

Review of intellectual property legislation under the Competition Principles Agreement



September 2000

**Final report by the
Intellectual Property and Competition Review Committee**

to

**Senator the Hon Nicholas Minchin
Minister for Industry, Science and Resources**

and

**the Hon Daryl Williams AM QC MP
Attorney-General**

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ISBN: 0 642 70508 9

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INTELLECTUAL PROPERTY AND COMPETITION REVIEW COMMITTEE

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Dear Ministers

We have pleasure in submitting the Intellectual Property and Competition Review Committee's final report, which fulfils the Committee's commitment to inquire into and report on the interaction and appropriate balance between competition policy and the designated intellectual property legislation.

As you are aware, the Committee sought an extension of time in which to report to you to allow interested parties more time to respond to our Interim Report. It was agreed that a report on parallel importation of copyright material be submitted by 30 June 2000 and that a final report on all other matters would be submitted by 30 September 2000.

The issues in the Committee's, *Report on Parallel Importation under the Copyright Act 1968*, submitted on 30 June 2000, are linked to those considered in the final report. The Committee therefore believes its recommendations are more effectively viewed and considered in their entirety. Consequently, the Committee has incorporated the discussion and recommendations of our first report into this final report to present an integrated document that reflects the totality of the inquiry outcomes.

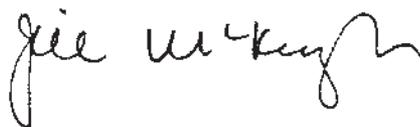
The Committee makes a number of recommendations. We believe these recognise the role and importance of intellectual property in the innovation process, and more generally to Australia's economy and society, and meet the objectives of the Government's competition policy.

The Committee would like to acknowledge and thank Andrew Bain for his valuable input as Special Adviser to the Committee. The Committee was ably assisted by, and wishes to record its thanks to, the Committee's Secretariat, which was headed by Kay Collins.

Yours sincerely



Henry Ergas
Chairman



Jill McKeough
Member



John Stonier
Member

30 September 2000

ABBREVIATIONS

ABC	Australian Broadcasting Corporation
ACC	Australian Copyright Council
ACCC	Australian Competition and Consumer Commission
ACIP	Advisory Council on Industrial Property
ACS	Australian Customs Service
ADA	Australian Digital Alliance
AFP	Australian Federal Police
AFVSO	Australian Film and Video Security Office
AGS	Australian Government Solicitor
AIC	Australian Institute of Criminology
ALIA	Australian Library and Information Association
ALRC	Australian Law Reform Commission
APA	Australian Publishers Association
APRA	Australasian Performing Right Association
ARIA	Australian Recording Industry Association
art. , arts.	article, articles
ASCAP	American Society of Composers, Authors and Publishers
ASEAN	Association of South-East Asian Nations
ATA	Australian Toy Association
AVCC	Australian Vice-Chancellors Committee
AVSDA	Australian Visual Software Distributors Association Ltd
Berne Convention	Berne Convention for the Protection of Literary and Artistic Works
BIE	Bureau of Industry Economics
CAL	Copyright Agency Limited
CCG	Copyright Convergence Group
CER	New Zealand-Australia Closer Economic Relations Trade Agreement
CD, CDs	Compact Disc, Compact Discs
Circuit Layouts Act	<i>Circuit Layouts Act 1989 (Commonwealth)</i>
CLRC	Copyright Law Review Committee
Computer Programs Act	<i>Copyright Amendment (Computer Programs) Act 1999</i>
CPA	Competition Principles Agreement
Copyright Act	<i>Copyright Act 1968 (Commonwealth)</i>
CRCs	Cooperative Research Centres
Designs Act	<i>Designs Act 1906 (Commonwealth)</i>
DAB, Digital Agenda Bill	Copyright Amendment (Digital Agenda) Bill 1998 – 2000
DAA, Digital Agenda Act	<i>Copyright Amendment (Digital Agenda) Act 2000</i>
DMCA	<i>Digital Millennium Copyright Act 1998</i>
DOCITA	Department of Communications, Information Technology and the Arts

DPP	Director of Public Prosecutions
DVD	Digital Video Disc / Digital Versatile Disc
EEA	European Economic Area
EEC	European Economic Community
EPO	European Patent Office
EU	European Union
FACTS	Federation of Australian Commercial Television Stations
FICPI	Australian Federation of Intellectual Property Attorneys
FTC	Federal Trade Commission
GATT	General Agreement on Tariffs and Trade 1994
GDP	gross domestic product
GIs	geographical indications
gTLD	generic top level domain name
IBM	IBM Australia Limited and IBM Global Services Australia Limited
ICANN	The Internet Corporation for Assigned Names and Numbers
IP	intellectual property
IPAC	Industrial Property Advisory Committee
IPCR	Intellectual Property and Competition Review
IPCRC	Intellectual Property and Competition Review Committee
IPRs	intellectual property rights
IPTA	Institute of Patent and Trade Mark Attorneys of Australia
ISPs	Internet service providers
ISR	Department of Industry, Science and Resources
IT	information technology
MCEETYA	Ministerial Council for Education, Employment, Training and Youth Affairs
MPA	Motion Picture Association
MIPI	Music Industry Piracy Investigations
NAFTA	North American Free Trade Agreement
NCC	National Competition Council
NCP	National Competition Policy
NZ	New Zealand
NZIER	NZ Institute of Economic Research (Inc.)
OECD	Organisation for Economic Cooperation and Development
Patents Act	<i>Patents Act 1990 (Commonwealth)</i>
PCT	Patent Cooperation Treaty
PIRs	parallel import restrictions
PMSEC	Prime Minister's Science and Engineering Council (Office of the Chief Scientist, Department of the Prime Minister and Cabinet)
PPCA	Phonographic Performance Company of Australia
RAIA	Royal Australian Institute of Architects

R&D	research and development
s., ss.	section, sections
SBS	Special Broadcasting Service
SLC	substantial lessening of competition
Screenrights	The Audiovisual Copyright Society
SMEs	small and medium (business) enterprises
tm, .tm	trade mark
Trade Marks Act	<i>Trade Marks Act 1995</i>
TPA, Trade Practices Act	<i>Trade Practices Act 1974 (Commonwealth)</i>
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights (1994)
UDRP	Uniform Domain Name Dispute Resolution Procedure
UK	United Kingdom
URL	Universal Resource Locator
US, USA	United States of America
USPTO	United States Patent and Trade Mark Office
VCD	Video Compact Discs
WCT	WIPO Copyright Treaty
WIPO	World Intellectual Property Organization
WIPO Convention	1967 Convention Establishing the World Intellectual Property Organization
WPPT	WIPO Performances and Phonograms Treaty
WTO	World Trade Organization

THE REVIEW COMMITTEE

Chairman Mr Henry Ergas, Managing Director, The Network Economics Consulting Group Pty. Ltd.

Members Associate Professor Jill McKeough, Head of School, Faculty of Law, University of NSW, lecturer and author in IP and consumer protection.

Mr John Stonier, Company Director and Consultant in areas involving the development, negotiation and management of IP and technology agreements.

Special Adviser Mr Andrew Bain, Company Director of Natural Resource Consulting Pty Ltd.

EXECUTIVE SUMMARY

This report considers the effects on competition of Australia's intellectual property laws—that is, the *Copyright Act 1968*, *Patents Act 1990*, *Trade Marks Act 1995*, *Designs Act 1906* and *Circuit Layouts Act 1989*. It examines these effects in light of the objectives of this legislation and of the Competition Principles Agreement.

The intellectual property system seeks to promote investment in, and access to the results of, creative effort. It involves balancing the interests of the owners of intellectual property material with the interests of users or potential users of that material.

The Competition Principles Agreement seeks to promote efficiency by ensuring that legislative restrictions on competition are only maintained where their benefits clearly outweigh any costs they may impose.

Background

Competition is the process of rivals striving for an advantage. In the supply of goods and services, it involves the efforts of producers, acting independently, to secure sales and profits at the expense of rivals. To this end, producers in competitive markets constantly seek to be more favourably positioned than their rivals in terms of the prices they offer, the range, quality and innovative nature of the goods and services they provide, and their reputation as suppliers. As a result, consumers benefit with better, more affordable products, and the increased efficiency achieved through competition expands the income available to society as a whole.

Experience and analysis has repeatedly shown that while there are costs associated with competition, it promotes economic growth and helps achieve and maintain high living standards more surely and consistently than alternative approaches to controlling the allocation of scarce resources. As a result, there is a well-justified presumption in favour of competition, and creating and maintaining competitive markets is an important objective of economic policy.

In pursuing this objective, it is important to recognise that competition occurs in a number of dimensions. More specifically, firms do not only compete in the prices they set but also in their ability to develop new processes and to design and market new products. This dynamic competition is of special importance. In effect, rather than simply reallocating existing resources, it expands the resources on which society can draw and allows for sustainable increases in living standards. It is also important because in practice it is the main way established market positions are over-turned, and the threat of competition made into an ever-present constraint on the conduct of firms.

An effective system to define and enforce intellectual property rights is critical for this type of dynamic competition to occur on a material scale.

The creation of intellectual property involves intellectual effort and can entail substantial resource outlays. Private producers will not have an incentive to make these outlays unless they receive an appropriate return.

This is only attainable if producers can appropriate at least some of the value that users place on the outputs of the creative process. However, the characteristics of intellectual property mean that in many instances the results of investment in creative effort can be reproduced at little or no cost.

Put slightly differently, without a system of intellectual property rights it is difficult to prevent 'free riding' by those who did not contribute to the original investment. Creators could therefore find it difficult to recoup the cost of their investment, let alone its economic value. Under these circumstances, economic incentives for intellectual property investment would likely be deficient, leading to under-investment in creative effort. To varying extents and in varying ways, the intellectual property laws help redress this problem, and hence make possible investment in, and rivalry through, innovation.

Intellectual property laws on one hand and competition policy on the other are consequently largely complementary. The intellectual property system serves to promote innovation, which is a key form of competition. Competition policy, by keeping markets open and effective, preserves the primary source of the pressure to innovate and to diffuse innovations.

However, there are also important tensions between these policy instruments.

These tensions arise because there is a cost to granting intellectual property rights. While conferring intellectual property rights encourages investment in creative effort, it can allow the owners of the results of this effort to unduly restrict the diffusion and use of these results. In an ideal world, purchasers of ideas whose cost of reproduction is virtually zero would, at the margin of consumption, face a price that was itself close to zero. In practice, intellectual property rights ensure that owners of ideas can, and almost always do, charge some positive price at that margin. As a result, the consumption of the existing output of investment in creative effort falls below that which, in the short term, would maximise social income. Additionally, while most intellectual property rights do not confer monopoly power, some do, and when this occurs, the owner of these rights could further restrict diffusion below the level that maximises society's gain from the stock of knowledge.

Intellectual property laws must therefore involve some balance between the incentives to invest in creative effort and the incentives for disseminating material that is the subject of intellectual property protection. This balance turns on determining the appropriate scope of protection, in terms of the conditions under which protection is granted, the scope and effectiveness of the exclusive privileges provided by protection, and the duration of the protection given.

Balancing between providing incentives to invest in innovation on one hand, and for efficient diffusion of innovation on the other, is a central, and perhaps the crucial, element in the design of intellectual property laws. In the Committee's view, it is essential that the terms of this balance be clearly set out in the intellectual property laws themselves, so that rights owners and users can be certain about the scope and content of the grants being made.

It must also be recognised that the rights granted by the intellectual property laws can be used for anti-competitive ends. This occurs when the rights are used to claim for the creator not merely a share of the efficiency gains society obtains from the creation, but also super-normal profits that arise from market power unrelated to the creation.

That is, in addition to the income from the improved efficiency of the creation, the owner of the intellectual property right secures extra profits means that ultimately reduce social output—for example, by using intellectual property licenses to effect a horizontal price-fixing agreement. Where rights are thus used for purposes beyond the intention of the original grant, significant competition policy issues arise that need to be addressed.

Intellectual property rights should not therefore provide blanket immunity from the competition laws. Rather, the community's interest in competitive markets needs to be protected by ensuring that abuse of those rights is prevented.

The interaction of intellectual property laws and of competition policy therefore occurs at two levels: first, competition concerns must play an important part in the design of the intellectual property laws themselves, ensuring that the rights granted are not over-broad; and second, effective remedies must be available if the rights are abused. These goals underpin this review.

The Committee's approach

The Committee has identified and reviewed areas that raise serious concerns for competition. More specifically, the Committee considered whether there are aspects of the intellectual property laws that grant exclusive privileges not needed to encourage an efficient level of investment in creative effort. We also examined whether there are effective remedies for instances where properly granted rights are used for purposes which go beyond the intended scope of the grant in ways that reduce competition.

Subsequent sections of this summary set out the main areas the Committee examined and the conclusions reached.

Areas of concern related to the Copyright Act

The **restrictions on parallel imports** under the Copyright Act were considered by the Committee to be a significant competition issue. These restrictions allow owners of copyrighted material to geographically segment markets, creating added scope for owners of this material to charge higher prices in Australia than overseas. In the absence of these restrictions, competing imports more readily negate attempts to charge durably higher prices for material in Australia than overseas.

The Committee received conflicting opinions on whether prices of copyrighted material were higher or lower in Australia than in the main overseas markets, and whether removal of the restrictions would result in lower prices.

The Committee's considered view is that the restrictions do allow higher prices to be charged for the protected material than would otherwise prevail. A significant proportion of the benefits from these higher prices flow to foreign rights holders. The corresponding costs are borne in Australia, by Australian consumers and industries—such as the domestic software industry—that use imported protected material as an input in their production process.

The Committee does not believe the gains to Australia from these restrictions outweigh their costs.

Removing the restrictions is unlikely to materially alter the availability of copyrighted material. However, removing the restrictions will benefit consumers and the industries that rely on this material as an input, by ensuring that prices are not set higher than overseas.

Removing the restrictions on parallel importation does not undermine the efficacy of copyright as a stimulus to creativity. Already, there are no restrictions on parallel imports within the European Union. This ensures that even the smaller economies in Europe can benefit from the intense competition, low prices and wide product availability associated with large, integrated markets. In contrast, Australia, as a relatively small, isolated economy, is exposed to segmentation of its market from international competitive pressures, as long as the parallel importing restrictions remain in place. Removing the restrictions will provide to Australia the same benefits as other economies secure through their far larger internal markets.

The Committee considered whether removing restrictions would undermine the enforcement of copyright or the efficacy with which consumer standards are implemented. Based on advice received from the Australian Institute of Criminology, the Committee believes that removing the restrictions is consistent with effective copyright enforcement. The Committee does not believe restrictions on parallel imports are a cost-effective means of securing consumer standards.

The Committee considered whether the restrictions are required under Australia's international obligations, and concluded that removing the restrictions would be fully consistent with these obligations and more generally with Australia's commitment to an open, competitive trading system.

The Committee therefore recommends repeal of the parallel importation provisions of the Copyright Act, with a 12-month transitional period for books. One member of the Committee dissents from this finding. This member believes that parallel import restrictions do not, in most situations, constitute a restriction on competition and considers that in the book industry at least, the benefits of parallel import restrictions exceed the costs. This member's statement is included in this report.

The **activities of collecting societies** under the Copyright Act are also of concern. The Committee recognises the importance of collective rights administration to an efficient copyright system and, in that respect, strongly endorses the role of the collecting societies. However, there are potential effects on competition that can flow from the market position of collecting societies. Several of the Committee's recommendations are aimed at making the collecting societies more open and accountable, and at achieving a more appropriate balance between public access to copyright material and producer incentives for innovation.

The Committee's views are influenced by the fact that the coordinated nature of the collecting societies' activities reduces competition between entities that would otherwise be competitors in some way. By eliminating that competition, the societies may significantly enhance efficiency; but the resulting balance needs to be tested—with continued attention to opportunities for encouraging more competition without reducing the efficiency gains of collective rights administration. With this end in mind, the Committee's recommendations are aimed at providing for more effective scrutiny of the societies' operations.

Specifically, the Committee recommends that the wider economic aspects of a collecting society's conduct should be taken into account when reviewing a society's declared status.

In particular, these wider aspects of a society's conduct should be considered when determining whether the society is 'functioning adequately' as a collecting society. Issues such as the adequacy of a society's dispute resolution mechanism could play a part in this evaluation. The Committee also recommends that collecting societies be more fully exposed to the authorisation processes of the Trade Practices Act. Finally, the Committee sets out a process for allowing the referral of disputes that involve the societies, in their non-statutory activities, to the Copyright Tribunal.

The Committee agrees with the general direction of the new **Digital Agenda Act** but is concerned to ensure that the capacity of libraries to discharge their functions as disseminators of information in an online world is not jeopardised or undermined. The Committee also attaches great importance to maintaining the vitality, in a digital environment, of provisions allowing access (on the basis of fair dealing) to copyrighted material in the interests of research and study and of other designated socially and economically desirable activities. The Committee believes the Government should ensure that the current balance between copyright owners and copyright users remains clear, certain and unaltered in relation to the fair dealing provisions. The Committee consequently recommends a thorough examination of the effects of the library and archives provisions on markets, and more generally on libraries, archives and end-users of copyrighted material, as part of the Government's proposed three-year review of the operation of the Digital Agenda Act.

In relation to **computer software issues** the Committee supports the introduction of amendments to the Copyright Act to allow decompilation for the purposes of interoperability. The Committee's recommendations are aimed at ensuring that the changes made to the Act are fully effective in securing this goal. Further, the Committee recommends that Australia's position in negotiations on protection of compilations and databases, in relation to the Agreement on Trade-Related Aspects of Intellectual Property Rights 1994 (TRIPS), be determined by a cost/benefit analysis to Australian society.

Issues relating to the Patents Act

Because patents can be used to appropriate the general application of ideas, and not just particular embodiments, they have the potential for conferring greater market power than other areas of intellectual property (IP) law. However, in practice alternatives and substitutes usually exist for patented products and processes.

The benefits of patents must be balanced against their costs in determining the *maximum term* and the *scope* of the rights granted.

The *term* of patents is now fixed at 20 years under TRIPS and was not considered by the Committee to require change. However, the Committee does recommend that IP Australia examine the scope for imposing more steeply rising renewal fees on patents, thus encouraging owners to allow less valuable patents to lapse.

As regards the *scope* of a patent, this is largely determined by its inventiveness relative to existing public knowledge (prior art).

The Committee recommends that Australia has an inventive step test that is in line with that adopted by our major trading partners. Having a lower threshold is likely to lead to patents being granted too readily, imposing unnecessary costs on the Australian economy.

The Committee has developed a number of proposals to make the inventive step test more demanding, with the result that patents are only given where a genuine contribution has been made relative to prior art.

In the controversial area of patenting gene sequences, the Committee considers that the tests for granting a patent should be non-technologically specific. The Committee strongly believes that mere discoveries should continue to be excluded from patentable subject matter. It recommends the Patent Office help ensure this outcome by requiring that granted patents disclose specific, substantial and credible uses.

Having appropriately high tests for patentability is not enough to ensure that the benefits to society of granted patents outweigh their costs. Rather, it is equally important that examination of patents against these tests be of a uniform high standard. Rigorous examination will also help ensure that granted patents are strong and hence ultimately enforceable. To improve the quality of examination, the Committee's main recommendations are that the 'benefit of the doubt' currently given by examiners to applicants be changed to 'balance of probabilities'; and that applicants have greater responsibility to disclose any prior art known to them up until acceptance.

Issues arising in respect of other IP legislation

During the review, the main competition issues raised in relation to **design rights** were the protection of functionality and spare parts. The Committee is not convinced that either is a cause for concern at this stage, especially in light of the proposed new design legislation. The Committee supports the aim of the new legislation, urges its early release and recommends that its impact be reviewed and monitored.

The Committee considered claims that there is uncertainty surrounding the issue of parallel importation of **trade mark** goods in Australia, and found this to be a significant competition issue. The Committee noted that the Trade Mark Act embraces the principle of international exhaustion. 'International exhaustion' means that the intellectual property right owner loses the exclusive right after the first legitimate sale of the product anywhere in the world, thus allowing parallel imports from another jurisdiction to freely enter the market. The Australian courts have reinforced this by consistently rejecting the rights of international trade mark owners to control the distribution channels of goods through trade mark rights. However, the Committee has also noted that the intention of the Trade Mark Act to allow parallel importation of legitimately trade marked goods has the potential to be circumvented by the assignment provisions of the Act.

