



Australian Government

IP Australia

**REVIEW OF THE
“SPARE PARTS”
PROVISION
IN THE
*DESIGNS ACT 2003***

December 2005

Contents

Executive Summary and Review Recommendations	3
The spare parts/right of repair provision	4
The Review	5
Design Applications	6
<i>Review Findings</i>	
European Union Developments	6
Review Submissions	
(i) Current impact of the spare parts provision	7
<i>Review Findings</i>	
(ii) Content of submissions	8
<i>Review Findings</i>	
(iii) Specific issues/proposals	11
<i>Review Findings</i>	
Conclusions	14
Attachment A:	
List of submissions, including acronyms for submitters	15

Executive Summary

This Review was conducted in accordance with the Government's commitment in 2003 to conduct a formal review of the spare parts provision in section 72 of the *Designs Act 2003* ("the Act") before the end of 2005.

Section 72 of the Act provides a complete defence against infringement where a component part embodying a registered design, or a design substantially similar to the registered design, is used for the purpose of repair of a complex product, so as to restore its overall appearance in whole or in part.

IP Australia launched this Review with the publication of a short issues paper on 18 August 2005. The paper canvassed the Government's case for the spare part provision and invited submissions on how the provision had impacted on industry and the community since the Act came into effect on 17 June 2004.

11 submissions were received from a range of parties including IP owners, IP attorneys, motor vehicle manufacturers, insurance companies and consumer interests. These submissions are listed in Attachment A to this report and are available on the IP Australia website.

The spare parts provision has operated for a relatively short period. The Review accepted the common view in submissions that the spare parts provision was yet to have a significant effect on industry and consumers.

A number of submissions noted the long lead times between design registration and the appearance on the market of complex products. It was also noted that designs registered under the *Designs Act 1905* (the old Act) in the year to June 2004 would retain their monopoly for 16 years, or to 2019-2020. Accordingly, the Review found that the full impact of the provision on industry and consumers is unlikely to become evident for several years to come.

The provision is yet to be tested before the courts in Australia. The Review could draw no firm conclusions on the impact of the spare parts provision from the continuing increase in design applications in 2003-04 and 2004-05.

Most submissions expressed strong views concerning the potential impacts of the spare parts provision, but provided little hard information on developments in relation to the operation and impact of the Act. The Review could draw no firm conclusions as to whether the Government policy objectives were being met. By the same token, on the limited available information, the Review could find no reason to suggest that the Government's policy objectives were not being met.

A number of specific proposals were raised in submissions. These are canvassed in section iii, specific issues/proposals. The Review found that these matters had been considered by Government in 2002-03 and that the

submissions did not provide sufficient detail or evidence of problems with the implementation of the Act to warrant revisiting them at this stage.

Review Recommendations

- No changes to the spare parts provision in the Designs Act 2003 are required at this stage.
- IP Australia should continue to monitor overseas developments in relation to the spare parts issue.
- IP Australia should continue to monitor developments in relation to the operation and impact of the Act and, in consultation with industry and stakeholders, recommend appropriate action at a time when there is more information on the operation and impact of the spare parts provision.

The spare parts/right of repair provision

When the Government approved a new designs registration system in 2002, it decided, in principle, to exclude spare parts¹ from protection.

The Government decision on spare parts was taken after a series of studies and reports. These included the Australian Law Reform Commission (ALRC) Report No 74 of 1995, *Designs*, and the *Review of intellectual property legislation under the Competition Principles Agreement*, conducted by the Intellectual Property and Competition Review Committee headed by Mr Henry Ergas in 2000. These reports, and the designs legislation itself, were the subject of extensive consultation that involved a wide range of interests.

Over the past decade, the concern relating to spare parts markets has focused on motor vehicles, although parts for mining equipment, photocopiers, cash registers and computers have also been mentioned.

The ALRC Report acknowledged that separate markets for spare parts may emerge and disappear under different market conditions. It noted, for example, that the separate market for car spare parts was relatively recent and followed reduced tariff protection and technological advances that allowed parts such as body panels and the like to be reproduced by reverse engineering.

