

THE FEDERAL COURT OF APPEAL RULES ON WHETHER LICENSES DEMONSTRATE THAT COMPETITION IS NOT LESSEMED UNDER THE COMPETITION ACT

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INTRODUCTION

On appeal from a decision rendered by the Federal Court of Canada (the “Federal Court”) granting motions for summary judgement brought forth by Eli Lilly and Company (“Eli Lilly & Co.”), Eli Lilly Canada Inc. (“Eli Lilly”) and Shionogi & Co. Ltd. (“Shionogi”) (Eli Lilly & Co., Eli Lilly and Shionogi collectively the “Respondents”), with regard to the striking out of certain paragraphs contained in Apotex Inc.’s (“Apotex”) statement of defense and counterclaim and the dismissal of Apotex’s counterclaim against Shionogi, the Federal Court of Appeal (“Court of Appeal”) dismissed the aforesaid motions for summary judgement and reinstated the paragraphs stricken from Apotex’s statement of defence and counterclaim and restored Apotex’s counterclaim against Shionogi.

THE FACTS

On June 18, 1997, Eli Lilly & Co. and Eli Lilly (collectively “Lilly”) instituted legal proceedings against Apotex whereby Lilly claimed that Apotex had infringed seven of its process patents relating to intermediate compounds and processes for preparing intermediates useful in the preparation of the antibiotic cefaclor. Lilly amended its initial statement of claim on January 11, 2001 to include an eighth patent which Lilly claimed had also been infringed by Apotex.

Four of the eight patents allegedly infringed by Apotex had been assigned to Lilly in 1995 by Shionogi, whereas Lilly owned the other four prior to the assignment.

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In response to Lilly's statement of claim, Apotex alleged, in the amendment to its statement of defense and counterclaim filed on March 9, 2001 that the aforesaid assignment violated section 45 of the *Competition Act* (*Competition Act*, R.S.C. 1985, c. C-34; the "Act") thereby entitling Apotex to seek damages against the Respondents under section 36 of the Act. Essentially, Apotex claimed that the Respondents conspired, agreed, or arranged to hinder, restrict or minimize the manufacture of cefaclor.

In December 2002, Apotex elected to seek legal recourse against Shionogi as well and amended its statement of defense and counterclaim to add Shionogi as a defendant to the counterclaim proceedings instituted by Apotex.

Three motions were brought before the Federal Court each of which were granted. In the first, Lilly sought summary judgement striking the paragraphs contained in Apotex's statement of defense and counterclaim which made reference to anti-competitive behaviour on the part of both Lilly and Shionogi and dismissing Apotex's counterclaim against Shionogi. In the second motion, Shionogi sought a summary judgement striking Apotex's counterclaim against the former. Finally, in the third motion, Shionogi appealed the ruling of Prothonotary Arnovitch refusing to strike Apotex's counterclaim against Shionogi.

According to the Federal Court, Apotex had failed to demonstrate, to the satisfaction of the Court that it had a viable cause of action against the Respondents, and as such concluded that Apotex's amendments to its statement of defence and counterclaim should never have been permitted, and that its counterclaim against Shionogi should have been dismissed on the latter's motion.

Discontented with the Federal Court's ruling, Apotex filed a motion for leave to appeal before the Court of Appeal, a motion which said Court later granted.

On appeal, the Court of Appeal held, with respect to the order of Prothonotary Arnovitch regarding Apotex's cause of action against Shionogi that such an order should not have been overturned as it was not apparent and prominent that Apotex had no arguable cause of action against Shionogi. With respect to the two motions for summary judgement respecting Apotex's statement of defence to Lilly's action for infringement and counterclaim against Shionogi, the Court of Appeal ruled that Apotex's appeal should be allowed and that such motions should be remitted back to the Federal Court for further consideration.

According to the Court of Appeal, it was paramount that the Federal Court, while examining the arguments raised by the Respondents and Apotex, address the following three issues:

- (i) whether agreements involving the exercise of patent rights are subject to subsection 45(1) of the Act;
- (ii) whether the facts in the case at bar demonstrated, to the satisfaction of the Federal Court, that Shionogi's and Lilly's conduct was in breach of section 45 of the Act; and

- (iii) supposing that the Federal Court determined that subsection 45(1) of the Act applied and that the Respondents contravened section 45 of the Act, whether Apotex's claim under section 36 of the Act would not prevail for the reason that: (a) Apotex's cause of action was statute-barred, (b) Apotex did not suffer any damages, or (c) Shionogi and Lilly were exempt in accordance with subsection 45(3) of the Act.