As a general matter, the Committee believes suppliers should be able to enter into exclusive dealing arrangements. The contractual assignment of trade marks is one of the ways exclusive dealing arrangements may be established. However, the Committee does not accept that these arrangements should be allowed where they substantially lessen competition in the market.

In keeping with the Committee's broader approach on parallel importation of copyright material, we believe contractual assignment of trade marks to circumvent the parallel importation of trade marked goods should not be permitted and recommend the Trade Marks Act be amended to reflect this.

Representations were made to the Committee supporting the re-introduction of mandatory disclaimers for trade marks. This was based on claims that the absence of mandatory disclaimers leads to over-broad trade mark rights, increased levels of uncertainty and higher costs for users. The Committee sees value in having a screening process to limit the scope of trade marks by disclaiming the descriptive or non-distinctive elements of the mark, and notes that a voluntary system currently exists. However, on balance, and in the absence of convincing evidence to the contrary, the Committee does not believe that the benefits of re-introducing a mandatory system outweigh the costs. Instead, the Committee supports the concept of providing incentives for trade mark owners to make better use of the existing voluntary disclaimer system. More specifically, the Committee recommends requiring the courts, in determining relief in cases of infringement, to take account of the completeness of any disclaimers made in respect of the mark.

Section 51(3) of the Trade Practices Act

The exclusive privileges that intellectual property legislation confers on right owners are designed to promote innovation. The Committee believes that these privileges should be able to be exercised, even if this involves, as it generally must, the exclusion of others. In addition, the Committee believes it is desirable for right owners to have the scope to enter into efficient contracts that involve intellectual property rights, and to be able to do so free of onerous and ultimately counter-productive regulatory burdens. However, that is not to say the Committee believes that intellectual property rights should be used to go beyond the market power these rights directly confer, or that they should be extended into a wider right of exclusion, which may be used to substantially lessen competition.

The Committee maintains the view that intellectual property rights are sufficiently different from other property rights and assets to warrant special exemptions from the general provisions of the Trade Practices Act (TPA). However, the Committee believes that the existing intellectual property exemptions under s. 51(3) of the TPA are seriously flawed, as the extent and breadth of the exemptions are unclear, and may well be over-broad. In the Committee's view, these exemptions do not provide an appropriate balance between the needs of the intellectual property system and the wider goals of competition policy. Further, the Committee believes the recommendations for changes to s. 51(3) proposed by the National Competition Council (NCC) do not adequately address the deficiencies in the current provisions.

The Committee believes an appropriate balance can be achieved by amending the TPA to ensure conditions in a contract, arrangement or understanding related to the subject matter of the intellectual property statute, do not contravene Part IV or s. 4D of the Act—unless those conditions are likely to result in a substantial lessening of competition. The test of whether a substantial lessening of competition is likely should be defined and interpreted in a manner consistent with the case law under the TPA. The Committee also recommends that the Australian Competition and Consumer Commission (ACCC) issue guidelines to provide sufficient direction to intellectual property right owners, clarifying the types of behaviour likely to result in a breach of the Act's provisions.

The Committee believes its proposed recommendations to the TPA will support the efficient development and exploitation of intellectual property, while ensuring that intellectual property rights are not used to extend market power beyond the scope of the right initially allowed.

As a consequence of these amendments to the TPA, the Committee also recommends that the compulsory licensing provisions of the Patents Act be amended to include a competition test; and that certain provisions in the Patent Act relating to licensing contracts be repealed.

LIST OF RECOMMENDATIONS

Copyright Act

Parallel importation

The Committee recommends repeal of the parallel importation provisions of the *Copyright Act 1968*, with a 12-month transitional period for books.

We also recommend that the Government consider a program aimed at informing the book industry of the changes and of the options created by the new environment.

One Committee member expressed substantial reservations about lifting parallel import restraints and his views on this are contained in a dissenting opinion (See page 73).

Copyright term

The Committee is not convinced there is merit in proposals to extend the term of copyright protection, and recommends that the current term not be extended.

We also recommend that no extension of the copyright term be introduced in future without a prior thorough and independent review of the resulting costs and benefits.

Fair dealing and the Digital Agenda Act

The Committee believes the Digital Agenda Act strikes a reasonable balance between the interests of copyright owners and the interests of users of copyrighted material. We stress the importance to the Australian community of ensuring that libraries can discharge their functions as disseminators of information in an online world. The Committee does not believe that the libraries and archives provisions of the Act will detrimentally affect the capacity for development of online markets. However, we recommend a thorough examination of the effects of the library and archives provisions on markets including libraries and archives, and end-users of copyrighted material, as part of the Government's proposed three-year review of the operation of the Digital Agenda Act. We also recommend the operation of the new right of first digitisation and its effects on the market place and on consumers be considered in the three-year review.

The Committee is broadly satisfied that the Government's approach to the issues associated with technological protection measures preserves a reasonable balance between competing interests. However, we would be concerned if the use of technological locks, perhaps accompanied by greater reliance on contract, were to displace or in any way limit the effectiveness of fair dealing provisions. As a result, we urge that the review of the provisions of the Digital Agenda Act encompass a careful consideration of the evolving role of technological measures in the copyright system.

Copyright protection of computer software

The Committee supports the introduction of amendments to the Copyright Act to allow decompilation for the purposes of interoperability. The Government should review the operation of the Computer Programs Act to ensure that the wording of the amendments permits all legitimate acts necessary to allow the creation of interoperable products.

We recommend that Australia's position in negotiations on the issue of protection of compilations and databases—as part of WIPO negotiations and the Agreement on Trade-Related Aspects of Intellectual Property Rights 1994 (TRIPs)—be determined by a cost/benefit analysis to Australian society.

Caching—temporary reproductions

The Committee recognises that, at least at present, caching appears to be of considerable significance to the efficiency of the Internet; and that the transaction costs to secure licences to cache could be prohibitive for ISPs. As a result, Government policy should help ensure that this efficiency-enhancing activity is not prohibited.

If there is evidence that the defence in new ss. 43A and 111A inserted by the Digital Agenda Act does not sufficiently cover caching, then our view is that the Act should be amended to rectify this. For example, s. 43A of the Digital Agenda Act could be modified to include the phrase: 'other works temporarily made merely as an element in and so as to enhance the efficiency of the technical process of making or receiving a communication'.

Crown ownership of copyright

The Committee does not believe that the Crown should benefit from preferential treatment under the Copyright Act as compared with other parties. As a result, we recommend that s. 176 of the Copyright Act be amended to leave the Crown in the same position as any other contracting party.

Broadcast fee price capping

To achieve competitive neutrality and remove unnecessary impediments to the functioning of markets on a commercial basis, the Committee recommends that s. 152 (8) of the Copyright Act be amended to remove the broadcast fee price cap.

We recommend that no change be made in relation to the ABC under s. 152(11) of the Copyright Act.

Recommendation

Statutory licensing scheme

The Committee recommends that the current statutory licensing scheme remain unchanged at this time.

Collecting societies

The Committee recommends that:

The grounds for ministerial revocation (s. 135ZZC of the Copyright Act) be broadened to cover all collecting society arrangements, both input and output, including the disclosure of information to members and the public. Relevant ministers should issue guidelines to each collecting society, in the spirit of a contract between the society and the community, that specify the Government's expectations regarding the society's conduct, including in terms of the information required to be disclosed and the process for disclosure.

Assuming a continued role for the Copyright Tribunal over the output arrangements of statutory societies in respect of compulsory licences, there should be scope for the Tribunal to play a similar role in respect of other licences. The required mechanism should be for the ACCC to determine whether a reference should be made to the Copyright Tribunal, based either on the application by a collecting society, or from an actual or potential licensee, taking account of:

- any market power that can be exercised by the collecting society;
- whether there are alternative means of dispute resolution that could be used and that would impose less burden on the public; and
- the public interest in balancing public access to copyright material with the legitimate commercial interests of copyright owners.

If the Committee's proposed changes to s. 51(3) of the Trade Practices Act are accepted, then collecting societies would have to seek authorisation from the ACCC for those activities that fall within the scope of the prohibitions in the Part IV of the Trade Practices Act. If the Committee's proposed changes to s. 51(3) of the Trade Practices Act are not accepted, the Government should ensure a requirement for such authorisation through specific legislative amendment. In the Committee's view, the ACCC should ensure that such authorisations are reviewed periodically (for example, every three years).

Copyright Law Review Committee (CLRC) Report—simplification of the Copyright Act 1968

The Committee recommends that, in considering the CLRC report on fair dealing, the Government should ensure the balance between owners and users remains clear and certain. We do not believe there is a case for removing the elements of the current Copyright Act, which define certain types of conduct as coming within the definition of fair dealing.

The Committee does not believe that it would be appropriate, at this stage, to proceed with the CLRC's Part II recommendations. This is because we are not convinced that the benefits to the community as a whole would be outweighed by potential costs due to uncertainty surrounding the operation of a new regime.

2. Patents Act

Manner of manufacture

The Committee believes that Australia has on the whole benefited from the adaptiveness and flexibility that has characterised the ‘manner of manufacture’ test. As a result, we recommend that this test be retained.

The Committee recommends that the Patent Office ensure in its examination practice that the use described in the specification is specific, substantial and credible to a person skilled in the art.

The Committee recommends that where substantial areas of uncertainty exist in application of the patent law, particularly the threshold tests for granting a patent, IP Australia should initiate test cases to resolve the issues expeditiously.

Inventiveness or obviousness test

The prior art base for inventive step currently takes regard of documents available publicly anywhere in the world, but only of acts and common general knowledge in the patent area (i.e. Australia). The Committee recommends that the prior art base for obviousness should include all information, including acts and common general knowledge, anywhere in the world which a person skilled in the art could have been reasonably expected to find, understand and regard as relevant.

The Committee also recommends that, when considering inventive step, it should be permissible to combine two or more documents or parts of documents, different parts of the same document or other pieces of prior art where such a combination would have been obvious to the person skilled in the art.

Administration

The Committee recommends that the scope for, and impact of, implementing more steeply rising renewal fees for patents be considered by IP Australia.

Innovation patent

The Committee strongly supports the Advisory Council on Intellectual Property (ACIP) Review of Petty Patents recommendations on the innovation patent, and urges the Government to expeditiously progress the relevant changes to the Patents Act. We believe that the role of the innovation patent will be enhanced if the Committee’s proposals for higher thresholds for the standard patent are implemented.

Section 119 of the Patents Act 1990—prior use rights

The Committee recommends that s. 119 (1) (a) and (b) of the Patents Act be amended to make it clear that the prior use be only in the patent area and that this includes experimental use. A majority of Committee members recommend that only the actual prior user should be able to have the benefit of s. 119.

Provisional patent applications

The Committee is not convinced of the need to amend the current arrangements regarding provisional patent applications. However, we believe there is merit in introducing a grace period for public disclosure affecting the prior art base for novelty and inventive step. In the event that moves to introduce such a grace period are made by the European Patent Organisation on an expeditious basis, in the context of the European Patent Convention, then the introduction of a grace period in Australia should be coordinated with its introduction in Europe. However, if it appears that such moves in Europe will take more than five years from October 2000, then Australia should seriously consider proceeding before its European counterparts. When introduced, IP Australia should actively inform inventors in Australia of the implications of the grace period, and also of the risks that disclosure may incur to patentability in jurisdictions without a grace period.

Sections 144–6 of the Patents Act 1990—contracts

The Committee recommends that ss. 144–6 of the *Patents Act 1990* be repealed, as these provisions are not soundly based on efficiency considerations, and as the conduct they address is better dealt with through the provisions of s. 51(3) of the Trade Practices Act, amended in line with the Committee’s recommendations.

Section 133 of the Patents Act 1990—compulsory licensing

The Committee recommends that s. 135 of the Patents Act be repealed and that s. 133(2) be amended to include an order requiring a compulsory license to be made if and only if all of the following conditions are met:

- a. access to the patented invention is required for competition in the (relevant) market;
- b. there is a public interest in enhanced competition in that market;
- c. reasonable requirements for such access have not been met;
- d. the order will have the effect of allowing these reasonable requirements to be better met; and
- e. the order will not compromise the legitimate interests of the patent owner, including that owner’s right to share in the return society obtains from the owner’s invention, and to benefit from any successive invention, made within the patent term, that relies on the patent.

Such orders should be obtainable on application first to the Australian Competition Tribunal, with rights of appeal to the full Federal Court.

Stringency of tests for patentability

The Committee recommends changing the Patents Act to require a ‘balance of probabilities’ approach to be used during examination, rather than conferring the ‘benefit of the doubt’ to the applicant as at present.

Quality of examination

The Committee recommends that IP Australia devote additional resources to improving the quality of examination, particularly to prior art search processes, including through enhanced use of information technology. We also recommend that IP Australia continue to explore cooperation with other intellectual property offices in the region, including the possibility of forming a Patent Office covering East Asia, Australia and New Zealand.

Disclosure of prior art

The Committee recommends that the Patents Act be amended to require applicants to continuously disclose to IP Australia any prior art material that comes to their attention up until the date of advertisement of notice of acceptance. A company applicant must make ‘reasonable enquiry’ within its own organisation about what prior art is known to the company. Intentional non-disclosure of prior art would lead to a patent being unamendable, to reflect that prior art, after acceptance.

Patent hearing mechanism

The Committee recommends that Patent hearings should continue to be pre-grant and the responsibility of IP Australia. On this basis, a specialist hearings section would not be established, but there would be a senior officer directly responsible to the Commissioner of Patents for hearings, with hearings officers continuing to be drawn from senior examination staff of the Patent Office. We also recommend that IP Australia take further measures to improve the perceptions of the hearings process being independent of, and more generally fair and equitable to, all parties.

Patent appeals, challenges and enforcement in the courts

The Committee recommends that the Federal Magistracy be used as a lower court for the patent system, particularly for matters relating to the innovation patent.

3. Trade Marks Act

Parallel importation

The Committee recommends the Trade Marks Act be amended to ensure that the assignment provisions are not used to circumvent the intent to allow the parallel importation of legitimately trade marked goods.

Disclaimers

The Committee recommends that:

- mandatory trade mark disclaimers not be re-introduced;
- voluntary trade mark disclaimers be encouraged and that:
 - it should be made clear in the legislation that the use of a voluntary disclaimer should not adversely affect the registerability of the mark, which must be determined by considering the distinctiveness of the mark as a whole; however
 - courts, when awarding relief in disputes, should be directed through the legislation to take account of whether the trade mark owner has appropriately defined the scope of the right by the use of voluntary disclaimers over any non-distinctive elements in the mark.

4. Section 51(3) Trade Practices Act

The Committee recommends that intellectual property rights continue to be accorded distinctive treatment under the Trade Practices Act (TPA). This should be achieved by:

- amending s. 51(1)(a)(i) of the TPA to *list* all the relevant intellectual property statutes, that is ‘an Act relating to patents, trade marks, designs, copyright, circuit layouts and plant breeder’s rights’;^{*}
- repealing the current s. 51(3) and related provisions of the TPA; and
- inserting an amended s. 51(3) and related provisions into the TPA to give effect to ensuring that a contravention of Part IV of the TPA or of section 4D of that Act shall not be taken to have been committed by reason of its imposing conditions in a licence, or the inclusion of conditions in a contract, arrangement or understanding, that relate to the subject matter of that intellectual property statute, so long as those conditions do not result, or are not likely to result in, a substantial lessening of competition. The term ‘substantial lessening of competition’ is to be interpreted in a manner consistent with the case law under the TPA more generally.

The ACCC should be required by the legislation to issue guidelines as to the manner in which it will implement any enforcement activities related to these provisions. These guidelines should provide sufficient direction to owners of intellectual property rights to clarify the types of behaviour likely to result in a substantial lessening of competition. Provisions should exist within the guidelines for parties to seek a written clearance from the ACCC. This written clarification process should operate in a similar fashion to the ‘letters of comfort’ provision included in the ACCC’s Merger Guidelines. The ACCC should be required to consult widely with intellectual property owners, users, licensees, facilitators and the public generally in preparing these guidelines.

^{*} It should be noted that this recommendation has strayed beyond the Terms of Reference of the review in respect of the reference to plant breeder’s rights. The Committee has taken the liberty of including this reference as we believe it is important to capture all intellectual property rights within the relevant provisions, including those intellectual property rights which are not a specific subject of this review.

INTRODUCTION

The Intellectual Property and Competition Review was established by the Minister for Industry, Science and Resources and the Attorney-General as a result of the Competition Principles Agreement between the Commonwealth Government and State Governments. The agreement requires that all legislation with the potential to restrict competition should be subject to periodic review. Clause 5(1) of the Competition Principles Agreement states that:

The guiding principle is that legislation (including Acts, enactments, Ordinances or regulations) should not restrict competition unless it can be demonstrated that:

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

This review has been accorded the highest classification of importance by the Government, leading to the establishment of an independent committee to examine all intellectual property legislation (except that relating to plant breeder's rights).

The Terms of Reference for the review (**Appendix 1**) requires the Committee to have regard to:

- Government policy; and
- international agreements.

A summary of Australia's relevant international agreements is given in **Appendix 2**.

The Committee's Terms of Reference also require it to consider and report on the conclusions and recommendations of the National Competition Council report, entitled *Review of Sections 51(2) and 51(3) of the Trade Practices Act 1974*, and of the Copyright Law Review Committee report, entitled *Simplification of the Copyright Act 1968* (to the extent that they affect competition).

In accordance with the Competition Principles Agreement, the guiding principle of this review is that legislation should not restrict competition unless it can be demonstrated that the benefits to the community outweigh the costs, and that the objectives of the legislation cannot be achieved by less restrictive means.

The review was announced in national newspapers on 17 July 1999, and expressions of interest were sought from interested parties by 1 November 1999. Additional announcements were made in selected regional and capital city newspapers on 23 October 1999.

After preliminary consultation and research, the Committee released an Issues Paper in September 1999, to stimulate public discussion on the issues being examined by the review. This paper raised potential issues for consideration and invited further comments and written submissions from interested parties.

The Committee met with groups and individuals to discuss issues of concern. It received 83 written submissions. We produced and invited further comment on an Interim Report released in April 2000.

This report identified perceived problems requiring further consideration, provided description and background on areas of concern, set out broad policy objectives which the Committee believed should be pursued, and presented the Committee's preliminary views on options for achieving the objectives. Following the Interim Report, a further 56 written submissions were received. Not all of these were relevant to the Committee's Terms of Reference.

A number of public consultations were held in Canberra, and seminars were held in Melbourne and Sydney, during April and May 2000. In addition, we sought input from experts invited to roundtable discussions on issues relating to patents, copyright and s. 51(3) of the Trade Practices Act.

We received a significant number of representations from interested parties stating that they found it difficult, or impossible, to meet the advertised timeframes for providing written submissions on the Interim Report. In most instances, the parties requested an extension of time to submit their comments. The Committee was sympathetic to these requests, believing that the integrity of the review depended in part on the due consideration of relevant comments from interested parties, and that it was important that everyone seeking to comment have a reasonable opportunity to do so. However, we were also conscious that complying with these requests would make it impossible to deliver a final report on all the complex issues falling within the Terms of Reference of the review by 30 June 2000.

As a consequence, the Committee sought an extension of time to deliver its final report. Additional time was granted on some, but not all, issues. We were asked to report on the parallel importation of copyright material by 30 June 2000, and on all other issues, on or before 30 September 2000.

The Committee's *Report on Parallel Importing under the Copyright Act 1968* was publicly released on 24 August 2000. We are mindful that the overall issues in the parallel import report, and those considered in this final report, are interconnected, and believe that the recommendations of both reports will be most effectively viewed and considered in their entirety. We have therefore incorporated the discussion and recommendations of the parallel import report into this final report, producing an integrated document that reflects the totality of the inquiry outcomes.