The Government's in principle decision² to exclude spare parts from design protection would apply wherever spare parts had economic features distinct from other products protected by intellectual property law. It was concerned

¹ The term "spare part" is used in the paper to refer to a component part of a complex product that is used for the purpose of repair of the complex product, so as to restore its overall appearance in whole or in part - consistent with Section 72 of the *Designs Act 2003*. Complex product is defined in the Act as a product comprising at least two replaceable component parts permitting disassembly and re-assembly of the product.

² The Government's considerations, rationale and policy objectives set out in this section are drawn from the Explanatory Memorandum to, and the second reading speech for, the Designs Bill 2002

that, in the absence of such an exclusion, parts producers who did not have market power in a primary market for the complex goods may be able to charge a monopoly price for spare parts in the derivative aftermarket in which spare parts are sold. This could result in higher prices for parts and restrict competition for the repair and servicing of complex products.

The Government recognised there were complex issues involved, but decided to exclude spare parts from design protection to ensure effective competition in the spare parts market, giving consumers greater choice and lower prices when they repair complex products to their original equipment.

A number of options for excluding spare parts from design protection were considered and the Government decided on a right of repair provision. Under this provision, registration of all new and distinctive designs of component parts are permitted, but where these parts are used for the repair of a complex product so as to restore the product's overall appearance, manufacturers and suppliers of these component parts are exempt from any liability for infringement.

The Government considered that the right of repair provision was a relatively clear and accessible provision that struck an appropriate balance between its policy objectives to:

- encourage innovation by providing protection to component suppliers in their dealings with manufacturers of original complex equipments (the primary market);
- open up the spare parts market (the aftermarket) to greater competition and thus secure benefits for consumers in the form of lower prices; and
- operate a clear, accessible design registration system that strikes a balance between consumer benefits, compliance costs for business and industry and administrative costs for the Government.

The Review

In his second reading speech to the Parliament in December 2003, Senator the Hon Nick Minchin said "Given the complexities of the spare parts issue, the operation of the right of repair exemption will be closely monitored with a formal review to take place before the end of 2005."³

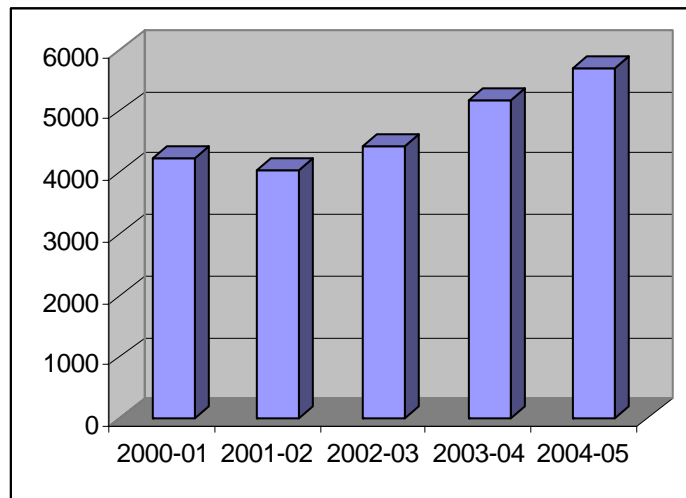
Accordingly, IP Australia launched a review of the spare parts exemption with publication of a brief issues paper on 18 August 2005. The paper is at http://www.ipaustralia.gov.au/resources/officialnotices_d0.shtml.

11 submissions were received from IP owners, IP attorneys, insurance companies, consumer representatives and the motor industry. A list of submissions is at Attachment A.

³ Hansard, 4 December 2003

Design Applications

The chart shows total number of designs filed for each year since 2000-01.



The significant increase in design applications in 2003-04 (up 17% on the year before, to 5181) has continued in the first full year of the operation of the new Act, 2004-05, but at a slower rate (up 10%, to 5698). It is unclear whether the new legislation has played a role in this change.

There has also been an increase in designs registered in 2004-05 (up 27%), reflecting the fact that under the new Act only a formalities check is required for registration.

Review Findings

The Review found that in the first year of the operation of the Act, design applications continued to increase. The 10% increase in 2004-05 was less than that for 2003-04, but in line with that for 2002-03. Given the fluctuations in design applications, the Review drew no firm conclusion concerning the significance of the increase in design applications under the new Act.

