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Intellectual property and price discrimination: Do as you please in the name of innovation?

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Abstract

This paper considers policy towards the exercise of market power by holders of intellectual property rights (IPRs). In particular, we ask whether intellectual property protection should extend to price discrimination. To answer this question, we present a very simple model of IPRs, designed to make clear the trade-offs that face government policy makers in designing IPRs. We find that there are strong arguments for requiring price discrimination undertaken in the context of enforcing IPRs, that results, or is likely to result, in a substantial lessening of competition, to be subject to some form of public benefits test.

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1. Introduction

This paper considers policy towards the exercise of market power by holders of intellectual property rights. In particular, we ask whether intellectual property right protection should extend to price discrimination. Price discrimination is the sale of the same product to different consumers at different prices, where the differences do not reflect the cost of supply.

In general, price discrimination is not directly attacked by competition law in Australia or New Zealand. However, the law in both countries prohibits agreements

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that have the purpose or effect of substantially lessening competition (unless there are countervailing benefits) and prevents firms from taking advantage of their market power for prohibited purposes: restricting the entry of others into the market, preventing others from engaging in competitive conduct, and eliminating others from the market. Hence, as a general policy, price discrimination which has the purpose or the effect of reducing competition would not be permitted. However, on both sides of the Tasman, the law exempts the above actions when they are carried out for the purpose of enforcing a statutory intellectual property right. This appears to grant to holders of intellectual property rights the ability to maintain exclusive, geographically or otherwise delineated distribution arrangements or to tie in the sale of other products in situations where such arrangements cannot necessarily be justified on the grounds of economic efficiency and without gaining authorisation.

In this paper, we ask whether such exemptions are good policy. Our discussion is structured as follows. Firstly, we discuss price discrimination further and consider its consequences from an economic efficiency point of view. We then go on to consider the relationship between intellectual property protection and competition. Section 3 considers the welfare impact of intellectual property rights, with particular reference to the impact of changes in the design of intellectual property rights, and presents a simple model that identifies the trade-offs implicit in the design of intellectual property rights. We finish with a discussion of the implications for policy with respect to price discrimination in licences or contracts involving intellectual property rights.

We conclude that licenses and contracts, arrangements or understandings involving statutory intellectual property rights should be subject to a public benefits test where they result, or are likely to result, in a substantial lessening of competition. We therefore agree in principle with the approach recommended by the Australian Intellectual Property and Competition Review Committee¹ with respect to section 53(1) of the Trade Practices Act, to the extent that it has this effect.

2. Price discrimination

The key feature that is consistent across all forms of intellectual property right is the granting of an exclusive right of some kind to the holder of the right. This may confer market power on the right holder, depending on the scope of the right and the availability of legitimate substitutes. The holders of intellectual property rights can be expected to utilise this power in every possible way to earn economic rents from their inventions. (From an economic point of view, enabling the owners of intellectual property to earn rents in this way is, at least to some extent, a key objective of intellectual property right protection. More on this later.)

Price discrimination is one of a range of strategies available to intellectual property owners to maximise profits. Price discrimination can be defined as:

¹ Australian Intellectual Property and Competition Review Committee, 2000.

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