Bureau focuses on whether the conduct will result in horizontal anti-competitive effects — consequences for firms producing substitutes or firms potentially producing substitutes (see Examples 3.1, 3.2 and 3.3).

Even though an arrangement may be vertical, such as the acquisition of a retail shoe outlet by a shoe manufacturer or the licensing of the right to use a particular food additive to a food producer, it can still have

horizontal effects in a relevant market (see Example 4). If an arrangement is vertical, the Bureau considers whether it is likely to result in horizontal effects among either sellers or buyers.

## 5.3 Anti-competitive Effects

A transaction or conduct must create horizontal effects for the Bureau to conclude that it is anti-competitive. In this regard, the Bureau analyzes whether the transaction or conduct facilitates a firm’s ability to exercise market power, either unilaterally or in a coordinated manner, in the areas such as pricing and output.

Anti-competitive horizontal effects may arise if the transaction or conduct increases competitors’ costs. For example, a transaction can prevent, or raise the cost of, competitors’ access to important inputs. IP licensing arrangements that involve one firm selling the right to use IP to another are inherently vertical, but can have horizontal effects, particularly if the licensor and licensee would have been actual competitors in the absence of the licensing arrangement. In addition, a transaction or conduct that reduces innovation activity could be anti-competitive if it prevents future competition in a prospective product or process market.

## 5.4 Efficiency Considerations

A fundamental objective of competition law is to ensure the efficient use of resources through vigorous competition. However, there may be instances in which restrictions on competition can lead to a more efficient use of resources. This may be particularly true of arrangements and transactions involving IP that are inherently vertical and combine complementary factors. Moreover, there may be instances when creating or increasing market power is justified because of the efficiencies created. Indeed, this principle is consistent with

<sup>33</sup> The fact that anti-competitive conduct can create barriers to entry was recognized by the Competition Tribunal in *Laidlaw*.

<sup>34</sup> Of course, the purpose of providing innovators with IP rights is to foster the development of new products. In this sense, IP rights may encourage firms to participate in environments in which technology changes very rapidly.

the protection afforded by IP laws, which foster dynamic efficiency and competition by facilitating the creation of valuable works or processes that result in long-term increases in product selection, quality, output and productivity. In providing incentives for investment, IP laws grant exclusivity to the protected works that may result in temporary market power. Consequently, the Bureau considers both the short-term and long-term efficiency implications of conduct or a transaction when analyzing efficiencies in cases involving IP. Efficiencies are explicitly recognized in section 96 of the *Competition Act* in the context of mergers.<sup>35</sup> In addition, under the abuse-of-dominant-position (section 79) and exclusive dealing, tied selling and market restriction (section 77) provisions,<sup>36</sup> efficiency rationales and business justifications may be relevant to determining whether conduct is, on balance, anti-competitive.<sup>37</sup>

If the Bureau concludes that a merger is likely to substantially lessen or prevent competition in a relevant market, it next considers whether the merger generates efficiencies that offset the anti-competitive effect. The Bureau then determines, in the manner more fully described in the Merger Enforcement Guidelines, the net effect in the relevant market(s) by assessing whether the efficiency benefits are sufficient to offset the anti-competitive effects.

In assessing whether conduct involving IP substantially lessens or prevents competition under the abuse-of-dominant-position or exclusive dealing, tied selling and market restriction provisions, the Bureau considers any pro-competitive effects (efficiencies or business justification) generated by or associated with the conduct. For example, a licensing arrangement between an IP owner and a distributor may restrict *intra*-brand competition, but at the same time further *inter*-brand competition. A licensing arrangement between two potential competitors may result in a new product being developed that would not otherwise have been developed. In each case, the level of competition in the market would be enhanced.<sup>38</sup>

The Bureau also considers whether the firms could have used commercially reasonable means to achieve efficiencies that are or were less harmful to competition. If such alternatives exist, the Bureau would compare the anti-competitive effect of the transaction or conduct to such alternatives. In making this comparison, the Bureau does not attempt to uncover all of the theoretically possible alternatives for achieving the efficiencies. It considers only those means that are commercially reasonable and consistent with the firm's IP rights. The Bureau also considers the impact that using an alternative would have on the firm's ability to exercise its IP rights.

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<sup>35</sup> Section 95 provides a specific exemption under the merger provisions to research and development joint ventures that satisfy certain criteria outlined in the provision.

<sup>36</sup> While there is no explicit recognition of efficiencies in the conspiracy provisions (section 45) of the *Competition Act*, there are 12 specific defenses to agreements between competitors that may encompass efficiency-enhancing arrangements involving IP. Among these, the following may be more likely to apply to agreements involving IP: the exchange of statistics, the definition of product standards, the size and shapes of product packaging, cooperation in research and development, restrictions on advertising or promotion, measures to protect the environment, and export consortia or specialization agreements as defined in section 85(f).