THE FEDERAL COURT JUDGEMENT

On reconsideration, the Federal Court struck yet again Apotex's claim under section 45 of the Act against the Respondents. While the Federal Court adjudged that the assignment agreement by and between Lilly and Shionogi did indeed effect a lessening of competition, it concluded that such lessening was not "undue" on account of the fact that section 50 of the *Patent Act* (*Patent Act*, R.S.C. 1985, c. P-4; the "*Patent Act*") expressly authorizes the transfer of patents.

As to the first issue, the Federal Court, in relying on the Court of Appeals decision in *Molnycke AB. v. Kimberly-Clark of Canada Ltd* (1991), 36 C.P.R. (3d) (493 F.C.A.); "Molnycke") opined that agreements pertaining to patent rights are not, as a general rule of law, immune to the liability provisions set forth in the *Patent Act*. The Federal Court argued that "where an agreement deals only with patent rights and is itself specifically authorized by the Patent Act, any lessening of competition resulting therefrom, being authorized by Parliament, is not "undue" and is not an offence under section 45" (*Eli Lilly and Co. v. Apotex Inc.*, [2004] FC 1445.).

In other words, the Federal Court concluded, with regard to the first issue, inapplying the principles set forth in *Molnycke*, that the entering into of an agreement authorized by an Act of Parliament such as that of an assignment under the *Patent Act*, cannot embody conduct which unduly diminishes competition for the purposes of section 45 of the Act and that it is only those agreements which involve the mere exercise of patent rights which may be exempt from subsection 45 (1) of the Act.

As to the second issue, the Federal Court considered the fact that (i) the patents assigned by Shionogi in favor of Lilly were for processes instrumental in the manufacture of cefaclor, (ii) Lilly was the proprietor of four other process patents useful for the same purpose, and (iii) the patent for the product cefaclor had itself expired.

While the Federal Court concluded, with respect to the second issue, that the assignment agreement by and between Shionogi and Lilly precipitated an increase in Lilly's market power and a lessening in competition by virtue of Lilly's ownership of all eight process patents instrumental in the manufacture of cefaclor, it determined that such a lessening could not be "undue" on account of the fact that it had been authorized by an Act of Parliament.

Essentially, the Cour opined that by their very nature, patents accord their owners a monopoly in a particular market. Parliament authorizes patent owners to assign their

rights to persons of their choice via written agreements. Therefore, such written agreements necessarily result in the transferring of the patent owners market power from the assignor to the assignee, thereby increasing the latter's market power.

In their defence, the Respondents argued that Apotex's claim for damages pursuant to section 36 of the Act should be dismissed by the Court as (i) Apotex did not institute legal proceedings against the Respondents within the prescribed period of time, (ii) Apotex did not meet its burden of proof by demonstrating that it had indeed suffered damages, and (iii) the research and development exemption set forth at section 45 (3) of the Act applied to the Respondents. Though the Federal Court initially affirmed that it would not comment on the third issue, it later decided to very briefly explain the reasons why it would reject the defences raised by the Respondents.

With regard to the first and third defence raised by the Respondents, the Court concluded that "there is sufficient conflict and lack of clarity in the relevant evidence on the questions of foreseeability and the reach of the 1975 research and development agreement between Lilly and Shionogi that those questions are not suitable for summary judgement and should only be resolved after a full trial". With respect to the second defence raised by the Respondents, the Federal Court was unable to definitively determine whether such a defence would succeed in the event that Apotex was successful in its claim for damages against the Respondents under section 36 of the Act despite the fact that the Court concluded that such a defence was based on Apotex's admissions that: (i) it had not been delayed in bringing its version of cefaclor to the market and (ii) the damages suffered by Apotex were restricted to the amounts Apotex may be ordered to remit to Lilly should the Federal Court determine that the former violated the patent rights of the latter.

THE FEDERAL COURT OF APPEAL JUDGEMENT

On appeal, the Court of Appeal considered and ruled on the three issues it previously ordered that the Federal Court examine.

As to whether an agreement which pertains exclusively to the exercise of patent rights can be actionable under section 45 of the Act, the Court of Appeal adjudged that section 50 of the *Patent Act* cannot immunize a patent assignment agreement from section 45 of the Act in the event that such an assignment effects an increase in the assignees market power in excess of that inherent in the patent rights assigned. In reaching such a determination, the Court of Appeal examined the Federal Court's interpretation of *Molnlycke*, and the latter's conclusion that the mere exercise of patent rights precludes the determination that competition has been unduly lessened. According to the Federal Court, *Molnlycke* cannot have the effect of hindering the application of the provisions set forth in the Act in those cases where there is clear evidence of *something other* than the mere exercise of patent rights which influences competition in a particular market.

Apotex alleged that the “*something other*” was the fact that the assignment in question resulted in Lilly acquiring rights to patents which permitted it to control all of the commercially viable processes for making cefaclor when such processes were controlled by both Shionogi and Lilly prior to the assignment.