As indicated in the issues paper published in August 2005, design applications for motor vehicles and related equipment saw a significant (27%) decline in 2004-05. This may have largely reflected an increase in applications in 2003-04 under the old Act before the spare parts provision came into effect. However, caution must be exercised about any interpretation from a single year's figures, particularly in a sector with long lead times and long product lifecycles.

European Union Developments

In the European Union, there is a proposal currently before its Parliament to harmonise the different national approaches and liberalise the spare parts market.

Under present arrangements, 16 Member States extend design protection for spare parts and 9 member states do not. The European Commission (Commission) estimates that spare parts are 6-10% more expensive in Member States where they are subject to design protection.

The Commission proposes to allow independent part manufacturers to compete throughout the EU market for visible replacement parts. The Commission proposes a right-of-repair clause, similar to that in Australia under which all member states will ensure that protection shall not exist for designs which constitute a component part of a complex product used for the purpose of the repair of that complex part, so as to restore its original appearance.

The proposal is yet to be agreed by the European Parliament and the Council of Ministers and become law.

Review Submissions

(i) Current impact of the spare parts provision

Essentially, the submissions did not provide any hard information or evidence in relation to most of the issues raised in IP Australia's discussion paper published on 18 August 2005.

There was little or no hard data against which judgements might be made on the cost/benefit of the current exclusion of spare parts on business, industry, consumers or the Australian economy generally. There was little objective information to judge how well the Government's policy objectives, as summarised above, are being met.

A common view given in submissions is that it is too early to draw any final conclusions about the effectiveness or otherwise of the spare parts provision in terms of its impact on industry and consumers. Typical comments in various submissions include:

- "15 months provides insufficient "real world" experience in which to make useful judgements concerning the new arrangements"; there is certainly no evidence of consumer benefits (Ford)
- "in an industry that develops and manufactures complex products with long lead times and lifecycles, it is too early to assess their (the spare parts provisions) true impact" (GM Holden)
- "too early to judge whether the legislation is working"; yet to be tested in the courts; no evidence to suggest the government's objectives are being met; (IPTA – Institute of Patent and Trade Mark Attorneys - and FICPI Australia – Australian Federation of Intellectual Property Attorneys)
- the Government's policy objectives will take many years to be delivered because companies retain monopolies on all the parts registered

before June 2004; the benefits of the Act will flow through only gradually (IAG – Insurance Australia Group)

- only a limited time to assess the impact of the provision on the incentive to innovate in design in Australia and no demonstrable benefit to consumers (FCAI – Federal Chamber of Automotive Industries)
- it is early days and the monopoly of many spare parts will persist for almost 15 years to come (ACA – Australian Consumers Association)

Review finding

The Review accepted the common view in submissions that the spare parts provision was yet to have a significant effect on industry and consumers. It was therefore too early to draw firm conclusions as to whether the provision had met the Government's policy objectives.

While AMPICTA made a general comment that innovation had been suppressed in all areas of engineering manufacture and design, no submissions were received in relation to specific markets for spare parts and/or complex products other than motor vehicles. However, given the lack of submissions from industry outside of the motor vehicle and related industry, it is possible that the impact of the spare parts provision in the Act is yet to be felt across manufacturing industries.

In relation to motor vehicles, the Ford and IAG submissions noted that current model motor vehicles were generally launched in 2004 or earlier and the parts were registered in 2003 or earlier. Moreover, demand for competitive parts from alternative suppliers is generally focused on older motor vehicles, after warranties have expired, their value has depreciated and they are often into second or third owners.

The Review concluded that the full market impact of the spare parts provision is unlikely to be evident for several years to come.