<sup>37</sup> In *Tele-Direct*, the Competition Tribunal stated that, "[w]hat the Tribunal must decide is whether, once all relevant factors have been taken into account and weighed, the act in question is, on balance, 'exclusionary, predatory or disciplinary'. Relevant factors include evidence of the effects of the act, of any business justification and of subjective intent which, while not necessary, may be informative in assessing the totality of the evidence. A 'business justification' must be a 'credible efficiency or pro-competitive' business justification for the act in issue. Further, the business justification must be weighed 'in light of any anti-competitive effects to establish the overriding purpose' of the challenged act..."

<sup>38</sup> In *Nielsen*, the Competition Tribunal held that even if there is some justification for the alleged anti-competitive conduct, this must be weighed against any anti-competitive effects.

## **PART 6: COMPETITION POLICY ADVOCACY\_\_\_\_\_**

The Bureau may use its mandate to promote competition and the efficient allocation of resources to intervene in policy discussions and debates regarding the appropriate scope, definition, breadth and length of IP rights. The Bureau may also intervene in Federal Court and Superior Court cases when it believes it is important to bring a competition perspective to proceedings that will not be brought by the parties.

In other proceedings, when the Bureau believes that IP rights could potentially be defined, strengthened or extended inappropriately, the Bureau may intervene to make representations concerning the scope of the protection that should be accorded IP rights.

Part 7 of this document sets out hypothetical situations to illustrate the Bureau's enforcement approach.

## PART 7: APPLICATION OF COMPETITION LAW TO IP: HYPOTHETICAL EXAMPLES

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### Example 1: Alleged Infringement of an IP Right

TAX is a software company that produces and distributes a sophisticated and complex tax management program to help households with their tax planning. As is customary in the software industry, TAX assigns a serial number to each copy of the program that it distributes. A customer may register with TAX by providing the serial number listed on the packaging along with certain personal information. TAX offers upgrades to its software from time to time to respond to changes in the tax code and technology advances, and users need to be registered to receive these upgrades at low prices. If TAX finds that a serial number has been used more than once, it knows that its software has been illegally reproduced. TAX realizes that serial numbers do not prevent duplication but do provide a mechanism for detection, thus weakening incentives to copy. TAX has been selling its product for a number of years and is now widely recognized as a leading producer of tax management software.

More than two years ago, a key member of TAX's software engineering team left the company to start her own software business, called UPSTART. Recently, UPSTART began to market its own tax management program to be used in *conjunction* with TAX's product. UPSTART designed its program to operate as a graphical user interface to TAX's software. Furthermore, relatively minor changes in the tax code can be incorporated into UPSTART's product. As a consequence, for users who already own TAX's product, there is no longer a need to get upgrades from TAX. Instead, they can purchase UPSTART's product for a much lower price and can continue to buy upgrades from UPSTART.

TAX has publicly alleged that UPSTART must have infringed TAX's copyright because it would have been impossible for UPSTART to have created its program without having copied TAX's source code. Despite its claims, TAX has not filed a suit against UPSTART. Instead, TAX has made a formal complaint to the Bureau that UPSTART's conduct is predatory since it has undermined TAX's serial number policy by making it less valuable for users to become registered with TAX. TAX claims that since UPSTART's product came on the market, there has been widespread piracy of TAX's program and, consequently, the market for its product has evaporated.

#### Analysis

*The Bureau would likely conclude that the underlying issue in this case is the possibility that UPSTART infringed TAX's copyright. Therefore, the Bureau would inform TAX that the Bureau does not view the matter as raising any issues under the Competition Act and would suggest that TAX seek legal advice on other remedies, if any, that might be available.*

### Example 2: Price Fixing

Three firms, each of which has developed and owns a patented technique, offer competing cosmetic surgical procedures to treat a particular condition. All three procedures involve several visits to a private clinic over six months, produce no side effects and have approximately equal success rates. The only existing alternative to the three procedures is an expensive medication that causes undesirable side effects in some patients. The three firms have agreed on a minimum price at which each will perform the procedure as well as a minimum fee to license each procedure to third parties. Prior to entering into the agreement, the procedures cost approximately \$5,000 each. After the agreement, prices increased to approximately \$8,000 on average.