The overall structure of this report is as follows:

1. The first section discusses the general nature and objectives of the intellectual property system and competition policy, and their interaction. This sets the context in which each intellectual property law is considered. Australia's international treaty obligations are also briefly described, as these put limits on recommendations that the Committee has made here.
2. The next sections consider in detail each Act within the Committee's Terms of Reference in the context of the Competition Principles Agreement. Each discusses the following issues: the intellectual property right; the objectives of the legislation, including what problems that right is attempting to address; the nature of restrictions that the right produces on competition; the alternatives to the current IP rights, including those afforded by non-legislative means; and our international obligations, particularly treaties that Australia has signed relating to that right.

3. The appendices include reports commissioned by the Committee; one on the likely effects on piracy in Australia, and the other on the experience of New Zealand since its removal of parallel import restrictions on copyright material.

Nature and objectives of the intellectual property system

Broadly speaking, ‘intellectual property rights’ is a generic term for the various rights accorded by law for the protection of creative effort or for the protection of economic investment in creative effort (see **Appendix 3**). In Australia, legislation grants limited exclusive rights to the owners of creative works, in order to encourage investment in innovation, as well as its diffusion throughout the economy.

- A more detailed description of the scope of the term can be derived from two important international agreements relating to intellectual property:
- the 1967 Convention Establishing the World Intellectual Property Organization (WIPO Convention); and
- the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS), a World Trade Organization (WTO) Agreement, which came into effect on 1 January 1995.

Article 2 (viii) of the WIPO Convention defines intellectual property to include the rights relating to: literary, artistic and scientific works; performances of performing artists, phonograms and broadcasts; inventions in all fields of human endeavour; scientific discoveries; industrial designs; trade marks, service marks, and commercial names and designations; protection against unfair competition; and all other rights resulting from intellectual activity in the industrial, scientific, literary or artistic fields. Not all of these rights are specifically protected under Australian laws.

One of the most important international conventions in the field of intellectual property law is the TRIPS Agreement. Although this agreement does not contain a definition of intellectual property, Article 1.2 indicates that the term refers to the seven categories of rights or subject matter which are dealt with in the agreement: copyright and related rights, trade marks, geographical indications, industrial designs, patents, layout designs of integrated circuits, and undisclosed information.

For the purposes of this review, the term intellectual property will be used to refer to the rights and obligations governed by the statutes referred to in the review’s Terms of Reference, as well as common law and equitable rights relating to the protection of confidential information and business reputation.

The general objective of the system of intellectual property law in Australia is utilitarian, and more specifically economic, rather than moral in character. It serves to (and, in the Committee’s view, should aim to) maximise the difference between the social value of intellectual property created and used, and the social cost of its creation, including the cost of administering the system.

More specifically, the intellectual property laws ought to provide incentives for efficient investment in innovation.

The creation of intellectual property involves considerable effort and can entail substantial resource outlays. Private producers will not have an incentive to make these outlays unless they receive an appropriate return. This is only attainable if producers can appropriate at least some of the value that users place on the outputs of the creative process. The characteristics of intellectual property mean that in many instances the results of investment in creative effort can be reproduced at little or no cost.

Put slightly differently, without a system of intellectual property rights it is difficult to prevent free riding by those who did not contribute to the original investment. Creators could therefore find it difficult to recoup the cost of their investment, let alone its economic value. Under these circumstances, economic incentives for intellectual property investment would likely be deficient, leading to under-investment in creative effort. To varying extents, and in varying ways, the intellectual property laws help redress this problem.

While seeking to redress the problems associated with free riding, the intellectual property laws must also seek to address the adverse economic effects that the grant of protection may itself create. For example, given that patents are granted to the first person to register an invention, the race to win patents could result in a higher than efficient investment of resources. The inefficiency occurs because the private reward from accruing monopoly profits outweighs the social gain from accelerating the invention process. Encouraging patent applications at an early stage of the innovation process can help address this issue.

Similarly, where innovation is cumulative, the incentive to develop subsequent inventions may depend on the price that second-generation innovators must pay for first-generation technology. A number of provisions of intellectual property law help address this issue by lowering the costs of subsequent innovations. For example, patent registration requires inventors to fully describe and disclose their invention, thus helping subsequent innovators to build on the advances made in existing inventions.

Last, but by no means least, conferring intellectual property rights, while encouraging investment in creative effort, can allow the owners of the rights to unduly restrict the diffusion and use of the results of these efforts. In an ideal world, purchasers of ideas, whose cost of reproduction is virtually zero, would at the margin of consumption face a price that was itself close to zero. However, in practice, IP rights ensure that owners of ideas can, and almost always do, charge some positive price at that margin. As a result, the consumption of the existing output of investment in creative effort falls below that which, in the short term, would maximise social income. In addition, while most intellectual property rights do not confer monopoly power, some do, and when this occurs, the owner of these rights is likely to further restrict diffusion below the level that maximises society's gain from the stock of knowledge.

Consequently, there is a cost associated with granting intellectual property rights. Intellectual property laws must therefore involve some balancing between the incentives to invest in creative effort and the incentives for disseminating material that is the subject of intellectual property protection. This balance turns on determining the appropriate scope and strength of protection, in terms of the conditions under which protection is granted, the scope and effectiveness of the exclusive privileges protection provides, and the duration of the protection given.

Balancing between providing incentives to invest in innovation on one hand and for efficient diffusion of innovation on the other is a central and perhaps the crucial element in the design of intellectual property laws. In the Committee's view, it is essential that the terms of this balance be clearly set out in the intellectual property laws themselves, so that rights owners and users can be certain about the scope and content of the grants being made. We therefore believe that the intellectual property laws, rather than other policy instruments (such as the Trade Practices Act), should continue to be the prime focus for defining the nature of the rights and obligations granted for investment in creative effort. Other policy instruments, most notably the Trade Practices Act, should come into play when intellectual property rights are used in ways that *go beyond* the scope of the right being granted.

Nature and objectives of competition policy

The overriding objective of competition policy is to maximise social welfare by maintaining and enhancing competition in markets. Competition is the process of rivalrous striving. Competition in the supply of goods and services involves the efforts of producers, acting independently, to secure sales and profits at the expense of rivals. To this end, producers in competitive markets constantly seek to be more favourably positioned than their rivals in terms of the prices they offer, the range, quality and innovativeness of the goods and services they provide, and their reputation as suppliers. As a result, consumers benefit from better, more affordable products, and the greater efficiency that competition secures increases the income available to society as a whole.

Experience and analysis has repeatedly shown that while there are costs associated with competition, it promotes economic growth and the achievement and maintenance of high living standards more surely and consistently than alternative approaches to controlling the allocation of scarce resources. As a result, there is a well-justified presumption in favour of competition, and creating and maintaining competitive markets is an important objective of economic policy.

In pursuing this goal, it is important to recognise that competition occurs in several dimensions. More specifically, firms not only compete in the prices they set but also in their ability to develop new processes and design and market new goods and services.

This dynamic competition is of special importance for several reasons. First, rather than simply reallocating existing resources, it expands the resources on which society can draw and allows for sustainable increases in living standards. Second, in practice it is the main way established market positions are over-turned, and the threat of competition made into an ever-present constraint on the conduct of firms.

Seen in this perspective, it is a misconception to view the goal of competition policy as being the creation of atomistic, 'perfectly competitive' markets. Rather, competition policy concerns itself with creating and preserving conditions under which market power can be challenged and dissipated, both by rivalry between existing firms and by the threat of new entry. Innovation, in all its varieties, plays a central role in this rivalry. Through its effect on innovation, the IP system is therefore a vital factor shaping and supporting the competitive process.

The interaction between intellectual property law and competition policy

Both intellectual property law and competition policy serve to correct market failure in the pursuit of economic efficiency. However, tension between the objectives and instruments of the two systems occurs when the correction of one form of market failure creates another.

The major concerns of competition policy in regard to intellectual property rights are the market power that may result from granting such rights, and the detrimental effects caused by the anti-competitive exercise of IP rights. At its simplest, market power can harm consumers by setting prices which are higher than those needed to secure cost-effective production. Moreover, the harm caused by market power may extend beyond this, when the protection granted to firms allows them to slow or distort innovation. Under these circumstances, market power will limit the growth of productivity over time, and reduce the scope for sustainable increases in living standards.

However, harm to competition should not, and cannot, be inferred from the mere existence of an exclusive right, such as those conferred by the intellectual property laws. Incumbent firms whose intellectual property benefits from protection may be subject to rivalry from numerous sources, including from other firms supplying differentiated but substitutable products. Perhaps more importantly, they may also be subject to the threat of their product being superseded by technologically superior versions. The very protection an incumbent firm enjoys may provide the incentive for its rivals to invest in developing these alternatives—so that the intellectual property protection, rather than undermining contestability, stimulates and channels it in directions that are usually socially beneficial.

The system of intellectual property rights does not only affect the ability to exercise proprietary control over intellectual property and increase the incentive to invest in creative effort. By setting out a clear framework of property rights, it also increases the ease with which intellectual property can be traded, most visibly through assignment and license. This, in turn, increases the likelihood that technology will gravitate towards those best placed to use it. And it creates a means for those who are best placed to advance technology, to have access to the existing base of proprietary knowledge by means of contract. A well-functioning system of intellectual property rights therefore encourages efficiency both in the production and in the allocation of knowledge.

These effects of an intellectual property rights system need to be gauged relative to non-legislative alternatives. Without such a system, investors in intellectual property would have to rely on contractual mechanisms to protect their interests. In many areas of technology, and particularly those where copying or reverse engineering are relatively easy, such contractual restraints could not provide adequate protection. Even in areas where contractual mechanisms could be *effective*, it is not likely that they would be *efficient*. Rather, social costs would almost certainly be higher under such arrangements, than they are under the current panel of protective instruments.

For example, a system that relies on contract and on the duty of confidence sharply reduces the incentives for disclosure, as disclosure can lead to invalidity of any property right granted. This absence of disclosure results in economic and social costs.

Moreover, a system that relied on contract and trade secret systems to secure appropriate rewards for investors from innovation, would likely involve greater and more durable market power than its legislative alternative. Large incumbents would be especially well placed in seeking to keep information confidential, and would overcome the difficulties such a system would pose for technology licensing through international diversification. Small and new firms, by contrast, would find it difficult to innovate profitably, as imitation of their efforts by incumbents reduced or even eliminated their ability to appropriate the gains innovation can provide. The resulting trend towards concentration in a few firms of the gains from innovation would create both static and dynamic inefficiencies. In short, the mere grant of intellectual property rights, even when they do confer a degree of control over price and output, is consistent with a vigorously competitive economy. Indeed, it is a precondition for the dynamic competition that is essential for efficiently functioning markets.

Having said that, the exercise of IP rights needs to be analysed with care. There are genuine grounds for concern when these rights are used to prevent future competition from developing—that is, when they slow the process of innovation the intellectual property system is intended to foster. And mechanisms need to be in place to prevent firms from using intellectual property rights as a mere camouflage for entering into agreements to fix prices, to divide markets and/or in other ways to monopolise supply. But these concerns should not lead to unnecessary restrictions on the exercise of intellectual property rights.

For example, it may be more efficient for the owners of an intellectual property right to vest the use of that right in others—say through a system of exclusive territorial licenses underpinned by restrictions on output—rather than producing and distributing the output themselves. Restrictions on the ability of rights owners to enter into such arrangements could prevent the deployment of efficient means of working, and reduce both the return to innovators and the incentive value of the IP system. Ideally, competition policy would allow such efficiency-enhancing arrangements to proceed, while deterring those that do not serve a useful social purpose.

The relationship between the objectives of the intellectual property laws on one hand and competition policy on the other is therefore complex and multifaceted. There are many complementary elements: the intellectual property system promotes innovation, which is a key form of competition; and competition policy, by keeping markets open and effective, preserves the primary source of pressure to innovate and diffuse innovations. But there are also conflicts—such as when an intellectual property right serves to entrench market power. The need to avoid simplistic approaches to this relationship is emphasised by Mr William Baer, Director of the United States Federal Trade Commission:

Enforcement of competition laws no longer begins with the assumption that restrictive use of IP is necessarily anti-competitive. Current enforcement instead starts with three basic assumptions about intellectual property: first, intellectual property is comparable to other forms of property, so that ownership provides the same rights and responsibilities; second the existence of intellectual property does not automatically mean that the owner has market power; and third, the licensing of IP may often be

*necessary in order for the owner efficiently to combine complementary factors of production, and thus may be pro-competitive.*¹

The Australian Competition and Consumer Commission has expressed similar views.²

Overall, the Committee believes that the system of intellectual property laws acts to promote competition by maintaining the incentives to innovate, while striving to strike a balance—through the nature and content of the rights it grants—between those incentives and society’s interest in the widespread diffusion of ideas. It believes that the terms of that balance are properly specified in the intellectual property laws themselves, securing the greatest clarity for the rights being granted.

However, the Committee also recognises that the rights granted by the intellectual property laws can be used for anti-competitive ends. This occurs when the rights are used to claim for the creator not merely a share of the gains society obtains from the creation, but also rents that arise from market power: that is, when the rights are used to add to the income that comes from differential efficiency, gains from reducing output in ways unrelated to that differential efficiency (for example, by the use of intellectual property licenses to effect a horizontal price-fixing agreement). It is in these instances—where the rights are used for purposes that go beyond their grant—that significant competition policy issues arise and need to be addressed.

International obligations

Australia’s domestic intellectual property legislation is strongly influenced by its commitment to international conventions and agreements administered by the WIPO and the requirements of TRIPS.

Australia has entered into international agreements that require compliance with specified IP protection requirements and make a positive contribution to the international IP framework. Consistent with these obligations, Australian IP laws and administrative regimes are broadly compatible with those of most other countries. And Australia’s enforcement of IP rights is at least on par with most advanced economies. This factor, along with compliance with TRIPS, contributes to local and international confidence in the quality of IP protection provided in this country. Internationally consistent IP laws benefit Australia as they can facilitate international trade and investment. They do this both by eliminating official barriers to trade and investment and by reducing the transactions costs that would otherwise be faced by Australian exporters and importers—for example, in securing the international transfer of technology and of the results of investment in creative effort.

WIPO

Australia became a member of WIPO in 1972 and is a signatory to a number of its treaties and conventions. The WIPO agreements set minimum standards rather than prescribing

¹ Baer W, *Antitrust Enforcement and High Technology Markets*, address to the American Bar Association, November 12, 1998

² Prof. Allan Fels, Chairman, ACCC, *The Role of Competition Policy in Intellectual Property*, speech to the Victorian Branch of IPSANZ, 22 July 1999

optimal forms of IP protection, and are directed toward making the IP system more international in character and efficacy.

There has been a substantial dialogue within WIPO aimed at addressing significant issues regarding internationalisation of the system.

Accession and dialogue within WIPO is largely of a voluntary nature and there is no compulsion on nations to join any of the relevant agreements. Significantly, there are no formal mechanisms for the enforcement of WIPO agreements.

Australia is a party to a number of WIPO agreements and treaties affecting patents, trade marks, designs, copyright and circuit layouts as set out in **Appendix 2**.

TRIPS

Intellectual property rights received a significantly higher international profile as a result of the Uruguay Round of multilateral trade negotiations that led to the formation of the World Trade Organization (WTO) and the inclusion within the scope of its activities, of intellectual property rights through TRIPS, a subsidiary agreement under the WTO Agreement. TRIPS is binding on all WTO members, including Australia as a foundation member. TRIPS came into effect on 1 January 1995. As an industrialised country, Australia was obliged to abide by its provisions by 1 January 1996.

Main features of TRIPS

TRIPS strengthened the international IP environment by setting minimum standards of protection for domestic enforcement, and by making IP issues a core element of the international trading regime. Adherence to TRIPS is a requirement for membership of the WTO, and the dispute mechanisms of the WTO can be used to resolve disputes arising under TRIPS. TRIPS enforcement provisions provide minimum standards for effective domestic enforcement. Disputes between WTO members about the implementation of TRIPS are covered by the WTO dispute settlement procedures.

Apart from mandating stricter enforcement procedures, minimum standards for granting and administration of rights, mandatory transparency measures, and binding dispute settlement procedures, the provisions of TRIPS are in most part additions to, and elaborations of, the legal and institutional norms and practices specified in earlier WIPO agreements such as the Paris, Berne and Rome Conventions. The most significant elements contained in TRIPS are:

- the minimum patent term, which is set at 20 years, the minimum copyright protection term for sound recordings and performances at 50 years (from the date of recording) and 20 years for broadcasts;
- the requirement that computer programs and databases be protected by copyright, and in the case of computer programs, that they receive the level of copyright protection accorded to literary works;
- the requirement to provide for the registration of service marks;
- an extension and strengthening of the provisions of the Paris Convention regarding the registration/use of well known marks and geographical indications (GIs);

- the inability of a country to force the use of a local mark in combination with a foreign trade mark, and the prohibition on compulsory licensing of marks;
- the requirement to protect integrated circuit layout designs for a term of at least 10 years;
- the requirement to protect artificially developed new varieties of micro-organisms through patents;
- the requirement that no areas of technology are excluded from patent protection, with the optional exceptions of medical methods for the treatment of humans, and of new life forms above the micro-organism level;
- the requirement to protect new plant varieties, within the patent system or with a separate system of breeder's rights, or both;
- the requirement to develop a legal system for protecting trade secrets from unfair disclosure in accordance with principles of fair competition and, of more significance to Australia, the requirement to protect test data;
- the imposition of limitations to the application of compulsory licensing and Government use of patents, and the requirement for adequate compensation;
- limitations on exceptions to exclusive intellectual property rights where the interests of rights holders may be prejudiced;
- acknowledgment of the possibility of anti-competitive abuse of intellectual property rights and affirmation of the right to take action against abusive practices; and
- reversal of the burden of proof for process patents, and prohibition of any distinction in patent rights based on whether goods are locally produced or imported.

Almost all of these elements were independently present in Australian law prior to the conclusion of TRIPS. However, their inclusion in an international agreement with such weight is a factor that cannot be overlooked in a consideration of the Australian IP system.

Standards and application

TRIPS is not an exhaustive set of standards establishing what intellectual property rights are to be protected and how. In addition to general standards on what amounts to effective implementation, it sets minimum standards in certain key areas, but does not always clearly define them nor prescribe the precise way they are to be implemented.

The majority of TRIPS obligations may be carried out in a way that takes account of particular national considerations, such as domestic legal traditions, areas of regulatory priority, resource constraints, and the timetable of review of national laws.

New Zealand Australia Closer Economic Relations Agreement

On 1 July 1983 the Australian and New Zealand Governments entered into the New Zealand Australia Closer Economic Relations Trade Agreement (CER). The central provision creates a WTO Free Trade Area encompassing Australia and New Zealand. CER is not part of Australian domestic law, and is not actionable by individuals. However, the provisions of CER play a significant role in shaping Government policy across many areas.

Article 1 of CER states that one of its objectives is to eliminate barriers to trade between Australia and New Zealand in a gradual and progressive manner. Article 5 provides that quantitative import restrictions and tariff quotas on all goods originating in the territory of the other member state shall be progressively liberalised and eliminated. However, Article 18 of CER provides that the agreement shall not preclude the adoption of measures necessary to protect intellectual or industrial property rights.

The CER family of agreements does not formally cover IP rights, and Australia and New Zealand rely on TRIPS for the protection of IP rights. However, as the former Trade Practices Commission (now the Australian Competition and Consumer Commission) recognised:

...in the interests of increased competition and free trade between Australia and New Zealand, reciprocal amendments could be made to the various IP statutes to provide that the right to take action in one Member State to prevent importation of an infringing product will not apply where the product has been placed on the market of the other Member State by or with the consent of the IP owner.³

The trade implications of IP rights were considered in the context of parallel importation by a Report to Governments by the Steering Committee of Officials in 1990. The Steering Committee found that provisions preventing parallel importation were potentially a 'distinct impediment to trans-Tasman trade' but noted that the laws of both countries were essentially in harmony.⁴

Since then, the New Zealand *Copyright Amendment (Removal of Prohibition on Parallel Importing) Act 1998* has had the effect of permitting parallel importation of copyright material in most cases.