(ii) Content of submissions

For the most part, submissions to the Spare Parts review expressed views, either strongly for or strongly against, the spare parts exemption and suggested that time would eventually prove their concerns correct. Key points made include:

- while the exclusion was yet to have a measurable effect on insurance business, IAG estimated that the Act will eventually save consumers tens of millions of dollars in parts purchases and insurance premiums;
- IAG considered that the benefits of the Act will flow through only gradually as independent parts manufacturers are unlikely to produce large quantities of alternative parts until around 2009
- Ford considered there was no evidence of consumer benefits and remained opposed to the policy decision to exclude spare parts from design protection through a right of repair

- GM Holden considered that the provision “reduces the degree of intellectual property protection within the automotive industry and is inconsistent with the rights afforded to companies in other industries”
- GM Holden and ACEA suggest that any lower market prices for independent parts may come at the cost of quality and safety because independent parts are not subject to the same level of scrutiny as original equipment
- AMPICTA considered the spare parts provision is not in the best interests of Australian industry as a whole because it has suppressed innovation in engineering manufacture and design
- the ACCC considered that the available data was generally consistent with the right of repair exclusions having a positive effect in terms of outcomes for consumers
- FCAI considered that the provisions “potentially undermines the competitive position of vehicle manufacturers and importers operating in the Australian market and does not provide incentive for innovation”
- ACA considered that “the market is beginning to change with the supply of some third party parts to compete with OE⁴ parts and a decline in new registrations of particular motor body parts by Ford and Holden”

Very limited information was provided in submissions in relation to the operation of the Act since it came into force in June 2004:

IPTA reported there was no evidence to suggest that the provision has had a significant cost or benefit to IP Attorney business sector. FICPI reported that as advice in relation to the spare parts provision had not been required from a large number of their clients, it could be assumed that the provision has not caused undue issues for their clients.

IAG reported that the exclusion of spare parts was yet to have a measurable effect on its business or the insurance sector generally.

The ACCC advised that the number of complaints relating to the high price of spare parts, or the part required being available only as part of a larger more expensive part, was lower in 2004-05 than the average over the previous 8 years. It also reported that since late 2003, it has received a significant and increasing amount of anecdotal evidence from a range of sources that automotive manufacturers may be endeavouring to limit the effectiveness of the right of repair exclusion and, more generally, restricting the ability of independent repair businesses to gain access to technical information and equipment required to compete.

IAG reported two recent developments that it suggested would promote competition in the spare parts sector in future: the visit to Australia of a representative of the Certified Automotive Parts Association (CAPA)⁵ of

⁴ i.e. original equipment

⁵ CAPA is a non-profit organisation in the USA that certifies the quality of automotive parts used for collision repairs. It reviews and inspects factories and manufacturing processes; tests samples of

Michigan, USA, to explore prospects for CAPA certifying the quality of independent parts produced by alternative manufacturers in Australia. It also reported that a Melbourne-based company had initiated production of front bumper facias and headlamps that would have been subject to design protection under the old Act, although these products were yet to appear on the market.

One submission received, from the European Automobile Manufacturers Association (ACEA) and DaimlerChrysler AG, was a copy of its submission to the European Commission concerning its proposal to abolish design rights for automotive spare parts. The submission did not specifically address the Australian market but one issue that may be of particular relevance to Australia is ACEA's claim that the abolition of design rights does not lead to lower prices for spare parts or lower insurance premiums. This view is also supported by FICPI. The ACEA submission suggests that this is because the final spare parts consumer is separated from spare parts producers by numerous intermediaries (distributors, repairers, insurance companies), all of whom have opportunities to sequester the benefits of competition.

In addition to the formal submissions to the Review, IP Australia has also received some anecdotal feedback about the spare parts provision, raising similar issues to those raised in the submissions. However to date there has been no detail provided about actual problems and no evidence as to how well the Government's policy objectives are being met.

Review Finding

There were no submissions claiming severe unintended impacts on individual businesses. Indeed, some submissions stated that the spare parts exclusion in the Designs Act 2003 had imposed no significant costs to their industry sectors and had not caused any undue issues for the clients/members.

The Review noted, but could draw no firm conclusion, regarding the promising developments reported by the ACCC and IAG since the Act came into force in June 2004.

In relation to spare parts for motor vehicles, the Review acknowledged that the Australian consumer, like the European consumer, is separated from spare parts producers by parts distributors, smash repairers and insurance companies and that there may therefore be opportunities for the benefits of competition to be withheld from consumers.