## Analysis

*The Bureau would likely examine this agreement under the conspiracy provision in section 45 of the Competition Act.*

*To determine the relevant market, the Bureau would consider, along with other factors, direct evidence of the exploitation of market power, such as the fact that prices increased by \$3,000 following the parties' agreement. The Bureau may view this change in price as direct evidence that the three medical procedures are part of the same relevant market and of the parties' collective market power.*

*The Bureau would also look for evidence that the three firms intended to enter into the agreement, knew its terms and either knew or should have known that it would unduly lessen competition. The Bureau would also seek to assess the effect of the agreement, specifically to determine the extent to which it had added to the market power that the three firms could exercise together. If the Bureau determined that the three firms accounted for 100 percent of the relevant market and that their patents provided effective barriers that would prevent others from entering this market, it would likely conclude that the objective intent and likely effect of the minimum price agreement was to increase or create market power. Given evidence of the parties' intent to enter into the agreement and the market power resulting from the agreement, the Bureau would likely refer the matter to the Attorney General for prosecution under section 45 of the Competition Act.*

### **Example 3.1: Exclusive Licensing**

SHIFT recently developed a new gear system for mountain bikes. Two other firms manufacture systems that compete with SHIFT's. All three of these firms manufacture several varieties of bicycle gear systems and are engaged in research and development to improve gear system technology. SHIFT grants licenses for the use of its patented gear system technology to manufacturers of mountain bikes as it does not have the ability to manufacture mountain bikes itself. Demand for mountain bikes is supplied by three large firms, which account for approximately

80 percent of sales, plus six smaller firms. SHIFT has just granted ADVENTURE, the largest mountain bike manufacturer (accounting for 30 percent of sales), an exclusive license to use its new patented gear system technology on its mountain bikes. ADVENTURE does not own or have the ability to develop gear system technology. Although SHIFT's new gear system offers a number of features not available on other current products, the demand for mountain bikes with these new features is uncertain. In addition, ADVENTURE expects to incur significant expense developing and promoting mountain bikes that use SHIFT's new gear system technology. SHIFT has refused requests from other mountain bike manufacturers for a license for this technology. As a result of ongoing research and development, alternative gear system technologies are likely to become available in the future.

## Analysis

*The Bureau is likely to examine the conduct of both firms under the abuse-of-dominant-position provision (section 79) of the Competition Act.*

*SHIFT and ADVENTURE relate as supplier and customer, and are neither actual nor potential competitors in the markets for gear systems or mountain bikes. Since the firms do not compete, the exclusive license would likely not lessen competition between the two firms. The Bureau would nonetheless examine the markets for gear systems and mountain bikes to determine if the exclusive license lessened or prevented competition substantially in either or both of those markets.*

*Even though SHIFT's technology is not available to ADVENTURE's two principal rivals and the markets for gear systems and mountain bikes are concentrated, SHIFT's rivals in the gear system market may still sell to ADVENTURE. Furthermore, the other mountain bike manufacturers have access to other gear systems from SHIFT and to gear systems from other suppliers. The exclusive license may have been granted in consideration for ADVENTURE's agreement to incur significant expense in the development and promotion of mountain bikes that use SHIFT's technology.*

*In the course of its assessment, the Bureau would consider the competitiveness of the mountain bike market before and after the license. Since SHIFT is not a mountain bike manufacturer and has no obligation to license its gear system to a mountain bike manufacturer, any licensing agreement would enhance competition. In this case, the technology license mandated the development and promotion of mountain bikes using the technology, thereby enhancing competition without in any way limiting the ability of other mountain bike manufacturers to access or use competing technologies. Consequently, the Bureau would conclude, given the facts of this case, that the exclusive license arrangement did not raise any competition issues.*

### **Example 3.2: Foreclosure by Purchaser**

Consider a variation on the situation described in Example 3.1, in which ADVENTURE's business has grown to represent approximately 70 percent of mountain bike sales. ADVENTURE has taken advantage of its increasing sales share to independently negotiate long-term exclusive licenses and supply arrangements with the three competing suppliers of mountain bike gear systems. The inability of the competing manufacturers to obtain suitable gear system technology has put a number of them out of business and has substantially cut into the sales of the remaining firms. ADVENTURE has raised the prices of its mountain bikes by 25 percent. Although alternative gear system technologies are under development, it appears unlikely that a viable technology will be tested and in production in less than 36 months.

#### *Analysis*

*The Bureau is likely to examine ADVENTURE's conduct under the abuse-of-dominant-position provision (section 79) of the Competition Act.*

*The Bureau would initially determine whether mountain bikes comprised a relevant market and assess whether ADVENTURE substantially or completely controlled the supply of product within that relevant market. The Bureau would likely view the apparent lack of good substitutes and ADVENTURE's high sales share and ability to successfully impose a 25 percent price increase as evidence that ADVENTURE substantially controlled the mountain bike business and that mountain bikes comprise a relevant market.*

*The Bureau would then consider whether ADVENTURE's exclusive license agreements, through which it precluded its competitors from obtaining an adequate supply of gear systems, constituted anti-competitive conduct. While an exclusive licensing arrangement may enhance competition, as was apparent in Example 3.1, the use of an exclusive licensing arrangement to effectively control the supply of a competitively essential input may be anti-competitive. The Bureau would likely view as anti-competitive the systematic manner in which ADVENTURE prevented its competitors from obtaining access to this vital input through the execution of long-term exclusive licenses with each supplier.*