In *Molnlycke*, the only market power created by the assignment was that inherent in the patent assigned. There was no change in the number of patent-holders before and after the assignment. The assignment merely effected the transfer of a patent from one company to another, a situation quite unlike that opposing Apotex and the Respondents.

Essentially, the Court of Appeal argued that it was on this basis and this basis alone that *Molnlycke* needed to be distinguished from the case at bar and that the Federal Court had erred in failing to do so.

In its defence, the Respondents asserted that the fact that Shionogi had been granted a non-exclusive license to use the process patents demonstrated that the assignment had not lessened competition. According to the Respondents, there were two sources, namely Shionogi and Lilly, from which a competitor could purchase or seek a license to manufacture the antibiotic cefaclor, be it prior or subsequent to the assignment.

As to whether the facts evidenced that the Respondents were in breach of section 45 of the Act, the Court of Appeal ruled that it could not, in the absence of palpable error, challenge the Federal Court’s determination that Lilly’s ownership of the process patents for the manufacture of cefaclor prior to the assignment coupled with the fact that subsequent to the assignment it held all the process patents for the manufacture of cefaclor resulted in a lessening of competition. According to the Court of Appeal, it would be incumbent on the trial judge to determine if such lessening fell within the ambit of section 45 of the Act.

As to whether Apotex’s counterclaim could not prevail on account of the fact that it was not taken within the prescribed period of time, and that Apotex failed to demonstrate that it sustained damages following the assignment by Shionogi of its patents to Lilly, the Court of Appeal acquiesced with the Federal Court’s ruling that these issues be resolved at trial. The Court of Appeal did not comment on the third of the Respondents’ defences namely, that the research and development exemption provided for at sub-section 45 (3) of the Act applied in the case at bar.

The Court of Appeal ultimately held that Apotex’s appeal be allowed. The Court set aside the ruling of the Federal Court and dismissed the motions for summary judgement and for striking of Apotex’s counterclaims and various paragraphs contained in its statement of defence.

Thus the Court of Appeal adjudged that the assignment agreement by and between Lilly and Shionogi had indeed effected a lessening in competition and ruled that the trial judge had the responsibility of (i) determining whether such lessening was in fact “undue” in accordance with the stipulations set forth in the Act

and the criteria established in the Competition Bureau's Intellectual Property Enforcement Guidelines, which describes how the Competition Bureau determines whether conduct involving intellectual property raises an issue under the Act and (ii) further exploring the validity of the defences raised by the Respondents.

The Federal Court has not, as of yet, ruled on any such issues.

CONCLUSION

Agreements such as licenses and assignments are not intrinsically actionable under section 45 of the Act. Essentially, the provisions of the Act and the criteria set forth in the Intellectual Property Enforcement Guidelines establish cases where it may be necessary for the Competition Bureau to intervene in a business arrangement in order to maintain competitive markets. Each case must therefore be dealt with separately.

It is undisputed that intellectual property, by its very nature, lessens or prevents competition. If this weren't so, intellectual property owners would not spend large sums of money each year on the monitoring of their competitor's activities and on the prosecution of those who threaten the privilege they accord their proprietor. Implicit in the detention of intellectual property is the right for proprietors to decide where, when and for how much a third person may make use of such intellectual property.

Licensing is but one way intellectual property owners permit third persons to make use of their intellectual property, and is regarded in the vast majority of cases, as being pro-competitive on account of the fact that it actually facilitates the use, in any given market, of intellectual property by persons other than their proprietor. Further, a licensing agreement between two potential competitors for example, may result in the development of a new product which would not otherwise have been developed but for the license. In such a case, the licensing agreement would effect an increase in the level of competition in the relevant market.

Though the entering into of license agreements may, in some circumstances, enhance competition such agreements may also lessen competition and enhance the market power of one, both or all the parties thereof, as was the case in *Eli Lilly and Co. v. Apotex Inc.*¹ Prior to entering into the assignment agreement with Shionogi, Lilly controlled four of the process patents for producing the antibiotic cefaclor. Once the patents owned by Shionogi were assigned to Lilly, the latter controlled *all* the process patents for producing cefaclor. The assignment agreement therefore enhanced Lilly's market power, a fact undisputed by both the Federal Court and the Court of Appeal. The fact that Lilly granted, subsequent to the assignment, a non-exclusive license did not obliterate the fact that competition had been lessened following the intensification of Lilly's market power and that it was nonetheless Lilly who ultimately controlled the licensed patents, as the aforesaid

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agreement stipulated that Shionogi could not grant sub-licenses without first obtaining Lilly's written approval.

In conclusion, this case confirms that intellectual property owners should be weary of the fact that the granting of licenses to third persons may not necessarily demonstrate its willingness to participate in the market...

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