The Review also noted that insurance companies had a particularly large role in the choice of spare parts used in smash repairs in Australia. A recent Productivity Commission report found a stark difference in size between insurance companies and smash repairers: motor insurance is dominated by 4 large corporate groups while there are over 5000 smash repair businesses in Australia (none of which are very large). The Productivity Commission

individual parts; and conducts random checks to approve, certify and verify that CAPA quality standards are maintained.

found that the bulk of Australian motor insurance is through preferred smash repairer arrangements which reduce consumer choice and benefit the insurer (and ultimately consumers) through reduced overheads, lower repair costs from economies of scale, better quality control and faster turnaround times.⁶

There were no submissions before this Review that provided evidence that all, or even most, of the benefits of competition in the spare parts or smash repair business in Australia were being sequestered by any one group. The Review noted that the Government has agreed to facilitate and promote the development and implementation of an industry-wide code of conduct in respect of the relationship between insurers and repairers⁷. The Code, when implemented, should encourage transparency and limit further the risk of any group sequestering the benefits of competition in the spare parts or related markets.

As there were no submissions that reported on developments in other spare parts markets, the Review could also make no judgement on the operation of the spare parts market beyond motor vehicles.

Against this background, the Review concluded that the submissions had made no case for revisiting the Government's decision in 2002-03 to exempt spare parts from designs protection at this time.

(iii) Specific issues/proposals

A number of specific issues, proposals or suggestions were raised in submissions for the Review to address. These included:

- (a) Proposal from IPTA, FICPI Australia and Mark Pullen, Patent and Trade Mark Attorney, to amend Section 72(2) of the Act to reverse the burden of proof - that the use of the part is for repair of a complex product - from the owner of the design to the user or authoriser of the part. GM Holden said that because it is difficult to demonstrate intention of use other than repair, registered owners of the design are unable in practical terms to prevent the sale, manufacture or import of non-genuine parts regardless of use.

Comment

The Government acknowledged⁸ when the legislation was introduced that it would be impossible to know before the event whether a component will be used as a spare part rather than as original equipment. It also acknowledged that design owners

⁶ Smash Repair and Insurance, Productivity Commission Inquiry Report No 34, March 2005

⁷ Government Response to Productivity Commission Inquiry: Smash Repair and Insurance, 19 August 2005 (www.industry.gov.au - reports)

⁸ The Government's views as described in this section are also drawn from the Explanatory Memorandum to the Designs Bill 2002

could argue that it would be difficult for them to prove non-repair purposes.

Ultimately, the Government decided to place the onus on registered design owners because, if the onus was on the suppliers or manufacturers of spare parts, it would force them to track their entire inventory to see that it was being used for repair purposes. The cost involved would be a disincentive for new participants to enter the spare parts market and run counter to the Government's aim of ensuring effective competition in the spare parts market.

No evidence was provided to the Review to suggest that section 72(2) has had unintended impacts. As IPTA acknowledged, this section is yet to be tested in the courts.

- (b) Suggestion from AMPICTA and Mark Pullen that the current spare parts defence has cast doubt on the value of design protection across a range of products and should not continue in its current form. To remove the uncertainty that they say is suppressing innovation in a number of areas, they suggest that the provision be more narrowly defined to focus on spare parts for motor vehicles.

Mark Pullen proposes that this be done either by exempting motor vehicle parts from design protection or by limiting the term of protection for motor vehicle spare parts to, say, 5 years. AMPICTA suggests that allowance be made for small to medium enterprises and highly specialised players.

Comment

The Review has received no firm data to substantiate the claim that there is widespread doubt about the value of design protection. As indicated in the bar chart above, design applications have continued to increase in 2004-05.

As stated in the Explanatory Memorandum, the spare parts provision was intended to apply to all component parts used to repair complex products, including motor vehicle spare parts, toner cartridges for computer printers and the like. The reduced terms of protection for spare parts was also considered and rejected because of the uncertainty and costs associated with definitions and its likely breach of the term of 10 years mandated in the 1994 World Trade Organisation Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

Ultimately, the Government decided that, on balance, the right of repair provision provided an appropriate balance of consumer benefits, compliance costs for industry and administration costs for IP Australia. In particular, the Registrar of Designs would not

be involved in disputes in relation to definitional issues and the scope of the exclusion would be in accordance with the ‘user pays principle’, with costs borne directly by interested parties and not other users of the designs system. For example, whereas the Registrar might be required to apply, and defend before the courts, definitions such as those proposed by AMPICTA, under the right of repair provision it would be up to the respective parties to identify infringements and test their case in court, with the costs borne by them.