*The Bureau would then assess the impact of the exclusive licenses on competition. It would likely conclude that the adverse impact on the ability of other mountain bike manufacturers to compete that resulted from ADVENTURE preventing them from gaining access to proven gear system technology and the manner in which ADVENTURE successfully imposed substantial price increases constituted evidence that ADVENTURE substantially lessened or prevented competition. In the absence of compelling efficiency benefits or business justifications, neither of which are apparent in this case, the Bureau would likely seek to have the exclusive licenses voluntarily terminated. Failing that, the Bureau would likely bring an application before the Competition Tribunal seeking to terminate these licenses.*

### **Example 3.3: Foreclosure by Suppliers**

A variation on the situation described in Example 3.2 sees the gear system suppliers, concerned about ADVENTURE's growing purchasing power, enter into an agreement to subdivide the market for mountain bike systems among themselves. To make it easier to monitor compliance, the firms agree to enter into exclusive license agreements, at premium prices, with ADVENTURE. The result of this arrangement is as described in Example 3.2.

#### *Analysis*

*The Bureau is likely to examine this matter under section 45 as a conspiracy case against the gear system suppliers or under section 79 as a joint abuse-of-dominance case against the gear system suppliers.*

*A number of factors would influence the Bureau's initial decision to examine and possibly challenge these arrangements, including the existence of any legitimate business justification or efficiency rationale, whether ADVENTURE had been told about the arrangement and the business rationale for it and whether the parties had behaved covertly. If the agreement was a blatant market allocation scheme implemented in a covert manner, the Bureau would likely investigate it under the conspiracy provision. A specialization arrangement, under which each supplier publicly agrees to focus on a particular gear system technology that the parties disclosed to and discussed with ADVENTURE, would likely be investigated as joint abuse of dominance.*

*The Bureau would initially determine whether gear systems comprised a relevant market and assess whether the gear system suppliers either had market power or completely controlled the supply of product within that relevant market. The Bureau would view the apparent lack of good substitutes for gear systems, and the suppliers' and ADVENTURE's high sales shares and ability to successfully impose price increases as evidence that the gear system suppliers had market power or substantially controlled the gear systems business and that gear systems comprise a relevant market.*

*If the Bureau was investigating the matter under the conspiracy provision, it would then assess whether the requirements of that section, discussed in Example 2, had been satisfied. If the Bureau was investigating the matter under the abuse-of-dominance provision, it would then assess whether the requirements of that section, discussed in Example 3.2, had been satisfied in terms of the impact of the arrangement on the market for gear system technology and/or the market for mountain bikes. For the reasons discussed in Example 3.2, and in view of the facts of the case, it seems likely that the Bureau would conclude that the arrangement had either unduly or substantially lessened or prevented competition. It would then either refer the matter to the Attorney General (in the case of an investigation under the conspiracy provision) or seek to terminate the market allocation agreement and the exclusive licenses (in the case of an investigation under the abuse-of-dominance provision).*

### **Example 4: Exclusive Contracts**

SPICE, by virtue of its international patents, is the sole supplier of Megasalt, a unique food additive that has effectively replaced salt in certain prepared foods in most countries. SPICE's Canadian patent recently expired; however, SPICE still has valid patent protection throughout much of the rest of the world. Shortly before its Canadian patent expired, SPICE signed five-year contracts, which included exclusive supply rights, with its two principal Canadian buyers. These contracts prevent the two buyers, which use Megasalt in specially prepared foods for hospitals and other health care institutions, from combining Megasalt with any other salt substitute on the same product line. SPICE does not have long-term exclusive supply contracts with other buyers of Megasalt in Canada or elsewhere. Recently, NUsalt, a firm that has developed a potential alternative to Megasalt, filed a complaint with the Bureau alleging that SPICE's contracts are preventing NUsalt from manufacturing and marketing its product in Canada. NUsalt claims that SPICE's contracts have "locked up" a substantial part of the market, thereby precluding NUsalt from profitably entering Canada



## Analysis

The NUsalt allegations suggest that SPICE, as a result of its contracts with its two largest buyers, is currently exploiting market power within the market for salt substitutes. The Bureau would likely investigate these allegations under the exclusive dealing provision (section 77) or the abuse-of-dominance provision (section 79).