³ Trade Practices Commission *Background Paper on the Application of the Trade Practices Act to Intellectual Property*, July 1991, para 6.20

⁴ *Ibid*, para 6.21

COPYRIGHT ACT

Description of the rights granted by Copyright Act

In some respects copyright is more complex than other forms of IP such as patents or trade marks, due to the different layers of copyright ownership that may subsist in a single subject matter, and the different bundles of rights that may accompany that ownership.⁵

Copyright protects original ‘works’⁶ (literary, dramatic, musical and artistic) and ‘subject matter other than works’⁷ (cinematograph films, sound recordings, radio and television broadcasts and published editions). In Australia, computer programs are granted copyright protection under the category of ‘literary works’.⁸

Copyright protection confers upon the copyright owner a number of exclusive rights for a period specified by the Copyright Act. The rights granted depend on the category of copyright material. For example, the owner of copyright in a literary, dramatic and musical work possesses the exclusive rights to:⁹

- reproduce the work in material form;
- publish the work;
- perform the work in public;
- ‘communicate to the public’ (this new broad right, introduced by the *Copyright Amendment (Digital Agenda) Act 2000*, incorporates and will replace the former rights of ‘broadcasting the work and transmitting the work to subscribers to a diffusion service’);¹⁰
- make an adaptation of the work; and
- commercially rent the work (in the case of computer programs and works recorded in sound recordings).

In addition, the owner acquires the right to authorise, or licence, another person to exercise any of these rights.

⁵ For example separate copyrights might subsist in a literary work, in the translation of the work, in a film based on the work, in sound recordings used in that the film, and in the actual broadcast of the film.

⁶ *Copyright Act 1968* (Commonwealth), Part III

⁷ *Copyright Act 1968* (Commonwealth), Part IV

⁸ This extended definition of literary works was introduced by the *copyright Amendment Act 1984* (Commonwealth).

⁹ Owners of copyright in artistic works enjoy the following rights with the exception of the performance right and the right to make an adaptation of the work.

¹⁰ On 2 September 1999, the Government introduced into Parliament the *Copyright Amendment (Digital Agenda) Bill 1999* (the *Digital Agenda Bill*). The Bill was passed with some amendments in the House of Representatives on 28 June 2000, passed both Houses of Parliament on 17 August 2000, and received Royal Assent on 4 September 2000. The commencement date for the operation of the Act is 4 March 2001 (six months after Royal Assent). The *Digital Agenda Act* replaces existing rights of broadcasting and transmission to subscribers to a diffusion service with a new broad-based right of ‘communication to the public’. This right will apply to all categories of copyright material except published editions. This new right includes the exclusive right to ‘make available online’ and to electronically transmit that material to the public.

Owners of copyright in sound recordings, films, broadcasts and published editions enjoy exclusive rights to reproduce the material. There are additional rights relating to: showing films and playing sound recordings in public; broadcasting films and sound recordings; and rebroadcasting television and sound broadcasts.

In Australia the length of protection varies according to the nature of the copyright material, and whether or not it has been published. Copyright for literary, dramatic, musical and artistic works generally lasts for 50 years from the year of the creator's death. Copyright for films and sound recordings lasts for 50 years from publication, and for broadcasts, 50 years from the year they were made.

In Australia, copyright subsists automatically on the creation of 'work' or the 'making' of a 'subject matter other than a work'. There is no system of registration to obtain protection, as there is for many other intellectual property regimes. To receive protection, the work must be 'original' and reduced to material form. The standard of 'originality' does not pertain to artistic or creative merit, but rather relates to the requirement that the material not have been copied from the work of another creator.

A fundamental principle of copyright protection is that it protects the *expression* of the protected ideas, but not the underlying ideas themselves.¹¹ So expression of the same ideas in a different form may not constitute infringement. Neither will infringement be found if there is an independent creation of an identical expression (as would be prohibited under patent law). The limited scope of copyright protection means that competitors will often be able to produce non-infringing close substitutes to compete with the products protected by copyright. As a result, the anti-competitive effects of granting copyright over a particular product may be slight.

Objectives of the Copyright Act

One aim of copyright law is to ensure that creators, like others, are able to enjoy the 'natural rights' to 'the fruits of their labours'.¹² This natural right is also mentioned in the Universal Declaration of Human Rights.¹³ However, without detracting from the inherent strength of this claim, the Australian tradition in intellectual property law is more explicitly utilitarian: in the sense of seeking to maximize social welfare, rather than focusing on IP as having intrinsic value and hence merit. In this context, maximizing social welfare involves maximizing the difference between the social value of IP created and used, and the social cost of its creation, including the cost of administering the system of intellectual property rights itself.

¹¹ This has long been recognised within Anglo-Australian common law—see *Donoghue v Allied Newspapers* (1938) Chapter 106, and the Australian case *Mono Pumps v Karinya Industries* (1984) 4 IPR 505. The obligation is also set out in Art 9 (2) TRIPS Agreement (1994), which states 'Copyright protection shall extend to expressions and not to ideas, procedures, methods or operation or mathematical concepts as such'.

¹² Willes J stated the principle of natural rights long ago: 'It is not agreeable to the natural justice that a stranger should reap the pecuniary produce of another's work' in *Millar v Taylor* (1769) 98 ER 201, p. 223.

¹³ Art 27 (2) Universal Declaration of Human Rights states 'Everyone has the right to protection of the moral and material interests resulting from scientific, literary or artistic production of which [she or] he is the author'.

The creation of intellectual property involves intellectual effort and can entail substantial resource outlays. For private producers to have sufficient incentive to invest in these outlays, they must be able to appropriate at least some of the value that users place on the outputs of the creative process. The system of copyright protection seeks to do this by providing a right to prevent copying of works that could otherwise be copied at relatively low cost.

This goal of copyright has been succinctly outlined by several Commonwealth Attorneys-General:

*...it is a prime purpose of copyright law to protect creative works so that authors, composers, artists and sculptors may during the continuance of copyright protection, control the uses to which their works are put and get some return for the exploitation of their works.*¹⁴

and

*The laws relating to copyright and industrial property... have as their purpose the legal protection of creation and inventions from unauthorised use so that the creators and inventors will be able to profit by having for a time certain exclusive rights. This is seen as being in the overall interest of the public as we would not have the benefit of inventions or creations, or the industries upon which they are based, without the incentive of the certain economic return which the legal protection permits.*¹⁵

When the Copyright Bill 1968 was introduced, it was clear that the new legislation was designed to foster innovation and in particular, to grant protection for the emerging publishing industries.¹⁶ Over the decades since, the Copyright Act has been amended to deal with specific and significant challenges posed by advances in technology.

In effect, copyright, as much as—or even more than—any other area of the law, is fundamentally affected by technological developments which allow copyright material to be used in new ways. Advances such as mechanical recording, television broadcasting and the use of computers have increased the markets producers may reach, and new rights have been defined and granted. However, the technology has also brought new means of copying, such as record players, photocopiers, audio tapes, video cassettes, and more recently digital copying by computers, often aided by the Internet. These developments, particularly digitisation, reduce the costs of copying and raise the costs of enforcement.¹⁷ Basic rights have been extended, copyright protection has been granted, and offences have been created to deal with these developments. Most recently the challenges of the digital era—including the increasing ease of reproducing and disseminating perfect copies of digital copyright material, the threat of piracy, and the use of circumvention devices to seek unauthorised access to electronic copyright works—have led to the amendments contained in the *Digital Agenda Act 2000*.

¹⁴ Attorney-General, Hon Mr Bowen MP, Second Reading Speech, Copyright Bill 1968, House of Representatives, Hansard, 16 May 1969, pp. 1527–37

¹⁵ Attorney-General, Senator Gareth Evans, Second Reading Speech, Copyright Amendment Bill 1984, Senate, Hansard 4 June 1984, pp. 2418–24

¹⁶ Hon Mr Bowen MP, Second Reading Speech, *Copyright Bill 1968*, as above note 14

¹⁷ See for example, Towse R 'Copyright as an Economic Incentive,' 1999 *Copyright Reporter* Vol 17:1, p. 15–16, 1999.

In this way, the copyright system's ability to protect creators from the improper use of their work has been continuously preserved in the face of ongoing technological challenges.

Whilst seeking to redress the problems associated with free riding, copyright must also seek to address the adverse economic effects that the grant of protection itself may create.

It is, in this respect, a fallacy to suggest that policies conferring more income on copyright owners are in and of themselves socially desirable relative to those that confer less. Rather, the goal of the intellectual property system is to provide a *sufficient* incentive for socially useful investment in creative effort. This requires that compensation flowing to rights owners be enough to encourage investments whose social benefits exceed their costs.

Over-compensating rights owners is as harmful, and perhaps even more harmful, than under-compensating them. Copyright protection has therefore always involved a balance between the incentives to invest in creative effort and the incentives for disseminating or providing access to the material created. In the Committee's view, this balancing element that underpins copyright law is of critical importance.

From the introduction of the Copyright Act, and with all subsequent amendments, the Government has been keenly aware of the need, on grounds of public policy, to balance the competing interests of creators and users. Reflecting this intention, existing copyright laws contain a variety of exemptions, statutory licenses and other mechanisms, which place limits on the rights to ensure availability of protected materials to certain classes of user.¹⁸ Although technological change alters the protection needed, it does not undermine the vital nature of these limits. Rather, the limits must be maintained, within the changes imposed by technological developments. The Committee consequently notes and welcomes the Government's commitment to maintaining the balance between users and creators through the provisions set out in the *Digital Agenda Act 2000*.

Problems the Copyright Act attempts to address

As with other types of IP, the principal issue that copyright seeks to address is possible free riding on investment of intellectual effort.¹⁹ It seeks to do this by granting the right to prevent unauthorised copying, as well as other exclusive rights. This channels creative endeavour into new ways of expressing ideas, rather than encouraging mere copying, and granting such exclusive rights to generate a return is necessary to promote adequate levels of investment in creative effort.

However, it is also in the public interest to ensure dissemination of ideas to the public, thus permitting their use and subsequent development. For this reason, copyright protects only forms of *expression*, and not the underlying *ideas* themselves; the ideas in a copyright protected work can be freely used by others as long as they are expressed in a different form.

¹⁸ Senator Gareth Evans, Second Reading Speech, *Copyright Amendment Bill 1984*, above note 15

¹⁹ Free riding has also been described as 'the enforcement of exclusion'. See staff research paper prepared by John Revesz of the Productivity Commission, *Trade Related Aspects of Intellectual Property Rights*, 1999, pp. 15–16.

There are also important exceptions to the rights of copyright owners. For example, fair dealing provisions and/or compulsory licences are contained in the copyright regime to ensure appropriate access to material for a range of social policy reasons.

As in other areas of IP, the key to copyright reform is to set the level of the exclusive right granted by the statute so the interests of producers and consumers are both maximised.²⁰

Some technological developments have made it increasingly easy (and inexpensive) to copy works resulting from the intellectual or creative efforts by others, without paying any royalties for the privilege. This has been demonstrated recently in well-publicised cases concerning the (unauthorised) dissemination of digitised music via the Internet as MP3 files, which are copied without licence from—and without remuneration to—the copyright owners. It has been estimated that as many as 10 000 files per second are being copied in this way.²¹ ‘Sharing’ of copyright material by this mechanism is not limited to music files, but extends to other copyright works.²² Copyright enforcement is increasingly challenging in this new environment.

However, while digital technology does in some instances, and in some ways, shift the balance of power against copyright owners and in favour of users (or infringers), it also creates new weapons to detect infringement, and assists in proof of infringement through use of rights management protection measures such as watermarking or encryption.²³ For example, hundreds of piracy sites have been identified since Microsoft began using search software that locates illegal computer programs being offered on the World Wide Web.²⁴

One commentator has opined in the *New York Times*:

*From the viewpoint of economic policy, the critical thing is to set up a legal environment that provides sufficient incentives to the various parties to create and distribute creative work. There is no requirement that the law should try to preserve current ways of conducting business. Indeed, the rewards should go to those companies, incumbents or entrepreneurs, that take the risk of experimentation to find the models that fully realize the potential of new technologies.*²⁵

²⁰ Office of Regulatory Review, *An Economic Analysis of Copyright Reform*, Submission to Copyright Law Review Committee’s (CLRC) review of the Copyright Act, 1995, (attachment to Interim Report Submission 47), p. 1

²¹ Judge Patel stated in a 45-page document filed with the Court of Appeals (explaining why she imposed a preliminary injunction against Napster) that there was ‘statistical evidence of massive unauthorised downloading and uploading of plaintiffs’ copyrighted works, as many as 10 000 per second’—as reported in E. Wehede, ‘Napster Dances as Tunes Play’, *The Australian*, 29 August 2000, p. 48.

²² There is growing concern regarding the sharing of needlepoint and cross stitch designs via scanning and uploading onto the Internet: see Mills M ‘Piggies pinching patterns’, *Canberra Times*, 28 August 2000, p. 12; Mills M ‘The rise of pattern poachers’, *The Guardian*, 23 August 2000.

²³ American Bar Association (ABA), *Achieving Legal and Business Order in Cyberspace: A Report on Global Jurisdiction Issues Created by the Internet*, preview report for discussion at 17 July 2000 London session of the ABA annual meeting, available at <http://www.kentlaw.edu/cyberlaw/docs/drafts/draft.rtf> and also at <http://www.abanet.org/buslaw/cyber/initiatives/jurisdiction.html>.

²⁴ ‘Microsoft finds pirate software sites’, 3 August 2000, Canadian Press <http://www.globetechnology.com/archive/gam/News/20000803/RMICR.html>; and <http://www.ottawacitizen.com/hightech/000803/4524848.html>

²⁵ Varian, H., ‘Internet Changes the Economics of Information Industries’, *New York Times*, 27 July 2000

Are there alternate means to address problems including non-legislative means?

The effects of a legislative system of IP rights need to be gauged relative to available alternatives.

One commentator, Christopher Whitelaw, suggests there are four main approaches for resolving copyright protection issues being raised by digital communications: new laws; new contractual arrangements; new collective management regimes; and new technological solutions.²⁶ Whitelaw suggests that to address these issues effectively, there needs to be a high degree of global unity in developing appropriate solutions. Recognising this fact, WIPO was motivated to initiate revision of international copyright standards by updating the Berne Convention.²⁷

Without a statutory system of protection, investors in copyright would have to rely on contractual mechanisms to protect their interests. To some extent this occurs already and a further move from copyright to contract seems well underway.

With new technologies such as the Internet, it is becoming possible to protect material from unauthorised copying through instantaneous contractual agreements between the publisher and user. Although these may be termed ‘licence’ agreements, they often appear to be more in the nature of ‘access’ agreements. For example, to gain access to a file, the user may agree to certain conditions. These terms may prohibit reproduction or further dissemination of the material, or other limitations imposed by the publisher/ provider. This is known as ‘click wrapping’, and the rules are claimed to be similar to those that apply for ‘shrink wrap’ licences—i.e. licence agreements that impose terms on the use of CDs or software within plastic shrink wrap surrounding the product, binding once the consumer breaks the packaging seal.²⁸

There are shortcomings using contractual mechanisms (private ‘information licences’) rather than copyright as a means of protection:

- first, they are deficient in that they bind only the parties to the agreement, and not third parties who may come across the material;²⁹ and
- second, they may exclude public interest provisions of copyright law, so that the ideas and data actually contained within the copyright-protected material cannot be copied or used; where statutory provisions do not provide otherwise, the terms may also exclude

²⁶ Christopher Whitelaw, ‘Copyright and the Internet—an appraisal of the Government’s digital agenda reforms’, *Intellectual Property Law Bulletin*, Vol 12:9, April 2000, p. 93

²⁷ *Ibid*

²⁸ ‘Purchasers’ are said to be bound by the terms, having had notice of them. By removing the shrink wrap, the purchaser agrees to be bound by the licence terms. Similarly, a user clicking a button agrees to be bound by licence or access terms. However, this is not without complication. In Australia such terms could not exclude certain warranties nor could they impose ‘unconscionable’ terms under the *Trade Practices Act 1974*.

²⁹ Although the party to the original agreement (user) might be sued for breach of his or her agreement in providing access to the material to a third party, the law of privity of contract necessitates that the third party could not be bound by terms to which they have not specifically agreed.

other fair dealing provisions contained in the copyright regime to ensure appropriate access to material for a range of economic and social policy reasons.

In many areas of technology, and particularly those where copying or reverse engineering are relatively easy, such contractual restraints could not provide adequate protection. Without a system of protection, the only benefit a creator could enjoy would be lead-time in a market, before others tapped in to copy the work as free riders on the creator's investment.

Even in areas where contractual mechanisms could be effective, they are unlikely to be efficient. Social costs would almost certainly be higher under such arrangements than they are under the current legislative scheme. The Productivity Commission has pointed out that such contractual agreements are only effective for information that is of limited initial distribution. As distribution increases, transaction costs of formulating contracts rise and the potential for undetected breaches increases.³⁰

Landes and Posner have considered what might happen without copyright protection, and concluded that there may be a shift toward production of works that are difficult to copy (e.g. via encryption techniques). Authors might be more inclined to circulate work privately (compromising the free flow of ideas), and there might be an increase in the use of contractual means to restrict copying (which may be on more restrictive terms than provided for in the Copyright Act).³¹ There are possible constitutional impediments that may prevent abolition of statutory protection for copyright, where to do so would amount to an extinguishment of property rights without compensation.³² Additional restrictions on any winding back of copyright arise from Australia's international obligations.

Overall, copyright protection may in fact have a more important role in preventing market disorganisation than patents, given the vulnerability of most copyright material to easy duplication.³³ Moreover, the scope copyright protection affords for carefully defining the scope of rights, in ways that reflect wider economic and social concerns, makes the preservation of an efficient and effective statutory copyright system all the more crucial. As a result, the Committee does not consider there are effective non-statutory alternatives to the current copyright system.

International obligations

One objective of copyright law is to ensure that Australia meets its obligations under international law to provide copyright protection, and so protect its broader trading interests. Two important international agreements dealing with copyright (as well as other IP rights) are:

- the 1967 Convention Establishing the World Intellectual Property Organization (WIPO Convention); and

³⁰ Office of Regulation Review, *An Economic Analysis of Copyright Reform*, Submission by the Office of Regulation Review to CLRC, Canberra 1995, (Attachment to Issues Paper Submission 47), p. 45

³¹ Landes W and Posner R 'An Economic Analysis of Copyright Law' 1989 18(2) *J. of Legal Stud.*, p. 325

³² That issue has been addressed briefly in Office of Regulation Review, *An Economic Analysis of Copyright Reform*, Submission by the Office of Regulation Review to CLRC, Canberra 1995, (Attachment to Issues Paper Submission 47) pp. 53–4. It seems that until the issue is tested by the High Court, it is unclear whether the Commonwealth could remove the proprietary grant of copyright protection without compensating a prior copyright owner on just terms. *Ibid.*, p. 54.

³³ Revesz J *Trade Related Aspects of Intellectual Property Rights*, staff research paper, Productivity Commission, 1999, p. 35

- the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS), a World Trade Organization (WTO) Agreement, which came into effect on 1 January 1995.

TRIPS

The most significant elements contained in TRIPS in relation to copyright are:

- the minimum copyright protection term for sound recordings and performances which is 50 years (from the date of recording) and 20 years for broadcasts; and
- the requirement that computer programs and databases be protected by copyright and, in the case of computer programs, that they receive the level of copyright protection accorded to literary works.

There is also a requirement to protect integrated circuit layout designs for at least 10 years. The means by which this protection is accorded is at the discretion of the respective countries.

To a large extent, the rights provided for in these instruments relating to copyright are fully protected in Australia by the *Copyright Act 1968*.

Rather than being protected under the Copyright Act, circuit layouts are afforded a *sui generis* protection under the *Circuit Layouts Act 1989*, which is discussed elsewhere in this report.

WIPO Internet treaties

There are two other relevant treaties to which Australia is not yet a signatory, commonly known as the 'Internet treaties'. These treaties are yet to be ratified by the at least 30 countries needed for them to come into force. Although Australia has not yet signed these treaties, Government statements have been broadly supportive of their aims. Central to the treaties is the 'digital agenda' and an effort to bring international copyright standards into the new technological age. Rather than being stand-alone treaties, they update the Berne Convention, the Rome Convention and the TRIPS agreement.

WIPO Copyright Treaty (WCT)

The WCT was adopted by the Diplomatic Conference on 20 December 1996.³⁴

The preamble to the WCT highlights the need to 'provide adequate solutions to the questions raised by new economic, social, cultural and technological developments'.