The Government concluded that definitional concerns applied to all exclusion options and that a right of repair provision focused on component parts that are used as spare parts would affect fewer users of the design system. The Senate Economics Legislation Committee that reviewed the 2002 Bill found that alternatives to the right of repair defence “are likely to lead to complex and arcane legislation, and consequent commercial uncertainty, which may in fact limit innovation, consumer benefit and competition.”⁹

- (c) Proposal from ACCC that IP Australia consider whether manufacturers of complex products, such as motor vehicles, may be restricting the ability of independent automotive parts and repair businesses to compete against authorised dealers and original equipment suppliers by limiting access to technical information and specialist diagnostic equipment.

Comment

The spare parts exemption was intended to increase competition for both the spare parts market and the market for repair and servicing of original equipment. Investigation of market practices of the kind claimed by the ACCC go significantly beyond IP Australia’s role and functions. These issues have been addressed separately in the Productivity Commission Report into Smash Repair and Insurance and the Government’s Response to it mentioned above.

- (d) AMPICTA considered that the “single minded approach taken in relation to spare parts should not continue in its present form” and proposed a review of the *Designs Act 2003* “with a representative group of interested stakeholders working with appropriate IP Australia staff”.

Comment

The Review did not consider that a case has been made for a full review of the *Designs Act 2003* at this time. IP Australia is, however, consulting its stakeholders on a range of emerging issues in relation to the Act to allow preliminary consideration of

⁹ quoted in the ACCC submission to this Review

matters for possible future policy development of the designs registration process.¹⁰

- (e) FCAI proposal that the spare parts provision should be repealed or an automatic sunset clause introduced to provide for a fully informed assessment of its impact once a sufficient time has elapsed. GM Holden also called for the repeal or a review of section 72 of the Act when its true impact can be assessed.

Comment

The Government does not consider that a case has been made for amendment of the Act. IP Australia will continue to monitor developments in relation to the operation of the Act and its effects on industry and consumers.

Review Finding

The Review found that specific issues and proposals made in the submissions related to matters already considered and determined by the Government in 2002-03. The submissions did not present new information in relation to these matters. Accordingly, the Review concluded that these proposals could not be accepted at this time.

Conclusions

The Review concluded that there is no case, currently, for reconsidering the Government view in 2003 that the right of repair provision strikes an appropriate balance between the Government's policy objectives to encourage innovation by protecting component suppliers in the primary market; open up the spare parts aftermarket to greater competition; and operate an accessible design registration system that strikes the appropriate balance between consumer benefits, compliance costs for business and industry and administrative costs for the Government.

While it could draw no firm conclusions, the Review found that the limited available information in the submissions and on the operation of the designs system suggests that the Government's policy objectives may, arguably, be being met in the motor vehicle sector.

Given the continuing uncertainty about the operation and impact of the Act in all manufacturing industry, there may be a case for further consideration of the spare parts provision when more information becomes available.

As it is also unclear when such information might become available, the Review recommends that IP Australia continues to monitor the operation and impact of the spare part provision in consultation with relevant industry stakeholders, with a view to considering further action at an appropriate time.

¹⁰ details are at www.ipaustralia.gov.au – news section.

ATTACHMENT A

List of Submissions

1. Australian Competition & Consumer Commission (ACCC)
2. Australian Consumers' Association (ACA)
3. Australian Federation of Intellectual Property Attorneys (FICPI Australia)
4. Australian Manufacturer's Patents, Industrial Designs, Copyright and Trade Mark Association (AMPICTA)
5. European Automobile Manufacturers Association (ACEA)
6. Federal Chamber of Automotive Industries (FCAI)
7. Ford Motor Company of Australia Ltd (Ford)
8. GM Holden Ltd (Holden)
9. Insurance Australia Group (IAG)
10. Institute of Patent and Trade Mark Attorneys of Australia (IPTA)
11. Mark Pullen, Patent and Trade Mark Attorney