The Bureau would initially determine whether salt substitutes comprise a relevant market. This would entail determining whether salt substitutes are subject to effective competition from other substances (for example, salt) or whether salt substitutes have specific properties and functional characteristics that make salt ineffective as a substitute. The Bureau would then seek to determine whether SPICE substantially controlled the market in which its salt substitutes competed, and then assess SPICE's share of sales and barriers to entry to this market. Among others, the Bureau would consider all of the factors currently preventing alternative suppliers from offering their products to customers in Canada, including the effect of the exclusive supply contracts on the ability of alternative suppliers to obtain sales from a critical mass of customers. Assuming that the Bureau had determined that salt substitutes constitute a relevant market, it would likely conclude that SPICE substantially controlled that market.

The Bureau would then consider whether the exclusive supply contracts, through which SPICE had precluded its principal customers from obtaining salt substitutes from alternative suppliers, constituted exclusive dealing or abuse of dominance. The Bureau would likely conclude that the exclusive supply contracts constituted exclusive dealing. In order to assess whether the formation of these contracts was an anti-competitive act, the Bureau would examine the circumstances surrounding their negotiation and settlement and the extent to which they were exclusionary and intended to erect barriers to effective competition in the relevant market. If the Bureau found that the contracts in this case were intended to hold back a sufficient amount of market demand from potential entrants so that the remaining demand would provide an insufficient volume of sales to cover the cost of entry

and future operating costs in Canada, then the Bureau would likely view the execution of the long-term exclusive licenses as anti-competitive.

The Bureau would then assess the impact of the exclusive contracts on competition. In this regard, the adverse impact on the ability of other suppliers of salt substitutes to compete in Canada would be assessed to determine whether the contracts had substantially lessened or prevented competition. If the relevant market is narrowly defined as salt substitutes and SPICE's contracts are preventing the entry of potential salt substitute producers, the Bureau may conclude that the exclusive contracts have substantially lessened competition. By deterring firms from attempting to supply alternative salt substitutes in Canada, the exclusive contracts may cause other buyers in Canada not under contract with SPICE to pay higher prices than they would if SPICE faced effective competition. The magnitude of the decrease in competition would depend on the extent to which the contracts prevent entry and the expected degree of substitution that would exist between Megasalt and alternative salt substitutes, such as NUsalt, if the exclusive contracts did not exist. In general, if the contracts are determined to be the principal barrier to new entry and the new entrants' products are likely to be close substitutes for Megasalt, then the Bureau is likely to conclude that the contracts have substantially lessened competition. However, if the Bureau determines that, notwithstanding the contracts, there is still sufficient demand in Canada or the rest of the world to support effective competitive entry in Canada, then SPICE's exclusive contracts would not be considered to have substantially lessened or prevented competition.

The Bureau would also consider whether there are efficiency reasons or a compelling business justification for SPICE's exclusive contracts. For example, SPICE may have signed these contracts in order to ensure that it would have sufficient sales to justify investing in enough productive capacity to realize economies of scale. Also, the restriction preventing buyers from combining Megasalt with other salt substitutes could have a safety or quality rationale. If the Bureau concludes that SPICE's contracts substantially lessen competition, but that there is also a strong efficiency rationale or business justification for

*those contracts that could not be achieved without them being exclusive, the Bureau would not likely challenge the practice under sections 77 or 79 of the Competition Act. However, if there is no compelling efficiency rationale or business justification for the exclusivity provisions, the Bureau would likely seek to have SPICE's exclusive licenses voluntarily terminated. Failing that, the Bureau would likely bring an application before the Competition Tribunal seeking to terminate these licenses.*

### **Example 5: Output Royalties**

MEMEX currently holds a patent for the design of a memory component it manufactures for use in personal home computers. MEMEX does not manufacture personal computers, but instead sells its memory components and licenses the use of its technology to computer manufacturers. Historically, MEMEX's licensing contracts required that the licensee pay a fee for each MEMEX memory component it installed in a computer. Because of its patent, MEMEX currently faces no competition from other memory component producers wishing to use a similar design; however, MEMEX's patent is to expire within a year and there is speculation that once it expires other firms will begin manufacturing and selling memory components based on MEMEX's design. MEMEX has recently introduced a new license agreement. Under the new agreement, MEMEX grants non-exclusive licenses for the use of its technology and memory components to all personal computer manufacturers for a royalty on every computer shipped, regardless of whether the computer included a MEMEX memory component, and a further fee for every MEMEX memory component the manufacturer installs. MEMEX claims that the previous licensing policy had the unintentional effect of encouraging computer manufacturers to install too few MEMEX memory components, which detracted from computer performance. MEMEX claims that the new licensing practice makes it less

expensive for manufacturers to install a more appropriate quantity of memory in computers. To offset the loss in revenue, MEMEX charges a royalty on every computer sold.