It mentions two subject matters: computer programs (in whatever form); and compilations of data or other material (databases) which, by reason of the selection or arrangement of their contents, constitute intellectual creations. The WCT deals with three rights of authors: distribution; rental; and communication to the public (including the Internet).

³⁴ WIPO CRNR/DC/94 (23 December 1996) ('WIPO Copyright Treaty'), <http://www.wipo.int/eng/diplconf/distrib/94dc.htm>.

With the WIPO Performances and Phonograms Treaty (WPPT), it introduces new obligations to prohibit circumvention of technological measures (such as encryption) used to protect copyright and related rights, and to prohibit tampering with rights management information (such as watermarks). In addition, the WCT requires contracting states to comply with the substantive provisions of the 1971 (Paris) Act of the Berne Convention.

WIPO Performances and Phonograms Treaty (WPPT)

The WPPT was also adopted by the Diplomatic Conference on 20 December 1996.³⁵ The Commonwealth Government has included at least some of the WPPT's obligations into amendments to the Copyright Act. The treaty deals mainly with the IP rights of performers (singers, musicians, actors etc.) in their fixed, purely aural form ('phonograms') and of the producers of such phonograms. These rights include 'reproduction', 'distribution', 'rental' and 'making available'. The WPPT also grants economic rights to performers in respect of their unfixed (live) performances including the rights of broadcasting, communication to the public and fixation.³⁶ For both live and fixed performances, performers are granted moral rights, including being identified and objecting to any modifications prejudicial to the performer's reputation.

Nature of the restrictions on competition

Both IP law and competition policy serve to correct market failure in the pursuit of economic efficiency. However, tension between the objectives and instruments of the two systems occurs when the correction of one form of market failure creates another.

Copyright typically confers a far weaker right of exclusion on rights owners than some other forms of intellectual property rights, notably patents. The fact that copyright does not preclude or exclude independent creation of functionally similar material, sharply distinguishes the scope of the right being granted from that awarded under patent law.³⁷ Conversely, for copyright protection, as compared to patent protection, there are no formalities involved in obtaining the right, there is no requirement of inventiveness, and there is a low threshold of originality for the right to be validly held. Copyright is, in other words, a right that is more readily obtained, but confers far weaker protection than the patent system provides.

Bearing this in mind, some of the major concerns of competition policy in regard to IP rights generally, and to the rights conferred by copyright in particular, are the market power that may result from the granting of such rights, and the detrimental effects that may be caused by exercising those rights. At its simplest, market power may affect consumers by allowing prices to be set higher than is needed to secure cost-effective production.

When those prices exclude some consumers who value use of the protected material at more than its cost of reproduction, social welfare as a whole will be harmed. Further harm may arise when the protection granted allows IP rights holders to slow or distort innovation. Under these circumstances, market power will limit the growth of productivity over time.

³⁵ WIPO CRNR/DC/95 (23 December 1996), <http://www.wipo.int/eng/diplconf/distrib/95dc.htm>

³⁶ 'Fixation' generally refers to the process of reducing the work or subject matter to material form

³⁷ See *Corelli v Gray* (1913) 29 TLR 570

Though these concerns are valid, the delicate balancing of rights in the Copyright Act reflects an effort to balance the economic rights of authors or creators with the public's need for access to information. This balancing inevitably involves imposing some restrictions on competition.

Some of these restrictions arise from the very rights conferred. For example, restrictions on adaptations of existing works may impede the free flow of ideas. Restrictions on adaptations of artistic works may impede artistic ideas.³⁸ The Office of Regulatory Review has suggested that the expansion of education licences and of the fair dealing defences may be one way of facilitating dissemination of educational material.³⁹

However, the Committee notes that harm to competition should not, and cannot, be inferred from the mere existence of exclusive rights, such as those conferred by copyright law. The very protection a copyright holder enjoys may provide the incentive for rivals to invest in developing alternatives or substitutes—so that the copyright protection, rather than undermining contestability, stimulates and channels it in directions that can be socially beneficial.

In addition, and perhaps uniquely in respect of copyright, the exclusive rights granted are often tempered or qualified by a number of exceptions. These include compulsory licensing schemes, which effectively prohibit refusal of supply, but instead, compensate the rights holder with equitable remuneration and also include defences to infringement on public policy grounds (e.g. fair use of a reasonable portion of material for study or news reporting where use is not subject to any remuneration to the rights holder).

As a result, the Committee's overall view is that the Copyright Act, in its provisions, already takes account of the community's interest in competitive markets.

However, there are important concerns about restrictions relating to market segmentation. At issue here are the restrictions on parallel importation, which can give copyright owners power to control distribution channels within Australia. There are also important concerns about the actual administration of the copyright system, most notably in relation to provisions for collecting societies.

In short, this review has identified several areas of potential restriction on competition. These areas are:

- parallel importing;
- copyright in packaging and labelling;
- copyright term;
- *Digital Agenda Act 2000* particularly fair dealing, decompilation and caching;
- crown ownership of copyright;
- broadcast fee price capping;

³⁸ Revesz J, *Trade Related Aspects of Intellectual Property Rights*, staff research paper, Productivity Commission, 1999, p. 37

³⁹ Office of Regulation Review, *An Economic Analysis of Copyright Reform*, Submission by the Office of Regulation Review to CLRC, Canberra

- statutory licences;
- collecting societies; and
- simplification of the Copyright Act (CLRC Report).

Each will be discussed and analysed separately below, and will incorporate discussion of the cost-benefit analysis of the rights.

Parallel importation

Introduction

In June 2000, the Committee provided a stand-alone report to the Government addressing the competition effects of parallel importation restrictions. The following section largely reproduces our June report, which we believe should be included again here for the sake of completeness, and to facilitate cross-referencing with other recommendations. In a dissenting report, one Committee member expresses a contrary view to the majority's recommendations.⁴⁰

Overview

In addressing the issues of parallel importation, the Committee is constrained by the Terms of Reference. Paragraph 2(a) of the Terms of Reference states that the Committee must have regard to the determination in the Competition Agreement that legislation restricting competition should only be retained if the benefits to the community as a whole outweigh the costs, and if the objectives of the legislation can only be achieved by restricting competition.

With respect to discussion concerning the restrictions on imports in the Copyright Act, the Committee's *Interim Report* took an industry-by-industry approach, rather than dealing with material as 'works' or 'other subject matter' as the Copyright Act does. However, the great difficulty faced in this area is that the boundaries between different sorts of copyright material are becoming increasingly blurred. Attempts to deal with these industries separately will simply result in attempts to classify products in different ways by 're-badging' different forms of material. This merely imposes extra costs in terms of transferring works to another format without any corresponding social gain. A recent example occurred after parallel import restrictions were lifted on sound recordings. Some suppliers of sound recordings then incorporated video material into CDs to rely on the remaining restrictions protecting 'film' material against parallel imports. In its Digital Agenda Bill, the Government has also expressed a policy decision to be technologically neutral in copyright legislation. This report therefore adopts a more industry-neutral approach where possible.

In the context of the Terms of Reference, the questions asked by the Committee were:

- are parallel importation provisions a core mechanism by which the primary objectives of the Copyright Act are achieved?;
- do the parallel importation provisions of the Copyright Act amount to a restriction on competition?;

⁴⁰ See page 73.

- if yes, what are the likely costs, benefits and effects of this restriction?; and
- are there alternative means of achieving the objectives of the Copyright Act?

According to the Terms of Reference, if the Committee determined that the parallel importation provisions of the Copyright Act do, in fact, amount to a restriction on competition, the provisions should only be retained if:

- the objectives of the Act can only be achieved by restricting competition in this manner; and
- the benefits to the community from restricting parallel imports outweigh any costs.

The Committee considered each of these issues, and they are dealt with in our evaluation of the parallel import restrictions. However, the Committee's Terms of Reference also require us to take into account Australia's international obligations and so these will be considered first, together with a brief survey of the situation in some other OECD countries.

What is meant by parallel importing and other terms

'Parallel importation' provisions allow the use of intellectual property rights to prevent the importation of goods, which have been put on the market in another country by, or with the permission of, the intellectual property right owner. Parallel imports are not pirated goods. Rather, they are genuine goods sold in the country of export with the permission of the rights holder, but imported by a reseller without the authority of the rights holder in the country of importation.

The terms 'piracy' and 'counterfeit goods' are used in a wide sense in the 1994 Agreement on TRIPS.⁴¹ As specified in that agreement:

- 'counterfeit trademark goods' shall mean any goods, including packaging, bearing without authorisation a trademark which is identical to the trademark validly registered in respect of such goods, or which cannot be distinguished in its essential aspects from such a trademark, and which thereby infringe the rights of the owner of the trademark in question under the law of the country of importation; and
- 'pirated copyright goods' shall mean any goods which are copies made without the consent of the rights holder or person duly authorised by the rights holder in the country of production, and which are made directly or indirectly from an article where the making of that copy would have constituted an infringement of a copyright or related right under the law of the country of importation.

These categories are not mutually exclusive, as a pirated article may also be a counterfeit in the sense of being deceptively labelled. Accordingly, the production, importation, distribution and sale of pirated copies of copyright material may also involve breaches of trade mark laws, other intellectual property laws (such as those protecting designs) and various consumer protection laws.

⁴¹ TRIPS Agreement, Article 51, footnote 14

Australia's international obligations regarding parallel importation

International obligations under TRIPS, CER and other international agreements Australia has entered into may influence Australia's policies with respect to parallel importation.

TRIPS

TRIPS does not determine the issue of parallel importation. Rather it allows each WTO member to regulate parallel imports in the manner it feels appropriate. Article 6 of TRIPS specifically states that:

... nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights.

Australia is therefore free to adopt whichever exhaustion model it feels is in the national interest.

The term 'exhaustion' refers to the territorial rights of intellectual property owners after the first legitimate sale of their intellectual property-protected products. However, other provisions of the TRIPS Agreement may, to a certain degree, constrain any options for change in this area. For example, TRIPS requires parties to ensure that appropriate action can be taken to restrain abuses of intellectual property rights on a case-by-case basis.⁴² This suggests that although Australia has discretion to provide protection against parallel imports, fair and equitable protection must also be provided to deal, on a case-by-case basis, with any undue harm resulting from that prohibition.⁴³

Until recently, the Australian Copyright Act has been based on a system embodying the principle of 'national exhaustion'. This means that exhaustion of rights only applies to sales within Australia and that the rights owner can prevent parallel importation of their product from a foreign country, where it has been sold either by the rights owner or an authorised dealer. However, recent amendments to the Act have moved Australia closer to a system of 'international exhaustion' in the area of sound recordings. 'International exhaustion' means that the rights owner loses the exclusive privilege of publication after the first legitimate distribution of the product anywhere in the world, and allows parallel imports from other jurisdictions to freely enter the market after that point (also referred to as the 'doctrine of first sale').

The 'exhaustion' rules are subject to the provisions of non-discrimination, national treatment, and most favoured nation treatment. Exhaustion rules must therefore be adopted on a consistent basis, and cannot vary depending on the origin of the product.⁴⁴

⁴² TRIPS Agreement, Arts. 8(2) and 40

⁴³ Australian Law Reform Commission, *Designs*, Report No. 74, 30 June 1995, p. 296

⁴⁴ Arts 3, 4 TRIPS Agreement; Art 5 Berne Convention; see also, Cottier T, 'The WTO System and the Exhaustion of Rights', *Conference on the Exhaustion of Intellectual Property Rights and Parallel Importation*. in *World Trade*, Geneva, 6–7 November 1998, p. 2

WIPO treaties

The 1996 WIPO 'Internet treaties', which Australia is likely to sign, make explicit that exhaustion of rights is left to each country to decide. In addition, Australia is a signatory to the Berne Convention, which does not make explicit reference to exhaustion of rights after first sale or transfer.

Berne Convention

Article 14 of the Berne Convention states that:

Authors of literary works shall have the exclusive right of authorising...the cinematographic adaptation and reproduction of these works, and the distribution of the works thus adapted or reproduced...

WIPO Performances and Phonograms Treaty (1996)

Chapter II (Rights of Performers), Article 8 (Right of Distribution), states:

- 1) *Performers shall enjoy the exclusive right of authorising the making available to the public of the original and copies of their performances fixed in phonograms through sale or other transfer of ownership.*
- 2) *Nothing in this Treaty shall affect the freedom of the Contracting Parties to determine the conditions, if any, under which the exhaustion of the right in paragraph 1) applies after the first sale or other transfer of the ownership of the original or a copy of the fixed performance with the authorisation of the performer.*

Chapter III (Rights of Producers), Article 11 (Right of Distribution), states:

- 1) *Producers of phonograms shall enjoy the exclusive right of authorising the making available to the public of the original and copies of their phonograms through sale or other transfer of ownership.*
- 2) *Nothing in this Treaty shall affect the freedom of the Contracting Parties to determine the conditions, if any, under which the exhaustion of the right in paragraph 1) applies after the first sale or other transfer of the ownership of the original or a copy of the phonogram with the authorisation of the producer of the phonogram.*

WIPO Copyright Treaty (1996)

Article 6 (Right of Distribution) states:

- 1) *Authors of literary and artistic works shall enjoy the exclusive right of authorising the making available to the public of the original and copies of their performances fixed in phonograms through sale or other transfer of ownership.*
- 2) *Nothing in this Treaty shall affect the freedom of the Contracting Parties to determine the conditions, if any, under which the exhaustion of the right in paragraph 1) applies after the first sale or other transfer of the ownership of the original or a copy of the work with the authorisation of the author.*

The New Zealand Australia Closer Economic Relations Trade Agreement (CER) Agreement

The CER agreement created a WTO Free Trade Area encompassing Australia and New Zealand. Article 1 of CER states that one of its objectives is to eliminate barriers to trade between Australia and New Zealand, in a gradual and progressive manner. Article 5 provides that quantitative import restrictions and tariff quotas on all goods originating in the territory of the other member state shall be progressively liberalised and eliminated. However, Article 18 of CER provides that the agreement shall not preclude the adoption of measures necessary to protect intellectual or industrial property rights.

The Committee considered whether Australia's membership of CER (or indeed, ASEAN) might influence Australian decisions regarding parallel importation.

In a submission to the Australian Law Reform Commission (ALRC) report *Designs*, the New Zealand Ministry of Commerce stated:

*...to the extent that the designs legislation of either country contains provisions concerning parallel importation, the Ministry does not regard these as being inconsistent with CER providing these provisions 'are not used as a means of arbitrary or unjustified discrimination or an unjustified restriction on trade in the free trade area'*⁴⁵

However, in 1991 the former Australian Trade Practices Commission (now the Australian Competition and Consumer Commission) recognised:

*...in the interests of increased competition and free trade between Australia and New Zealand, reciprocal amendments could be made to the various IP statutes to provide that the right to take action in one Member State to prevent importation of an infringing product will not apply where the product has been placed on the market of the other Member State by or with the consent of the IP owner.*⁴⁶

A Report to Governments by the Steering Committee of Officials in 1990 considered the trade implications of IP rights in the context of parallel imports. The Steering Committee found that provisions preventing parallel imports were potentially a 'distinct impediment to trans-Tasman trade', but noted that the laws of both countries were essentially in harmony.⁴⁷ However, since 1998 this has no longer been the case, as New Zealand but not Australia, has comprehensively repealed parallel import restrictions.

Current provisions in the Copyright Act 1968 relating to parallel importing

Under the Copyright Act, it is generally an infringement of copyright to import an article into Australia for commercial purposes without the copyright owner's consent, where the

⁴⁵ ALRC Report *Designs*, 1995, p. 296, above n 43

⁴⁶ Trade Practices Commission, *Background Paper on the Application of the Trade Practices Act to Intellectual Property*, July 1991 paragraph 6.20

⁴⁷ Trade Practices Commission, above n 46, para 6.21, 1990

importer knew, or ought reasonably to have known, that if the article had been made by the importer in Australia it would have infringed copyright.⁴⁸

In essence, the parallel importation provisions of the Copyright Act allow a copyright owner or exclusive licensee to control the importation into Australia of copyright material, even if the products have been lawfully acquired overseas. The restrictions allow rights owners to separate the world market into self-contained segments to secure the greatest return on the protected subject matter.

The facts of the leading High Court case in this area provide a useful illustration of the effect of the parallel importation provisions in the Copyright Act.⁴⁹ In this case, a large bookseller was selling a range of cookery books for \$8.95 each. Competitors were selling the same books for \$16.95. The competitors obtained their copies from the authorised distributor, whilst the large bookseller had lawfully purchased the books from an American wholesaler. The High Court found that, as the large bookseller had not obtained a licence to import the books from the Australian copyright owner, it was therefore in breach of the Copyright Act.⁵⁰

However, this general prohibition regarding parallel imports has been relaxed for certain categories of subject matter, and separate regimes have been enacted to govern the book and sound recording industries. Also excluded from parallel importation control are works and other subject matter that are ‘accessories’. The general rule against parallel importing still applies to literary works (other than books), dramatic, musical and artistic works, broadcasts and cinematograph films.

Books

In 1990 provisions were introduced into the Act to govern ‘non infringing books’ (i.e. those legitimately manufactured in their country of origin).⁵¹ The provisions make a distinction between whether a book was first published in Australia or overseas. The Act imposes no restrictions on the importation of books first published in a foreign country.

There has been a partial relaxation of parallel import restrictions for books first published in Australia. A book is deemed to be ‘first published’ in Australia (defined to include supply⁵²) if it is published in Australia within 30 days of being published overseas. So, as long as foreign books are released in the Australian market within 30 days of being published overseas, they will be deemed to be ‘first published’ in Australia, and parallel import restrictions will apply.

Parallel importation of books first published in Australia is also allowed:

- to provide a single copy for a customer (subject to an undertaking that they will not enter into commercial dealings with that book);

⁴⁸ *Copyright Act 1968*, ss. 37 and 102

⁴⁹ See *Interstate Parcel Express Co Pty Ltd v Time-Life International (Nederlands) BV* (1977) 138 CLR 534 (the *Time-Life* case).

⁵⁰ Note that the position in the Copyright Act regarding the importation of books has altered since the *Time-Life* case.

⁵¹ *Copyright Act 1968*, ss. 44A and 112A. Note that there are some exclusions, such as manuals for computer software, musical scores and periodicals.

⁵² *Copyright Act 1968 (Commonwealth)*, s. 29

- to provide one or more copies for a non-profit library; and
- to satisfy local orders which have been unfilled for more than 90 days.

Sound recordings

Parallel importation restrictions have been removed for the ‘sound recording’ category of subject matter under the Copyright Act.⁵³ Copyright will not be infringed by importing into Australia a ‘non-infringing’ copy of a sound recording.

Section 10AA of the Copyright Act states that a sound recording will be a ‘non-infringing copy’ only if:

1. the copy is made by, or with the consent of:
 - the owner of the copyright in the sound recording in the country in which the copy was made (‘the copy country’);
 - the owner of the copyright in the country in which the original sound recording was made, if the copy country does not provide copyright protection for sound recordings; or
 - the maker of the sound recording, if there is no copyright protection provided for sound recordings in either the copy country or the country in which the sound recording was originally made;
2. the making of a copy does not infringe copyright in the copy country; and
3. the copy country is a party to the Berne Convention, a member of the WTO, and complies with TRIPS with respect to copyright in literary, dramatic and musical works.

Packaging and labelling

Australia has also enacted legislation to prevent owners of non-copyright products that incorporate copyright material from using the parallel importation provisions in the Copyright Act to prevent the importation of competitors’ products.⁵⁴ The legislation applies to those using copyright material such as artistic works on non-copyright products like labelling. These changes came into effect on 31 January 2000.

International comparisons of parallel importing of copyright material

New Zealand

The *Copyright (Removal of Parallel Importing) Amendment Act 1998 (NZ)* has removed the prohibition on parallel importation in New Zealand for all categories of works and other subject matter, provided that the conditions in s. 12 (5A) (a) and (b) are met.