#### *Analysis*

*The Bureau would investigate this case under the abuse-of-dominance provision (section 79).*

*The Bureau would first determine whether memory components that employ the MEMEX's technology comprise a relevant market and then assess whether MEMEX substantially or completely controls the supply of product within that market. In view of the rapid rate of technological development and intense competition in the production of integrated circuit devices, the Bureau may conclude that the MEMEX technology competes with other memory technologies, that barriers to entry are sufficiently low that the scope of the relevant market extends beyond the MEMEX technology, or that MEMEX is unable to substantially control the supply of products within the specified relevant market. If the Bureau determines that MEMEX faces substantial, effective competition from other suppliers of memory components then it would likely conclude that further investigation is not warranted. If, on the other hand, the Bureau concluded that the memory components supplied by the alternative suppliers are not considered good substitutes and would not allow computer manufacturers to build computers that could compete with those using MEMEX's memory component, the Bureau might determine that further inquiry was warranted.*

*Assuming that the Bureau determined that the MEMEX technology defines the relevant market and MEMEX substantially controls that market, the Bureau would then consider whether MEMEX's use of its new licensing arrangements constituted anti-competitive conduct. This determination would depend on the specific terms of the contracts and the likely effect they would have on competition in the relevant market. While MEMEX's licensing contracts do not expressly prohibit computer*

manufacturers from using memory components based on technology other than MEMEX's, they effectively impose a tax on computer manufacturers who use memory components from both MEMEX and another supplier.<sup>39</sup> The imposition by a dominant supplier of long-term licensing contracts containing such provisions could preclude competition and maintain the supplier's market power. Accordingly, the Bureau would determine whether these contracts are in widespread use and their duration, and whether the per computer royalty is sufficient to deter computer manufacturers from buying memory components from alternative suppliers.

If the Bureau determined the relevant market to be memory components based on the MEMEX technology and found MEMEX to have market power, then the Bureau would assess the likely impact of MEMEX's new licensing practice on competition and the price of memory components. If the Bureau determines that this practice would permit MEMEX to exercise a significantly greater measure of market power after its patent expired than would otherwise have been the case, the Bureau would consider MEMEX's efficiency rationale and any other business justification for charging the per computer royalty. In the absence of offsetting efficiency benefits or business justifications, the Bureau would likely seek to have the new licensing practice voluntarily terminated. Failing that, it would likely bring an application before the Competition Tribunal seeking to terminate this practice.

### **Example 6: A Patent Pooling Arrangement**

ABC and ZENIX have each developed a revolutionary new X-ray imaging machine to help diagnose cancer. Each firm has been granted a series of patents on certain components of their respective machines, and the machines themselves are functionally interchangeable. ABC's machine does not infringe on any of ZENIX's patents; however, the design of one of the components of the ZENIX machine may infringe on one of ABC's patents. ABC has threatened to sue ZENIX for patent infringement if ZENIX begins

marketing its machine without getting a license from ABC to use the component. ZENIX disputes ABC's claim of patent infringement. However, to avoid a messy court battle, the companies have placed their various patents in a patent pool. The pool has established a \$500 licensing fee, which is to be paid to the pool each time an X-ray imaging machine produced by either firm is used in a medical diagnosis. The proceeds from the license fees are split between the two firms according to a predetermined formula. As a result, neither firm is likely to charge medical practitioners less than \$500 per procedure.

### *Analysis*

The Bureau would examine this case under the conspiracy provision (section 45) of the Competition Act.

The Bureau recognizes that a patent pooling arrangement may provide pro-competitive benefits by, among other things, clearing blocking patents, avoiding costly infringement litigation, integrating complementary technologies and reducing transaction costs. If a firm is blocked from using its technology because it infringes on another firm's patent, and if it is not possible to "invent around" the blocking patent, then these firms cannot be considered to be horizontal competitors. In this case, ABC claims that a component of the ZENIX machine infringes on one of its patents; ZENIX does not claim that any part of ABC's machine infringes on any of its own patents. Therefore, ABC would be able to use its machine with or without reaching any agreement, including a patent pooling arrangement, with ZENIX. For this reason, the patent pooling arrangement is not necessary in order for the new X-ray imaging machine to be used in the marketplace. A competitively preferable alternative would have ABC simply license the use of its infringed patent to ZENIX. If the patent were truly blocking, a licensing agreement would provide ZENIX with an incentive to innovate around the blocking patent (in order to reduce its costs). ABC, on the other hand, may well wish to license the blocking patent in order to realize greater

<sup>39</sup> A manufacturer who wishes to use alternative memory products in addition to MEMEX memory components must pay twice, once for the alternative component and a second time for the per computer royalty payable to MEMEX.

revenues from its development work and to eliminate the possibility that its patent could be found by the court to be invalid (and therefore of no value). However, if the patent was not blocking, then ZENIX would have no incentive to enter a licensing agreement since, the license fees would represent a net cost to ZENIX which, unlike the patent pooling arrangement, provide no offsetting revenue benefits.