⁵³ *Copyright Act 1968 (Commonwealth)*, ss.44D and 112D

⁵⁴ The *Copyright Amendment Act (No.1) 1998* was passed by Parliament on 15 July 1998 but the commencement of the amendments in Schedule 2 was delayed for 18 months until 31 January 2000. The amendments in Schedule 2 deal with labelling and packaging and will prevent copyright control over ‘accessories’ being used to stop the parallel importation and sale of legitimate goods. The Government’s intention was that copyright in labelling and packaging should not be used as a back door means of protecting exclusive distribution arrangements.

Section 12 (5A) (a) permits parallel importation in most cases where the products are manufactured by, or with the consent of, the copyright owner in the country in which they were made.

The New Zealand Government has recently announced an intention to reintroduce some degree of parallel importation restrictions. The current intention seems to be to prohibit parallel importing of CDs, videos, films, books and software for up to two years after first release.⁵⁵ However, legislation to this effect has not, at the time of writing, been introduced.

The United States

The United States maintains stringent parallel importation restrictions in copyright, based on the concept of national exhaustion. However, in a recent case the United States Supreme Court distinguished copyrights in things associated with goods (e.g. labels and packages) from those of the goods themselves (e.g. CDs or books).⁵⁶

The European Union

It is the policy of the European Commission to move towards a harmonised position of 'community-wide exhaustion' in the European Union. This would mean that once an intellectual property owner places goods on the market within the European Economic Area (EEA), they cannot prevent the parallel importation of those goods within the EEA. They can, however, prevent the importation of goods from outside the EEA.

The European Union has adopted Directives related to computer software⁵⁷ and rental rights.⁵⁸ These Directives all adopt the principle of community-wide exhaustion. However, the remainder of copyright rights are at this stage still governed by the copyright legislation of individual jurisdictions.⁵⁹

Parallel importing and the objectives of the Copyright Act

Objectives of the Copyright Act 1968

In Australian law copyright has been very much an economic right. The conferring of property rights over intellectual property is designed to work as an incentive to appropriate forms of investment in creative endeavour. Where the incentive to create is not served by copyright protection, the justification for that protection must be questioned.

⁵⁵ Sir Michael Hardie Boys, *Speech from the Throne* 21 December 1999, available at <http://www.labour.org.nz/MediaCentre1/Speeches/991221.html>

⁵⁶ *Quality King Distributors Inc v L'Anza Research International Inc* 118 S. Ct. 1125 (1998)

⁵⁷ Council Directive 91/250 on the Legal Protection of Computer Programs

⁵⁸ Council Directive 92/100 on Rental Rights and Lending Rights and Certain Rights related to Copyright in the Field of Intellectual Property

⁵⁹ For a further discussion see Norman H *Parallel Imports from Non-EEA member states: The Vision Remains Unclear*, [2000] 22(4) EIPR 159.

Do restrictions on parallel importing promote the core aims of the Copyright Act?

The rights of the copyright owner include the right to prevent the reproduction (and in some contexts communication) of the material form of copyright material. The restrictions on parallel importing are unusual in that they attempt to restrict the trade in goods embodying the copyright work or other subject matter.

The core rights of copyright creators and owners do not necessarily require restrictions on importation of copyright material, nor is it required by Australia's international obligations. However, there is much argument as to how the restrictions on parallel importing affect the economic incentives arising from, and the overall effects of, the copyright system.

Arguments put to the Committee

Economic incentives to create

It was put to the Committee that lifting restrictions on parallel importing would reduce the incentives for copyright owners to invest in creative effort. This is claimed to occur mainly because the restrictions facilitate territorial price discrimination and may increase the returns accruing to rights owners.

As against this, the ACCC argues that:

Legislative restrictions on parallel importing are not justified by the traditional free rider concerns relating to intellectual property. These relate to the sphere of production, protecting IP property owners from unauthorised reproduction. By contrast, restrictions on parallel imports extend IP into the sphere of distribution. While legislative restrictions on imports of pirate and counterfeit goods are a necessary adjunct to restrictions on reproduction, restrictions on imports of goods legally marketed cannot be justified. While free riding may occur in the sphere of distribution, for example on marketing and promotional investments or on pre and after sales service, this is nothing unique to, nor even a necessary feature of, intellectual property.⁶⁰

The ACCC also argues that the existence of parallel importation restrictions may in fact impact detrimentally on competition in Australia:

Parallel import restrictions grant a 'monopoly' or exclusive right to import to IP owners. By preventing international arbitrage, these import monopolies may be used to support international price discrimination by firms with market power (either unilateral or coordinated market power). Indeed, the very existence of these exclusive rights tends to create a climate conducive to coordination rather than competition, since IP owners know they are not constrained by import competition.

⁶⁰ Issues Paper Submission 53, p. 4

It should be emphasised that restrictions on parallel imports do nothing to protect domestic industry, they simply provide the domestic rights holder with an exclusive right to import.

Whether they choose to invest and manufacture domestically are separate decisions which will be influenced by factors such as the likely international returns from investing in local R&D and the costs of local vs off shore manufacturing.⁶¹

The ACCC presented the view that problems such as free riding in markets should be tackled through specific contractual arrangements, rather than by embodying geographical restraints in the Copyright Act. In the Commission's view, if these arrangements are likely to contravene the Trade Practices Act, their specific costs and benefits to the community can be considered under the processes of authorisation and notification.

The ACCC's views are supported by the *Final Report to the Committee on International Trade Law of the International Law Association on the Subject of Parallel Importation*:⁶²

...elimination of barriers to the movement of goods and services across and within national boundaries is beneficial to global economic welfare because this encourages specialisation and efficiency in production and distribution, and results in an increased output of goods and services.

In the *Journal of International Economic Law*, F. Abbott argues that rules restricting parallel importation are susceptible to use as a cover for unjustifiable price discrimination: 'It remains to be explained why software developers should not be required to face price competition in international markets as other producers, and to charge a price that allows them a reasonable rate of return across all markets, even if this means reducing prices in developed country markets'.⁶³

'Rules prohibiting parallel importation are non-tariff barriers to trade that are inconsistent with basic WTO principles. They should be prohibited, absent of showing that they serve a social welfare purpose that outweighs their trade-restricting effect. The vertical territorial allocation of distribution markets by intellectual property rights owners can be accomplished by significantly less trade restrictive means.'⁶⁴

However, Barfield and Groombridge⁶⁵ state in response to Abbott that restrictions on parallel imports can be a cover for unjustifiable price discrimination:

Two factors mitigate against this concern:

- 1. price discrimination does not necessarily decrease consumer welfare; and*
- 2. the possibility of abusive price-discrimination must be weighed against the pro-competitive benefits conferred by allowing companies to control parallel imports.⁶⁶*

⁶¹ Issues Paper Submission 53, p. 5

⁶² Abbott F, *Journal of International Economic Law* (1998) 607-636 OUP, p. 611

⁶³ Abbott F, above n 62, p. 627

⁶⁴ Abbott F, above n 62, p. 635

⁶⁵ Barfield & Groombridge, 'The Economic Case for Copyright Owner Control Over Parallel Imports', Vol 1(6) *The Journal of World Intellectual Property* October 1998 pp. 1-37

⁶⁶ *Ibid* p. 4

There are four strong reasons why national governments and international agreements such as TRIPS should codify the legality of restrictions on parallel imports rather than rely on private contractual enforcement of contractual vertical restraints:

1. *legal structures of some developing countries make it difficult/impossible to enforce contracts privately;*
2. *there are difficulties in tracing the source of parallel imports and hence the party in breach of the contract;*
3. *globalisation is not a reality at the present; and*
4. *the ineffectiveness of contractual remedies.*⁶⁷

Likewise, the WIPO International Bureau has opined:

*The theory of international exhaustion does not take into account a well-established principle of competition law... namely, the principle that the 'vertical' exercise of exclusive intellectual property rights— such as the licensing of distribution rights by the author or other owner of copyright to different persons in different countries—does not constitute anti-competitive activity...The principle of territoriality provides security for the chain of authorisations that permit [an] orderly supply of copies for international distribution.*⁶⁸

Adoption of rules allowing international exhaustion would result in copyright owners losing 'one of the main forms of exploitation of their works, with a double result of increasing piracy and undermining the resources for important creative elements of the cultural and information industries and, as an inevitable consequence, a decrease in the supply of new works.'⁶⁹

The CLRC found (in 1988) that repeal of the parallel importation provisions in the Copyright Act would have a detrimental effect on Australian manufacture, technical know-how and consumer back-up services. The CLRC also reached the conclusion that the restrictions do provide very real protection and benefit to authors whose work is internationally distributed. It was also seen as important for Australia to maintain its position in relation to other nations with similar copyright laws.⁷⁰

Prices and availability

The motion picture and video games industries argue that Australia already has comparatively lower prices compared to countries elsewhere in the world. Although the United States has slightly cheaper products, this is often explained by the fact that it is less

⁶⁷ *Ibid* pp. 32–3

⁶⁸ WIPO *Questions Concerning Possible Protocol to the Berne Convention* Memorandum by the International Bureau: Part III, New Items, Geneva, 12 March 1993 pp. 9–10

⁶⁹ *Ibid*

⁷⁰ Summary of Copyright Law Review Committee's report, *The Importation Provisions of the Copyright Act*, September 1988, as taken from Lahore, *Intellectual Property*, Butterworths [34,570]

expensive to produce products in NTSC format (used in North America) than in PAL format (used in Australia).⁷¹ Australian Visual Software Distributors Association Ltd (AVSDA) has summarised this argument:

*We do not believe that the benefit which could be expected from such a change—lower prices—will occur through the importation of legitimate product. Further, the hoped for benefits of lower prices from allowing parallel imports are likely to be minimal at best. Australia already has low prices for video and video games by world standards...The importation of legitimate product through other channels will not change this.*⁷²

AVSDA expressed concern at the Interim Report's apparent reliance on the views of the ACCC with respect to price, and asserted that the discussion by the ACCC of pricing issues is incomplete and flawed.⁷³ International pricing comparisons provided to the Committee claim to support the submission that prices for games software compare favourably in Australia with the United Kingdom (32 per cent cheaper) and the United States (only seven per cent more expensive), and the price of video rental is lower in Australia than in both the United Kingdom and the United States, giving overall 'low prices by international standards'.

In its Issues Paper Submission, Text Publishing argued that the 'Australian market is effectively open now, with the exception of bestselling and Australian-originated titles. This is a critical point because it is precisely titles which fit both these categories which independent Australian publishers are in the business of finding...The current regime thus provides an incentive for internationally focussed Australian publishers to price their Australian editions competitively while also providing them with the same protection of territorial copyright that British and American publishers have.'⁷⁴

'It is reasonable to conclude that the effectively open market which we now have has permitted Australian publishers to flourish because the 30-day rule allows them to compete on equal terms with foreign publishers. It has permitted them to flourish not because they have resorted to publishing books without export potential but because they have used the fact of territorial copyright to increase their revenue by selling rights which in turn has allowed them vigorously to compete for new Australian writers.'⁷⁵

The Australian Publishers Association (APA) argues that 'the book industry is different from other intellectual property industries with regard to the large number of players, competitive pricing, ready availability of overseas titles from the Internet, and range of titles in retail outlets.'⁷⁶

According to this submission, the present situation, in place for the last decade with respect to books (the 30/90 day rule), means the market is effectively open 'with the exception of bestselling and Australian-originated titles.'⁷⁷ It is argued that this gives the right balance of competition and protection. The incentive provided by the 30/90 day rule to 'act quickly'

⁷¹ Issues Paper Submission 45, p. 5

⁷² Issues Paper Submission 45, p. 3

⁷³ Interim Report Submission 32, pp. 2–4

⁷⁴ Issues Paper Submission 25, pp. 14–16

⁷⁵ Issues Paper Submission 25, pp. 17–18

⁷⁶ Issues Paper Submission 56, p. 2

⁷⁷ Interim Report Submission 13, p. 7

means that Australian consumers get overseas titles speedily. The APA⁷⁸ argues that the ‘development of Australia as a separate territory for copyright purposes gave the major international publishers the confidence to invest in the development of local publishing infrastructure(s)’. The APA also stated that there are adequate natural market forces to protect Australian consumers from excessive pricing by vendors, and that there is no need for amendment to a policy and practice that has proven its worth to publishers, retailers and consumers.

On the other hand, the ACCC rejects arguments that prices for copyright goods in Australia are significantly lower than those overseas. The ACCC points out that the former Prices Surveillance Authority examined the effect of restrictions on parallel imports on relative prices in Australia and overseas for books, recorded music, computer software and farm chemicals, and found that Australia has suffered from significantly higher prices for each of these products compared with markets in Europe and North America, as well as problems of limited range and slow release of new product in some markets.⁷⁹

The Australian Digital Alliance (ADA) also support the removal of parallel importation restrictions from the Copyright Act, where the benefits of wider range, access and cost differentials of information products are of value to the community.⁸⁰ However, it argues that this should be done without causing a significant adverse effect to the legitimate interests of owners.⁸¹

Australia’s e-commerce industry has expressed significant opposition to parallel import restrictions. Various representatives argue that restrictions on parallel imports prevent Australian retailers from obtaining goods at the same price as their competitors, inhibiting their online competitiveness. For example, Software Engineering Australia states that:

In order for Australian e-commerce retailers to be able to offer products at prices which are competitive with those offered by e-commerce retailers overseas, Australian e-commerce retailers will need to be able to purchase goods at the lowest possible price. At the moment, the restrictions on parallel importation prevents this from occurring. Australian e-commerce retailers are forced to buy through licensed distributors within Australia, and must on-sell on the basis of the price charged by this distributor...Lifting the prohibition on parallel importation in Australia’s intellectual property legislation would enable Australian e-commerce retailers to overcome the current hurdles of price and availability, and negotiate for the direct importation into Australia of a wider range of products for resale both domestically and internationally at a cheaper price online.⁸²

⁷⁸ Interim Report Submission 29, p. 3

⁷⁹ Interim Report Submission 29, p. 5

⁸⁰ Issues Paper Submission 32, p. 3; Interim Report Submission 17, p. 1–2

⁸¹ Issues Paper Submission 32, p. 7

⁸² Issues Paper Submission 41, at pp. 5 and 8

Remainders

It was also argued that Australian book publishers would be vulnerable to remaindered foreign editions (from which the author either derives a minuscule royalty or no royalty at all) being sold in Australia at heavily discounted prices.⁸³

The remainder market is not large in Australia, but it is nonetheless argued that this practice would directly impact on independent Australian publishing companies.⁸⁴ In a submission regarding the interim report, Text Publishing re-emphasised the point that the parallel importation provisions at present are appropriate for Australian book publishers ‘who are successfully participating in a globalised industry.’⁸⁵ The submission claims that at some stage in the next year, Text Publishing’s sales of its books in print outside Australia will be greater than the value of the original domestic editions. This printing of books outside Australia will arguably expose the Australian domestic market to the threat of imported books ‘to capture the market which the Australian publisher created in the first instance. The Australian publisher has no ability to control how many copies of the book the foreign publisher will make, at what discount the foreign publisher will sell, to whom the foreign publisher will sell in the foreign territory, and how many copies will remain unsold or will be returned.’⁸⁶ The apprehension is that the cost of production in Australia will be higher, and that cheap imports will soak up the market presently satisfied by the more expensive Australian-produced books—the only publications on which Australian authors receive royalties and publishers receive returns on their investment. (This is despite the fact that ‘book prices have fallen dramatically in Australia’ since the introduction of the 30/90 day rule in 1991).

Publishers said it was not possible for the Australian rights holder to negotiate a contract price for the book with the overseas publisher, to reflect the expected return to the overseas purchaser. Contractual arrangements with the overseas publisher would not be effective in controlling wholesalers and remainder dealers, who would swamp the Australian market with cheap imports if the 30/90 day rule is changed. Indeed, it was alleged that United States publishers will probably ‘overprint’ in order to capture a significant part of the Australian market.⁸⁷ It would appear that Australian books are not remaindered as quickly as books in the United States, and so the remainder market there would kick in before the useful commercial life of a book was over. Naturally, the Australian rights holder has no capacity to delay the sale of the rights or the overseas publication of the book until the local product has satisfied the domestic market.

Local publishing activity would, according to Text Publishing, be eroded if parallel import restrictions on books are removed.

However, the submission then seems to reject the notion that it is important to protect local cultural endeavour: ‘Australian publishers do not want to be preserved, as if they were some kind of threatened species’.⁸⁸

⁸³ Issues Paper Submission 25, pp 8–9; Issues Paper Submission 56, pp. 2–3; Interim Report Submission 13, p. 5

⁸⁴ Issues Paper Submission 25, p. 9

⁸⁵ Interim Report Submission 13, p. 2

⁸⁶ Interim Report Submission 13, p. 4

⁸⁷ Interim Report Submission 13, p. 6

⁸⁸ Interim Report Submission 13, p.13

The APA identifies a number of community benefits associated with the present regime.⁸⁹ These benefits are said to include: increased amount of printing in Australia with consequently greater employment; encouragement to invest in local publishing; optimisation of price and availability; and the capacity of the protected local publisher to find export markets.

On the point of whether the objectives can be achieved by some alternative means (contractual instead of enshrined in legislation) the Text Publishing submission put the view that the ‘Committee is effectively arguing that the law should be changed so that things can stay the same’ and that this is just ‘nonsense’⁹⁰. Apart from which, it argues that is not possible to effect contractually the territoriality presently allowed for and, even if it was, ‘there is a profound contradiction at the heart of the Committee’s argument’⁹¹ since a non-legislative means of producing territoriality in the market place might be illegal under the Trade Practices Act, so the Committee’s encouragement to act through contracts might amount to encouraging anti-competitive behaviour.

Marketing and service

In its issues paper submission, IBM states: ‘Parallel importation of hardware and software will disadvantage local businesses and consumers. Local distributors and retailers will find that parallel imported products undermine their marketing and sales efforts. Then when consumers buy those products, service and support may not be available for them. Furthermore, consumers may not know at the time of purchase that their product will not be properly supported.’⁹²

In a subsequent submission pointing out the difficulties faced in an open market, IBM reasserted its support for the maintenance of parallel import restrictions for software. Arguments in favour of retaining parallel import restrictions include that consumers need authorised dealers to provide support for products, and failure to provide this support would dilute the goodwill associated with a successful developer such as IBM. IBM argues that it is difficult to enforce product standards in a service industry, and technology tends to outpace the setting of standards, so self-enforcement through restricting imports is a better alternative. Even a large corporation like IBM would find it difficult, expensive and probably ineffective to rely on contractual or technological means of controlling the flow of goods into Australia.

The Motion Picture Association said that parallel importing restrictions were necessary to maintain the industry’s ‘windows’ marketing system, enabling the release of a particular movie in different formats for different distribution channels (cinema, rental, direct sale as film, VHS or DVD) across the global market to maximise returns.

According to the Motion Picture Association:

The sequential ‘window’ marketing structure means that a parallel importer can seriously damage the business of a local licensed distributor and of retailers deriving rights from that distributor; disrupting the timing of the motion picture’s distribution at

⁸⁹ Interim Report Submission 29, p. 7

⁹⁰ Interim Report Submission 13, p. 9

⁹¹ Interim Report Submission 13, p. 9

⁹² Issues Paper Submission 50, p. 8

all levels, by trading on its premature availability on video. For example, video versions of an audiovisual work distributed by parallel importers actually may precede the release of the work in local cinemas or the local release dates for licensed video outlets that do not parallel import. The theatrical exhibition of motion pictures is likely to be adversely affected, as is the (later) legitimate video release.

The availability of parallel-imported videos also may inhibit the growth of such new services as Pay TV, again due to international timing differences in the sequential marketing 'windows' of cinema, video and television...Parallel importers also harm local competition by acting as free riders; for example, by distributing video copies during release to cinemas, they benefit from the advertising efforts of local theatrical distributors, while reducing legitimate theatrical revenues.⁹³

Arguments have also been raised in public consultations and written submissions that the development of the Internet may mean the parallel importation debate becomes irrelevant due to technological developments for distribution and access. Professor William Caelli suggests that the impact of global electronic commerce makes, or soon will make, much of the discussion about parallel importation irrelevant to the consumer.⁹⁴

The ADA states that distribution of material over the Internet is challenging traditional trade barriers and creating new market forces in disseminating creative innovation in copyrighted works. Competition policy and the wider public interest support the diversification of markets through parallel importation.⁹⁵

Censorship

AVSDA argues that the parallel importation restrictions in the Copyright Act play a direct role in maintaining an effective classification regime in Australia. It states in its issues paper submission:

The parallel importation provisions of the Copyright Act also have a direct impact on the effective operation of the Classification regime. Changes to the current system would remove the means to most effectively ensure compliance with the censorship requirements through the cooperation of the established distributors who have a long term vested interest in compliance with the legal requirements.⁹⁶

Although the paragraph above appeared in the interim report, the Committee was criticised by AVSDA for failing to 'address the issue of censorship', and it is therefore worth setting out the arguments in more detail here.

According to AVSDA, censorship in Australia is provided through Commonwealth legislation, which needs State and Territory approval, and thus changes are not usually achieved quickly. Opening up the importation of computer games or videos would tempt (and the temptation would be 'overwhelming') distributors to 'bring in material and dispose of it quickly without resorting to the classification system' since 'there would be a reluctance

⁹³ Issues Paper Submission 38, p. 12

⁹⁴ Issues Paper Submission 46, p. 3

⁹⁵ Issues Paper Submission 32, p. 8

⁹⁶ Issues Paper Submission 45, p. 4

on the part of legitimate importers to submit material because they would be apprehensive that while their material was progressing through the classification system, another importer would import the same game, make a quick killing by selling the game illegally and then skip the market before the classification becomes available.⁹⁷

AVDSA's argument is that the monopoly over distribution of material produced by the relevant copyright owners allows policing of censorship classification relating to that material. Since the industry is so concentrated, all audiovisual material imported is produced by this small group of 'majors'. The argument runs that there is material available overseas that AVSDA believes would be in breach of Australian censorship standards, but is nonetheless released in Australia (presumably under a different censorship classification from that used in the market from which parallel imports might be sourced).

Piracy

The Committee noted that, during consultations and in written submissions, there was a strongly held view that if parallel import restrictions were lifted on copyright goods there would be a significant increase in the importation of pirated and/or counterfeit goods.

This position is expressed by Microsoft:

*The lifting of the parallel importing restrictions in relation to computer software has the potential to result in a significant increase in the distribution of counterfeit computer software, at substantial social cost. Piracy continues to be of major concern to the software industry in Australia. In 1998, losses from software piracy were estimated to amount to 33% of packaged software sales in Australia, where annual sales revenue now exceeds \$A1 billion. This represents a substantial and serious loss both to Australia and overseas software publishers and distributors and reduces their ability to compete effectively in the Australian market for computer software... There are substantial practical difficulties associated with the detection of copyright infringement in the computer software industry. The parallel importing restrictions significantly assist in preventing the distribution of counterfeit software throughout Australia. The restrictions have the effect of channelling imported software through recognised distribution arrangements, thereby assisting the Australian Customs Service in policing the entry of computer software in Australia and in ascertaining the authenticity of such software. The removal of parallel importing restrictions would seriously complicate the detection of infringing computer software and would substantially increase copyright and trade mark enforcement costs. This has the potential to cause serious harm to the competitive position of the Australian software industry.*⁹⁸

The Motion Picture Association (MPA) states:

In Australia, AFVSO [Australian Film and Video Security Office] conducted over 350 investigations of possible piracy in 1998. While the piracy threat has been largely controlled for a number of years through vigilance in Australia, video cassette piracy

⁹⁷ Issues Paper Submission 45, p. 12

⁹⁸ Issues Paper Submission 52, pp. 8–9

has begun to grow again and VCD piracy—there is no legal VCD distribution in Australia—continues to grow. In the first half of 1999, AFVSO, working with Australian authorities, seized more than three times as much pirate material as in the whole of 1998. Without the protection of strong copyright laws in Australia and elsewhere, MPA and its member companies would have little recourse to protect their substantial investments in these copyrighted works or to earn any return on those investments.⁹⁹

AVSDA notes:

The main concern of these industries is that by allowing parallel imports the incidence of piracy and counterfeit product will increase significantly. It is sometimes argued that this should be countered by increasing policing and/or penalties. Such an argument borders on the disingenuous. The law enforcement agencies and the courts simply do not have the ability or the will to deliver adequate protection...The main reason that Australia currently has a comparatively low level of piracy and counterfeiting is the combined effect of the existing parallel importation laws, and the fact that AVSDA members have funded the policing of illegal activity and court actions to ensure compliance. Simply raising the penalties for infringement would not be sufficient. The current regime is the most cost effective way to the community of ensuring that piracy and counterfeiting are kept at an acceptably low level.¹⁰⁰

The ACCC presented an alternate view:

Piracy has been the main scare tactic used to deter governments from opening markets to parallel imports, particularly the markets for recorded music and computer software. At best, restrictions on parallel imports are a blunt means to clamp down on piracy, and one which comes with the high costs associated with restrictions on competition. Piracy should be tackled directly through specific sanctions and internationally through agreements such as TRIPS, which are now being implemented in Asia and elsewhere. Furthermore, technological developments are increasingly available to aid in the prevention of piracy. If pirate product is available, it will enter Australia regardless of restrictions on parallel imports, but only to the extent that we have the sort of informal retail sector and culture of acceptance which will facilitate its marketing and distribution. The Commission submits that this is not a widespread feature of Australian society and it has seen no evidence that imported piracy has significantly increased since the market for recorded music was opened up to parallel imports.¹⁰¹

AIC report into parallel importing and CD piracy

In response to the claims expressed regarding potential increases in piracy in the event of liberalisation of parallel import restrictions, the Committee commissioned the Australian Institute of Criminology (AIC) to undertake research and prepare an independent report on the extent and effects of counterfeiting and piracy in the Australian market particularly in relation to CDs (**Appendix 5**). The report, *Parallel Importing and CD Piracy*, mainly focuses on piracy in regard to CDs but, where appropriate, includes other goods. It addresses the level of piracy prior to the liberalisation on parallel imports on CDs; the level of piracy

⁹⁹ Issues Paper Submission 38, p. 8

¹⁰⁰ Issues Paper Submission 45, pp. 3, 4, 10

¹⁰¹ Issues Paper Submission 53, pp. 7–8

since the liberalisation on parallel imports of CDs; the possible causes for changes in piracy levels in CDs and other goods; and considers to what extent the supplementary measures including the simplified enforcement of pirated material (such as placing the onus of proof on the importer), have been effective.

The executive summary states:

Prior to liberalisation of parallel importing of CDs in mid-1998, Australia had a comparatively low level of CD piracy—estimated by industry groups at around 7% of total sales in 1998 (a rise from around 4% in preceding years). This compares with levels of around 4% for film piracy and over 30% for business software piracy.

The period since mid-1998 reveals little evidence of the increase in CD piracy predicted by opponents of liberalisation. Figures supplied by the Australian Customs Service (ACS), the Australian Federal Police (AFP) and the Director of Public Prosecution indicate levels of criminal infringement of copyright during 1998–99 roughly in line with previous years.

It may be that insufficient time has elapsed, particularly given the approximately 2 year time lag for prosecutions, to make a realistic assessment on the basis of these statistics of the effect of parallel importing liberalisation. This applies equally to the effect of increased penalties and the ‘reversal of onus of proof’ provisions in civil infringement actions, also introduced as part of the mid-1998 amendments.

However, anecdotal evidence and media reports indicate that factors other than legislative amendments in Australia may be responsible for an increase in CD piracy which does eventuate, particularly:

- *changes in economic conditions (such as the recent downturn in Asian economies) and the global enforcement environment within which music piracy operates; and*
- *technology advances enabling low-cost domestic CD piracy and electronic music piracy (INTERNET downloading).*

The AIC report considers that changes in the level of piracy and counterfeiting in the past have been attributable as much to advances in technology as to reform of the legislative framework for intellectual property protection.

The report also comments that while there will always be a proportion of imported CDs that are pirate copies—and the opportunities for this form of piracy are somewhat increased (along with penalties) by the liberalised parallel importing regime—the greater danger comes from new forms of piracy, both domestic and international, via electronic, rather than physical, transfer.¹⁰²

With respect to criminal enforcement aspects, the AIC notes that the liberalisation of parallel imports must make more difficult the detection of pirated material solely on the basis of goods descriptions required to be lodged by importers. Under the pre-1998 regime it was

¹⁰² Urbas G, Australian Institute of Criminology, *Parallel Importing and CD Piracy*, report prepared for Intellectual Property and Competition Review Committee, 26 January 2000, p. 1. Available online at: <http://ipcr.gov.au/ipcr/interim/piracy.pdf>

generally known which local distributors were exclusively licensed to import the products of major multinational record companies. An unauthorised import could therefore be detected (at least in some cases) by noting that the addresses of consignor and receiver were not those of a familiar importer. In the liberalised world of parallel importation, this is no longer a possibility. In this sense, ACS is now more dependent on physical inspection (assisted by intelligence from industry sources) as the main weapon in its detection strategy.

The AIC report also notes that a significant factor in the police response to allegations of intellectual property infringement is the perception that such matters are essentially commercial disputes best resolved through civil litigation. The AFP is quoted in the AIC report as stating that ‘in the AFP’s experience, the principal practical difficulties encountered in pursuing criminal prosecutions revolve around establishing and proving issues of fact [in regard to copyright ownership] rather than law’.

AVSDA criticised the report commissioned by the Committee as having a ‘fundamental flaw’ in that it is based almost solely on information provided by bodies for which copyright enforcement has a low priority. Furthermore, once imported, the illegal product can be pirated domestically much more easily using ever-improving technology, and ‘the main danger will be an even greater domestic piracy rate.’¹⁰³ As with censorship, the argument is that identifying legitimate product will become more difficult once the ‘majors’ no longer control all movement of the material into Australia. AVSDA describes the Committee’s ‘complacent attitude that piracy is not really a problem’ as ‘quite alarming’¹⁰⁴. However, the Committee recognises that piracy is a real issue—the question is: what is the appropriate way of dealing with it?

Since submitting our *Report on Parallel Importing under the Copyright Act 1968*, the Committee has become aware of reports that software companies are increasingly using Internet technology themselves to detect and take action on sales of pirate software.¹⁰⁵

Committee evaluation of issues related to parallel imports

The restrictions on parallel importation in the Copyright Act¹⁰⁶ provide owners of copyrighted material exclusive rights to import that material, adding to the set of exclusive rights already articulated. The Committee has considered whether granting such exclusive rights is justified. This section, which sets out the conclusions we reached, starts by considering the tests relevant to assessing these restrictions and then considers the impacts of those restrictions. On the basis of this analysis, we concluded that it would be in the public interest to repeal the provisions of the Copyright Act that restrict parallel importation.

¹⁰³ Interim Report Submission 32, p. 7

¹⁰⁴ Interim Report Submission 32, p. 7

¹⁰⁵ For example, hundreds of piracy sites have been identified since Microsoft began using search software that locates illegal computer programs being offered on the World Wide Web, see Canadian Press, *Microsoft finds pirate software sites*, 3 August 2000.
<http://www.globetechnology.com/archive/gam/News/20000803/RMICR.html>; and
<http://www.ottawacitizen.com/hightech/000803/4524848.html>

¹⁰⁶ *Copyright Act 1968* ss. 37, 38, 44A-C, s. 112A and s. 10AA. Sound recordings have been removed from the restrictions; see s. 44D, 112D

What is the relevant test?

The Committee started from the premise that restrictions on competition need to be justified. In other words, the Committee, consistent with the National Competition Policy and the Competition Principles Agreement, accepts that the onus of making a case lies with those who would prevent, limit, or in other ways restrict, competitive forces from operating.

More specifically, we accept that those who would restrict competition should establish that the restrictions are in the public interest, rather than merely serving the interests of particular producers. The Committee believes that this well-established principle—requiring those who would restrict competition to demonstrate the need to do so—appears to be fully justifiable.

However, experience and analysis amply demonstrates the importance of competition in promoting efficiency and underpinning prosperous, open economies. It also demonstrates the frequency with which restrictions on competition, though claimed to serve wider interests, have been used to confer above normal profits on narrow groups at the expense of the community. A presumption, albeit a rebuttable one, in favour of competition, is consequently clearly reasonable.

Such a presumption also places the evidentiary burden on those best placed to demonstrate the position. The reality is that the benefits from restrictions on competition generally accrue to concentrated groups, while the costs of these restrictions are spread widely throughout the community. Given this spreading of costs, it is far more difficult for those adversely affected by restrictions to organise themselves and present their case, than it is for the direct beneficiaries to support the restrictions.

As a result, the Committee believes that it is reasonable to expect those who would introduce or perpetuate restrictions to provide convincing evidence of why the restrictions are in the public interest.

It follows that the relevant test is whether the material made available to the Committee establishes that the restrictions these provisions impose on competition confer benefits on the community that outweigh their costs.

In cases where arguments put to us appeared weak, the Committee actively sought further information and tried to analyse the arguments in the best light. As a result, we are convinced that we have provided the differing points of view with a fair and thorough hearing.

What are the objectives being pursued?

In considering the issues, the Committee, in line with its Terms of Reference, was mindful of the objectives of the legislation.

We note that the *Copyright Act 1968* does not itself set out objectives. Nonetheless, we believe these can be inferred from the history of the protection of intellectual property. More specifically, intellectual property rights, in the Australian tradition, have the utilitarian justification of protecting and promoting investment in creative effort to secure, for the Australian community, gains associated with investment. The protection granted to the results of creative effort therefore needs to be justified in terms of the positive contribution made to Australia's quality of life.

The Committee therefore believes that the parallel import restrictions granted to owners of copyright material cannot be justified in terms of some inherent right that attaches to creative effort. Rather, *the restrictions need to be assessed in terms of whether the benefits they may bring, in improved investment in, and access to the results of, creative efforts, outweigh the costs they impose.* This assessment of the impact of the restrictions needs to include analysis of the wider costs and benefits associated with those impacts.

In carrying out this assessment, it is important to avoid the assumption that policies which give more income to owners of copyrighted material are ‘good’, compared to those that give less. Rather, it is a fundamental premise of the intellectual property system that rights owners should secure a reward sufficient to ensure socially useful investments in creative effort—but not more. Providing rights owners with more income than is needed to encourage investment in creative effort can be as socially harmful as not providing enough income to support creative effort. Therefore the fact that restrictions on parallel imports increase the rents flowing to rights owners is not justification in itself—rather, any such increase can only be legitimate if it also yields wider benefits to the community.

What do restrictions on parallel imports do?

Restrictions on parallel imports allow owners of copyright to rely on the coercive powers of the Commonwealth in geographically segmenting markets. While this will not always confer market power on owners of copyright, there are clearly circumstances in which it can. When no market power is conferred, so that copyright owners cannot price-discriminate internationally, the restrictions are ineffective. In this case there can be no public policy case for perpetuating them. The issue then is whether, when restrictions do confer some degree of market power, the exercise of that power creates benefits to the community which outweigh the costs of the restrictions.

Australia is a relatively small and somewhat isolated market, which is nonetheless attractive because per capita incomes are relatively high. Although international comparisons are difficult, it seems reasonable to assume that Australians are substantial consumers of material covered by copyright, in all its various forms. The willingness to pay for such material is likely to be quite high—most notably when compared to markets in poorer parts of the world. A supplier of such material with some degree of market power, and the ability to price-discriminate internationally, would likely set higher prices in the Australian market than elsewhere.

While industry bodies have argued to the contrary, this inference seems to be borne out by the ACCC’s comparisons of international prices for books, and by the work carried out for this review by the NZ Institute of Economic Research (Inc.) To the extent that the restrictions do confer market power on suppliers of copyright material, and allow them to exercise that power through price discrimination, Australian consumers could be disadvantaged.

Do restrictions on parallel imports confer or enhance market power?

The Committee believes that the restrictions are likely to confer on the owners of copyrighted material the power to charge higher prices to Australian consumers than would otherwise be the case.

In coming to this view, the Committee notes that industries supplying copyrighted material are relatively concentrated and becoming more so. The publishing industry has experienced substantial consolidation internationally, as ‘mega-mergers’ have expanded the reach of major conglomerates. A similar trend is underway in the already concentrated audio-visual industries, with the convergence of technologies lending further impetus to the process. Finally, the software industry—particularly in systems and applications that are of greatest relevance to mass distribution markets—is very highly concentrated, with the claim being made that at least some important segments of this industry are controlled by a single enterprise. In each case, there are numerous independent suppliers, for example, independent book publishers or small production shops in the film industry. It may be that in future, new technologies will reduce entry barriers and encourage the development of a more competitive industry structure. But for today and for the foreseeable future, the reality is industries that are oligopolies domestically and internationally.

Set against this context, it is disingenuous to claim that the extent of competition can be gauged by the number of copyrighted works on offer—as if each of these works stood in independent price and quality rivalry with the others. Rather, the activities at issue are best described as ones in which a relatively small number of suppliers assemble portfolios of differentiated, partially complementary, partially substitutable products. As with other differentiated goods industries, producers seek a positioning in product space, with each producer pricing its product portfolio in such a way as to internalise any gains or losses that arise from substitution or complementarity among the products comprising that portfolio. The constraints on each producer’s pricing arise from the portfolios of other producers, rather than being internal in character.¹⁰⁷ The restrictions on parallel imports are likely to relax these pricing constraints on two levels.

First and most directly, the restrictions free each producer of the threat of arbitrage that would otherwise come into play if prices in Australia were set materially above, or if availability in Australia was materially below, the levels prevailing overseas. As a result—and given that product supply is concentrated, with each product facing a fairly limited set of independently-priced substitutes—producers are more likely to act in the Australian market in a way that reflects that market’s relatively high willingness to pay.

Second, this effect will be accentuated by the impact of the restrictions on competition between firms. Even in relatively concentrated industries, firms can find it difficult to keep prices at supra-competitive levels if discounts and other forms of price chiselling are difficult to detect. Where retailers can access low-priced sources of supply, even if only at the margin,

¹⁰⁷ The Committee believes it is poor economics to claim that, in and of itself, the existence of many substitutes for (say) any single book means that the publisher of that book lacks market power. Indeed, a monopoly producer of books would supply a broad range of books, linked in a chain of substitution. Equally, a books duopoly would also extensively differentiate its output, though it cannot be said on a priori grounds whether it would make for more or less product variety. In each case, it would be absurd to point to the fact that there were substitutes as proof of the absence of market power. Rather, in both cases, prices would be marked up above the competitive level. To determine whether there was market power, the issue would be whether there were or could readily be (given any sunk costs that might be involved in entry) a range of competing portfolios of substitutable products. Here even submissions that favoured the restrictions on parallel imports pointed to high and rising concentration in the industries dealing with copyrighted material (see, e.g. interim report submission 52, pp. 4–5). Additionally, the claim that Australian publishers find it difficult to enter and successfully compete with the major multinationals (see, e.g. issues paper submission 25, p. 2) hardly points to low entry barriers.

producers will find it difficult to know whether price cutting at the retail level reflects independent conduct by the retailer or secret discounting by established suppliers. As a result, producers will face greater obstacles in seeking to police any degree of price coordination. In contrast, where potentially low-priced sources of supply are excluded, it will be easier for firms in concentrated industries to escape vigorous price competition.

Together, these factors imply that the restrictions on parallel imports have the potential to harm Australian consumers. Additionally, the restrictions may increase the costs and difficulties involved in entering activities ‘downstream’ from those being protected.

Evidence put to the Committee suggests that independent Australian software producers face higher costs in software development because the restrictions increase the prices they must pay for imported software. Equally, it seems that the restrictions may make it more difficult for new firms to contest the distribution of copyrighted material, as they cannot rely on imports from independent, and low-priced, overseas sources to do so. Given that there is concentrated distribution of several forms of copyrighted material—most notably books and videos—measures to discourage entry may expose consumers to less competition than would otherwise occur. Some double marginalisation at the distribution level may therefore add to the effect on price noted above.

What impact does the enhancement of market power have on the community?