Based on the above analysis, the Bureau would view the patent pool as an unnecessary and anti-competitive commercial arrangement which was not required in order for the new technology to enter the market. The Bureau would assess the strength of ABC's claim that a component on ZENIX's machine infringed on one of its patents. If ABC's claim had merit and ZENIX could not easily "invent around" ABC's patent, then the Bureau would not likely challenge the patent pooling arrangement as it would not lessen competition. If ABC's claim was baseless or if ZENIX could easily "invent around" ABC's patent, the Bureau would challenge the patent pooling arrangement under the conspiracy section of the Competition Act (section 45) as the patent pool would be, in substance, an agreement to prevent price competition between ZENIX and ABC.

### **Example 7: Agreement to Foreclose Complementary Products**

There are five major record labels. The largest two, ROCKCO and POPCO, which together account for more than 65 percent of total sales and 70 percent of all major label artists, have formed a joint venture (DISCO) to develop, produce and market a new generation of digital playback devices. The DISCO technology provides a level of sound quality and other features far superior to those offered by existing technologies. DATCO has also developed a digital sound technology with similar high-fidelity qualities, but which is also portable and allows users to record. The costs of the two technologies are similar, but the technologies themselves are incompatible: music digitally encoded in DISCO format must be re-encoded for playback on DATCO's player. Under

the terms of their joint venture agreement, ROCKCO and POPCO agree to not release, or license any other person to release, their copyrighted recordings in a digital format other than the DISCO format. Consistent with that agreement, ROCKCO and POPCO have declined DATCO's request for a license to convert and release ROCKCO and POPCO recordings in the DATCO format. The other three record labels predict — correctly — that consumers will be reluctant to purchase the DATCO technology if they are unable to obtain music from either ROCKCO or POPCO in that format. The other record companies are willing to release their recordings in the DATCO format, but find that there is no market for it and are compelled by popular demand to license the DISCO technology in order to release their recordings in the DISCO format. As a result of the foregoing, DATCO's digital sound technology, which reviewers have generally viewed as superior to the DISCO technology, is being withdrawn and DISCO is substantially increasing both the price of the playback equipment that it sells and the royalties charged to the other record companies for the use of the DISCO technology to release recordings in the DISCO format.

#### *Analysis*

*The Bureau would examine this case under the merger provision (section 92) and/or the abuse-of-dominance provision (section 79) of the Competition Act.*

*As a first step, the Bureau would consider whether the alleged anti-competitive conduct, namely the refusal of ROCKCO and POPCO to license the reproduction of their copyrighted recordings in the DATCO format, was a mere exercise of their IP rights or involved something more. In this case, the Bureau would likely determine that the terms of the DISCO joint venture agreement and the refusal to license lessen competition and would seek to review that arrangement under either the merger provision or the abuse-of-dominance provision of the Competition Act.*

*If the Bureau elected to review the joint venture agreement under the merger provision on the basis that the joint venture was, for the purposes of the digital sound business, in substance a merger of the musical recording assets of ROCKCO and POPCO, the review would be carried out in accordance with the Merger Enforcement Guidelines. If, on the other hand, the Bureau elected to review the joint venture agreement under the abuse-of-dominance provision, on the basis that the joint venture agreement established and provided for the joint abuse of a dominant position, the review would be carried out in accordance with the framework and criteria for abuse of dominance outlined in the previous examples. In either case, the Bureau would have to establish the affected relevant market or markets, consider barriers to entry and evidence of market power or dominance, demonstrate a substantial prevention or lessening of competition and assess any business justification or efficiency rationale.*

*If the Bureau were to proceed under section 79, it would have to establish that the DISCO joint venture has substantial market power in either the market for digital sound technology or digital playback equipment. In addition, it would have to find that the DISCO joint venture had engaged in anti-competitive conduct that substantially lessens or prevents competition. The anti-competitive acts in this case would relate to the acquisition and foreclosure by the DISCO joint venture of access by its competitors to the music in the ROCKCO and POPCO music libraries. Foreclosure of access to these materials is apparently preventing alternative sound recording technologies from acquiring the critical mass of desirable music content required for them to achieve viability. It appears that this conduct may be substantially preventing or lessening competition and leading to the monopolization or the creation of dominance in the markets for digital sound technology and/or digital playback equipment sound reproduction. The foreclosure of other technologies creates market power for DISCO in these markets and is inefficient, as it reduces consumer choice, leads to increases in the*

*royalties paid by the record companies to use this type of technology and increases the price of playback devices. The Bureau would likely seek an order requiring that ROCKCO and POPCO divest themselves of DISCO or that ROCKCO and POPCO license their works for release in alternative formats.*

### **Example 8: Refusal to License a Standard**

ABACUS and two other firms were the first to market a spreadsheet for personal computers. Electronic spreadsheet software was one of the applications that established personal computers as an essential tool for business. In the first five years, ABACUS outsold its nearest competitor nearly two to one and its installed base (cumulative sales) grew to 50 percent. In the next two years, its annual market share grew to more than 75 percent and one of the other original firms left the market. At about the same time and after three years of programming, CALCULATOR introduced spreadsheet software that had a number of innovative features not found in ABACUS. However, CALCULATOR soon ran into financial difficulties despite the innovative features and a lower price. CALCULATOR approached ABACUS and requested a licence to copy the words and layout of its menu command hierarchy (for the purpose of this example assume that permission was required since ABACUS had valid IP rights in these works). With permission, CALCULATOR could have relaunched its product with an emulation mode and a key reader, which would have given CALCULATOR the ability to read ABACUS files and ensured compatibility between the two products. ABACUS refused to grant a licence and publicly announced that it would enforce its IP rights against CALCULATOR if it copied the ABACUS hierarchy. In light of this, several other prominent software makers announced that they were discontinuing their spreadsheet development programs.

An important characteristic of spreadsheets that determines their benefits to a purchaser is network effects. Network effects exist if the value of a product increases with the number of others who purchase compatible spreadsheets. Network effects for spreadsheets arise since the greater the size of the network (the installed base of compatible spreadsheets), the greater the number of individuals with whom files can be shared, the greater the variety of complementary products (utilities, software enhancements and macros), the more prevalent consulting and training services and the greater the number of compatible data files.

#### *Analysis*

*Given the circumstances surrounding this case, ABACUS's refusal to license its IP would constitute a "mere exercise" of its IP rights and would, therefore, be subject to review only under section 32 of the Competition Act.*

*To establish whether ABACUS's refusal created an undue restraint of trade or lessened competition, the Bureau would determine whether the refusal adversely affected competition in a relevant market that was different or significantly larger than the subject matter of ABACUS's IP rights or the products or services which result directly from the exercise of such IP rights. In this case, competitive harm is alleged in the market for ABACUS-compatible spreadsheets.*

*Whether the relevant market is determined to be ABACUS-compatible spreadsheets depends on the extent and importance of network effects and switching costs. If network effects are important, consumers that have never purchased a spreadsheet may still purchase the more expensive ABACUS product. Consumers who are already on the ABACUS network may be locked in by the switching costs of joining a new spreadsheet network (for example, their sunk investments in training, files*

*and complementary products) and the loss in network benefits. If network effects and switching costs are material, then existing consumers are likely to stay and new consumers to choose ABACUS even if it is priced above competitive levels.*

*If the relevant market is determined to be ABACUS-compatible spreadsheets, then ABACUS would be the only producer and thus have 100 percent control of this market. If, in addition, entry barriers were found to be high, which is likely in an industry experiencing network effects, the Bureau would conclude that ABACUS is dominant. In determining whether the installed base of ABACUS contributes materially to entry barriers, the Bureau would consider the pace of innovation and the potential for a new technology to "leap-frog over" ABACUS despite its advantages (that is, its installed base and the switching costs). The Bureau would also endeavor to determine whether there are other efficient avenues for creating compatibility that would not infringe on the IP rights of ABACUS.*

*If the relevant market is determined to be ABACUS-compatible spreadsheets and the Bureau concluded that the relevant market was significantly larger than the subject matter of ABACUS's IP, and the products which result directly from the exercise of such IP rights, then the Bureau would likely conclude that ABACUS is dominant in the relevant market and that the IP is an essential input for firms participating in the relevant market. On this basis, ABACUS's refusal satisfies the first step of the Bureau's two-step analysis to determine whether it would seek to have an application brought under section 32.*

*In the second step, the Bureau determines whether ABACUS's refusal to license its IP would adversely alter firms' incentives to invest in research and development in the economy. In this case, the facts suggest that it is possible that ABACUS's ability to impose incompatibility may have a chilling effect on the development of more advanced spreadsheets. In addition, the choice*

*by ABACUS of the words and layout of its menu hierarchy was likely arbitrary and likely involved little innovative effort and had little value relative to other substitutes. In the absence of an installed base and switching costs, ABACUS's terms and menu hierarchy would be no better or worse than CALCULATOR's (or any other). It is only after consumers make sunk investments and adoption creates an installed base that ABACUS spreadsheets become the market or standard and that its choice of words and menu interface — required for compatibility with the ABACUS network — creates unintended and unwarranted market power, a situation that can be*

*corrected through enforcement action under section 32. On this basis, the Bureau would likely conclude that a special remedy invoked under section 32 would restore incentives for other firms to engage in research and the development of competing compatible spreadsheet programs.*

*If the facts of the case suggest potential enforcement under section 32, the Bureau would seek a special remedy that would allow other spreadsheet firms to gain access to the words and layout of ABACUS's menu hierarchy.*

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