In considering the impacts on the community, the Committee believes it is naive to claim that any losses in allocative efficiency will be offset by producers’ reliance on price discrimination within Australia—as a recent report prepared for the Centre for Copyright Studies claims.¹⁰⁸ Restrictions do not allow producers to prevent arbitrage within Australia. As a result, even if producers were inclined to discriminate between Australians with greater and lesser willingness to pay, their ability to do so is relatively limited. Indeed, the material put to the Committee by producers—for example, emphasising that remainder sales of books are very rare in Australia, compared to the United States—suggests that internal price discrimination is not widespread, at least for books (though it may be more widespread in the supply of software and of videos).¹⁰⁹

The mere fact that in economic theory, perfect or close to perfect price discrimination *could* materially negate the allocative efficiency losses that the exercise of market power would otherwise create, does not show that in any specific case it actually does so; and the Committee has not seen any evidence that would allow it to conclude that losses in allocative efficiency are *not* being imposed.¹¹⁰ Additionally, the charging of higher prices than would

¹⁰⁸ Richardson M, Gans J, Hanks F. and P. Williams, *The Benefits and Costs of Copyright—An Economic Perspective*, final draft of paper prepared for Centre for Copyright Studies Limited, June 2000; Interim Report Submission, p. 51

¹⁰⁹ Some price discrimination in books occurs through the release of paperback editions some time after sales of hardback editions have been made at relatively high prices.

¹¹⁰ Indeed, if it were believed that close to perfect price discrimination was possible and perhaps even likely, as the authors of the study for the Centre for Copyright Studies seem to do, all concerns about market power would be misplaced, and the competition provisions of the Trade Practices Act would be superfluous if not positively harmful.

otherwise prevail, taking advantage of the relatively low demand elasticity of Australian consumers for copyrighted material, has distributional consequences that cannot be ignored.

Reflecting its relatively small size, Australia has long been a substantial net importer of copyrighted material, and the Committee believes it should remain so. The terms on which these imports occur are one factor that determines the extent of the gains to the Australian community from the copyright system.

At least one commentator has suggested that it is ‘inappropriate’ to adopt a blanket application or assimilation of other countries’ intellectual property laws and policies into the Australian regime, in light of this net importer status.¹¹¹

The Centre for Copyright Studies report claims that consideration of Australia’s position as a net importer of copyrighted material is an instance of the ‘Mercantilist fallacy’—that is, the view that imports are ‘bad’, while exports are ‘good’. In the Committee’s view, that study is seriously incorrect in its economic analysis. More specifically, in economic terms the study fails to distinguish the welfare analysis of changes in the volume of trade flows from the welfare analysis of changes in the terms of trade.

We accept that rather than imports being bad and exports good, exports are merely the price the community pays for the benefits it secures from imports. Exports have an opportunity cost, in the form of foregone domestic consumption. However, the cost of replacing the imports through domestic output would be even greater, so that the community as a whole gains from international trade. As a result, it is erroneous to suggest that, holding all else constant, the community will benefit by reducing imports and/or increasing exports.

However, it simply does not follow from this that the community will lose from changes that improve its *terms of trade*—that is, changes that reduce the price of imports relative to exports. Rather, exceptional circumstances aside, improvements in a country’s terms of trade will always increase its national income, and allow a sustainable rise in living standards. While this proposition holds regardless of a country’s balance of trade, it is obvious that the impact of price changes in a context of intra-industry trade will depend on the balance and composition of trade flows. More specifically, the community will gain from price falls, and lose from price increases, on goods of which it is a net importer.

As a result, and given that Australia is a substantial net importer of copyrighted material, policies which increase the price Australia pays for imports of copyright material reduce national income and harm living standards. This suggests that removing the restrictions on parallel imports could enhance Australia’s economic well-being. However, before such a conclusion can properly be reached, the impacts of removing the restrictions on the supply of copyrighted material need to be considered.

Would removing the restrictions reduce Australia’s access to copyrighted material?

In practice, price reductions caused by removing restrictions on parallel imports are not likely to have any impact on foreign supply. In other words, it is implausible to suggest that foreign output of copyright material will fall in response to changes in the prices charged in

¹¹¹ Beard, K, ‘Competition and Copyright’ (2000), *inCite*, Vol. 21(5), p. 14

the Australian market. Rather, consistent with the ‘small country’ assumption that has long been made when analysing Australia’s international trade, supply of foreign output can be taken as given with respect to Australia’s policies on parallel imports.

Indeed, since copyrighted material typically has very low marginal costs, compared to the fixed costs of its original creation, there is unlikely to be any diversion of foreign output away from meeting Australian demand.

However, it cannot be assumed that output will remain constant with respect to Australian supply. There could be works that would cover their fixed costs with the restrictions in place, but could not do so if those restrictions are removed. Supporters of the restrictions did not provide the Committee with any evidence that such an effect was likely and we do not believe that it is.

Each type of copyrighted work needs to be considered individually in this context.

The Committee notes that adverse impacts on domestic supply are unlikely in the case of software and computer games. We have not seen any evidence that international price discrimination has any favourable effect on domestic output of software and computer games. Indeed, the independent Australian software industry argued that the current restrictions adversely affect its competitiveness. As a result, issues about adverse impacts on domestic supply are confined to books and other publications.

In considering the possible extent of these impacts, the publishing industry’s claim that prices are low relative to overseas must be taken into account. To the extent that this claim is accurate, it seems difficult to believe that removing the restrictions would have a materially adverse effect on output. However, even putting this aside, the Committee has doubts about the chain of argument provided by supporters of the restrictions.

In particular, it has been put to us that the primary price effects will occur as a result of imports from the United States, and, more specifically, from importation of books remaindered in the United States market. It is claimed this will erode the income of Australian rights holders, as they will be forced to discount Australian books.

The Committee believes that this argument is overstated and at best, incomplete. We understand that relatively little Australian-originated material is of interest in, or published in, the United States. The vast bulk of Australian-originated material is essentially of local interest (such as ‘how to’ books, which are tailored to the Australian market) and this material does not have identical or perhaps even close substitutes in the United States market.¹¹² As a result, only a small part of Australian literary output could be affected by the supply of remaindered editions from the United States.

With respect to the part of Australia’s literary output that could be affected, the Committee believes that contractual means could be used by Australian rights holders to control the flow of remaindered books into Australia.

¹¹² Moreover, to the extent that there are close substitutes, say for cookbooks, this is likely to be at the end of the market where competition is already relatively intense, so that the restrictions are likely to have little bite.

However, even if it is assumed that Australian rights holders could not use contracts to restrict supply into Australia of books produced by their licensees in the United States, the effect on income from the United States to Australian rights holders is unclear.

The ability to import remaindered books into Australia would make the licenses being sold by Australian rights holders to United States publishers more valuable (as the potential demand expands). As a result, Australian publishers would charge more for those licenses, at least partially offsetting any income lost through the subsequent import of remainders into the Australian market.

The Australian Publishers' Association contested whether this would happen.¹¹³ In suggesting that Australian rights owners could not secure some share of the increased value of Australian licences to United States publishers, the Association's arguments seem to imply that market forces, which operate reasonably effectively in the rest of the economy, do not work with respect to this particular activity. The Committee does not believe the available material supports this assertion and is not convinced that the income losses to Australian producers could be as substantial as the Publishers' Association suggests. It is significant that the Association did not provide any evidence to back the claims it made in this respect.

Having said that, we note that the mere threat of income losses to publishers is hardly sufficient grounds for maintaining restrictions. Indeed, had such a criterion been adopted, industry protection would never have been wound back, and the prospects for trade liberalisation internationally would be bleak. Rather, what matters is whether changes in income translate into wider losses for the Australian economy, or whether they merely amount to transfers.

The Committee considers wider losses for the Australian economy unlikely. As a matter of economics, the works which would have been published with the restrictions in place, but could not break-even without them, are likely to have been extremely marginal—that is, they are unlikely to be worth substantially more to the community than they cost to supply. As a result, the change in output is unlikely to have much impact on social surplus. In contrast, there could be substantial gains to the Australian community from lower prices on the far larger (and notably foreign copyrighted) output volumes that are maintained. The marginal loss, which by its nature is likely to be small, would in other words be readily exceeded by the infra-marginal gains, also taking account of the benefits to Australia from improvements in the terms of trade.¹¹⁴

In addition, as the economic reports commissioned by the copyright industries have emphasised, copyrighted works, though involving potentially substantial fixed costs, are largely 'non-rivalrous', i.e. marginal costs (the costs, say, of making an extra copy) are very low or effectively zero.

¹¹³ The Committee believes that the Publishers' Association view on parallel imports is inconsistent, as it claims *both* that current prices are low by international standards and that allowing direct imports from third markets would lower prices to the point of causing severe harm to the local publishing industry.

¹¹⁴ The mere fact that some part of these gains is transfers from a global perspective in no way undermines the conclusion that as far as Australia is concerned, the change amounts to a net increase in national income.

What this implies is that duplication of such works—in the sense of making another, closely analogous work, where one already exists—can involve pure waste: as the fixed costs required are being borne twice, even though output of one of the works could have been expanded at virtually no cost to meet all of demand. One of the effects of the restrictions is likely to be to encourage such duplication—as the higher prices being charged on works make it more attractive to produce close substitutes. As a result, more ‘look-alike’ products will be produced, with little net gain, or even a net loss, to the community. The output of these works is most likely to be affected by removing restrictions. In these cases, even if output fell, the community would be better, rather than worse, off.

With respect to videos, the argument has been put that removing restrictions on parallel imports would undermine the ‘windows’ system, where suppliers sequence the release of material in various countries. This provides for a form of inter-temporal price discrimination, by which suppliers of film material can set prices that more closely reflect willingness to pay.

It appears to be a common practice for films to be released in Australia later than its release in more major overseas markets. If parallel imports were allowed, it is claimed that this practice would be undermined and that this would erode incentives for investment in film production.

In considering this claim, the Committee notes that removing restrictions is likely to have only a marginal impact on the effectiveness of the windows system. In practice, demand for videos reflects the marketing of films, and this would remain largely under the control of the copyright owner. We note that while there is typically a gap between the release of films in Australia and New Zealand, removing restrictions on parallel imports into the New Zealand market does not appear to have led to any significant undermining of the windows system in that country.

However, even if it is accepted that removing restrictions would erode the ability of producers to delay the release of films in Australia until after the first release in major overseas markets, it is not apparent that this would cause a loss to the community. In effect, the rights owners could decide either to release films in Australia at about the same time as their release in major markets overseas, or consumers would benefit from earlier availability of those films on video. Given that these would be gains to the community, the question is whether there would be offsetting losses.

The film industry has not provided the Committee with convincing evidence of such losses to the Australian community, should the restrictions be removed. We do not accept the claim that the community would suffer if children’s films were available at times other than school holidays, for distributors would have little interest in showing them at those times, when their revenues are unlikely to be as high. As for the claim that Australian features that would otherwise have been made, would not be made, the complex chain of assumptions underpinning this hypothesised outcome makes its empirical relevance highly uncertain. At its simplest, the claim requires that there be Australian productions which are only likely to be successful if they are released overseas well before their release in Australia. But even if this were the case—and no evidence to this point was presented to the Committee—the consequent, marginal, loss of output and of corresponding surplus would need to be weighed against the gains to consumers from more timely access to, and/or lower prices for, the bulk of film material.

The film distribution industry has argued that removing restrictions on parallel imports in New Zealand has led to a substantial number of films not being released in that country. The Committee notes that this claim is directly inconsistent with the industry's assertion that it is vigorously competitive—firms in competitive markets do not have the degree of discretion over the timing of output that the industry's conduct points to. Additionally, the Committee notes that if there is some element of coordination in such conduct (as the Committee believes there may have been), there would be concerns under the Trade Practices Act. Most importantly, however, the information supplied by the industry is inconsistent with independent market inquiries made on the Committee's behalf by the NZ Institute of Economic Research.

Those inquiries found that there were indeed delays in some instances in the release of films in New Zealand; but that these reflected the size of the market and of demand for new release films, rather than being related to the decision to remove restrictions on parallel imports.

The Committee is therefore not convinced that removing restrictions on parallel imports would impose a net social cost. At the time of removing restrictions on parallel imports of CDs in Australia, the record industry claimed that supply would be adversely affected—with especially marked and serious consequences for the industry's ability and willingness to invest in young or less-known Australian musicians. This has not eventuated, and Australian output appears not to have been harmed or diminished. Indeed, even the Australian Publishers' Association, which strongly supports keeping the restrictions in place, could only point to a statement by Sony (not backed by any evidence) suggesting that conditions 'had not improved' since the restrictions on parallel imports of CD were allowed. The Committee believes that this is a far cry from the 'doom and gloom' scenario proponents of the restrictions have consistently painted. We are therefore not convinced that greater costs to the community would arise in the other industries at issue.

Are there other economic arguments in favour of retaining the restrictions?

Given the considerations outlined above, the Committee believes that the costs of removing the restrictions are likely to be small, relative to the gains. In coming to this view, the Committee notes other arguments that we received.

One argument, in the recent study for the Centre for Copyright Studies, claims that because price discrimination often enhances efficiency, and is no longer subject to any form of direct prohibition under the Trade Practices Act, it would be undesirable to remove the restrictions on parallel imports.

The Committee does not accept this argument. To begin with, the mere fact that price discrimination *can* enhance efficiency does not imply that the party paying the higher price is, in practice, better off as a result. Rather, this will only be the case if removing the discrimination *increases* price or *reduces* availability. Neither of these claims is plausible in this context, and the Committee notes that the study does not argue otherwise. Additionally, the assertion that the restrictions on parallel imports should be retained because price discrimination is not prohibited under the Trade Practices Act, is a non-sequitur. The removal of those restrictions will in no way prohibit price discrimination. It will merely mean that the industries currently affected by these restrictions are placed in exactly the same position as all other areas of economic activity—that is, they will be able to engage in price discrimination to the extent that it does not otherwise breach the competition laws.

Another argument put to us is that removing parallel import restrictions will undermine efficiency in distribution. It has, for example, been asserted that publishers will be less willing to supply facilities such as sell or return; and, more generally, that suppliers of copyrighted material will cut back the amount of service provided to their marketing channels.

In theory, it is possible that opening the market to parallel imports could lead to some measure of free riding on the investment suppliers make in distribution and support channels. However, the Committee is not convinced that this would be a problem in practice.

As Australian consumers well know, opening markets to import competition has generally resulted in better, rather than worse, service. To remain competitive with imports, domestic suppliers generally enhance the services they provide. Indeed, a study by the NZ Institute of Economic Research on the impact of removing the restrictions on parallel imports on books in New Zealand, found that it was precisely by offering a wide range of services (such as sell or return) that New Zealand publishers had remained by far the major option for booksellers and other retailers in New Zealand (see **Appendix 6** for the full study undertaken for the Committee).

Any problems associated with free riding are even less likely to occur in the other activities currently covered by the restrictions. The Committee notes that in software, the vast bulk of service is provided in product support rather than at the point of first sale. It is relatively easy for software vendors to contractually limit that support to particular classes of purchaser. Indeed, it is common for support to be restricted in some way—say to those who have registered. Equally, the Committee has not been pointed to any means by which free riding could be a material problem in respect of computer games and of videos.

Overall, suppliers of copyrighted material, along with suppliers of other goods and services, have had to react to the free riding issues that arise from the development of the Internet, and more generally from closer international integration (most notably within free trade blocks such as NAFTA and economic unions such as the European Union). In the process, they are developing ever more effective means of charging separately for various services they provide, and securing a return on investment in promotion, distribution and after-sales services. The Committee believes that any issues associated with free riding will have to be addressed by suppliers anyway, and that these issues do not provide convincing grounds for retaining the restrictions.

Another argument was that the restrictions on parallel imports of books, along with the 30/90 day rules, have had beneficial impacts on the printing industry.

The Committee has not been provided with any evidence to this effect, and we question whether changes in the level of printing activity in this country are due to these rules or to changes in competitiveness, including as a result of exchange rate movements. Nonetheless, even if this claim is correct, the Committee does not believe that the function of the Copyright Act is, or was ever claimed to be, to promote printing in Australia—as against the promotion of investment in, and access to the results of, creative effort. The claim is therefore irrelevant to the Committee’s considerations. Rather, we believe that decisions about the promotion of one manufacturing industry compared to others ought to be taken and implemented in an industry policy context.

Such decisions should also be subject to efficiency review, to ensure that the benefits to the community arising from favouring one form of manufacturing over others exceed the costs it imposes. The Committee has not been provided with any evidence that this cost-benefit test is met.

Overall, the Committee does not believe that the Copyright Act should be used as an indirect means of promoting particular forms of manufacturing. As a result, we do not accept that the claimed impacts of parallel import restrictions on the printing industry can justify keeping these restrictions in place.

Do concerns about copyright enforcement and consumer standards justify retaining the restrictions?

The argument has been put to the Committee that, regardless of the direct economic impacts of restrictions on parallel imports, they are required to secure desirable outcomes in terms of copyright enforcement and to maintain consumer standards and safeguards.

We find the link between restrictions on parallel imports and consumer safeguards a tenuous one. The Australian Toy Association (ATA) acknowledged this in its submission on the interim report, and argued that alternative mechanisms must be set in place (such as a mandatory approach to certain standards).¹¹⁵ The argument does not apply to books; and in the other activities at issue, the Committee believes that other means, more specifically targeted to the problem, would provide a more cost-effective policy approach.

We do not believe that piracy is a material concern in regard to books. However, the Committee recognises that copyright enforcement has been an issue with respect to software, including games and videos. It is conceivable that restrictions on parallel importation facilitate detecting and prosecuting infringing material. However, the issue we have had to address here is how substantial these impacts are, notably in relation to the costs the restrictions impose on the Australian community.

In considering this issue, the Committee sought and received advice from the Australian Institute of Criminology. That advice, consistent with the New Zealand experience, suggests that while piracy and other forms of infringement are a serious concern, removing restrictions on parallel imports is not likely to materially aggravate the situation. The Committee also notes that the owners of copyright material will continue to have a strong and direct interest in enforcing their rights. These industries are relatively concentrated, are well organised for the purpose of preventing infringement, and can rely on provisions which facilitate the making out of contravention and set down severe penalties when contraventions are established. As a result, the Committee concludes that any enforcement costs that might arise from removing restrictions could not outweigh the community benefits.

¹¹⁵ Interim Report Submission 36, p. 2

Is repealing the provisions consistent with Australia's international obligations?

The Committee has carefully considered whether restrictions on parallel importation of copyrighted material must be maintained under Australia's international obligations. We have consulted widely in this respect, and come to the view that repealing these restrictions would be entirely consistent with Australia's international obligations, including those arising under the Berne Convention and TRIPS Agreement.

As a result, and given the considerations set out above, the Committee concluded that the repeal of these provisions would be in the public interest and is consistent with the objectives of the Competition Principles Agreement.

Should there be transitional provisions?

The Committee recognises that we are proposing significant changes. Particularly in the publishing industry, it is important that there is time for contractual arrangements to be reviewed in the light of these proposals. The Committee is specifically concerned that Australian publishers have the opportunity to understand and adjust to the new environment in which they would be operating. As a result, the Committee recommends that there be a 12-month transitional period for the arrangements in respect of books and that consideration be given to a program aimed at informing the book industry of the changes and of the options created by the new environment.

Conclusions

The Committee notes that views differ on whether prices for goods affected by the restrictions are higher or lower in Australia than overseas. Firms and associations that support retaining the restrictions unanimously affirmed that prices in Australia were low by world standards. However, they also unanimously asserted that removing the restrictions would harm domestic suppliers by reducing prices to the levels set by cheaper sources of direct imports. These views are inconsistent and cast some doubt on their arguments.

We recognise that international price comparisons are complex and often controversial. Factors such as exchange rate changes and differences in tax levels and structures often affect the comparisons, and make assessment hazardous. Nonetheless, the Committee believes that prices are likely to be higher in Australia, notably for books and software products. It is our expectation that repealing parallel importation provisions will result in price reductions.

This conclusion notwithstanding, the Committee is less concerned with immediate price effects than with the longer-term framework for the products at issue. Repealing the parallel importation provisions would ensure that, whatever the current situation, changes in prices in Australia would not disadvantage Australian consumers relative to their counterparts overseas. This would be a material improvement on the current situation, where consumers are vulnerable to the risk of market segmentation strategies enforced using the Commonwealth's coercive powers.

Consumers in few countries are as exposed to this risk as consumers in Australia. There are no restrictions on parallel imports within the European Union. As a result, the market for consumers is very large, with decreasing price differentiation.

Consumers in high-income parts of the market are protected from higher prices because suppliers do not want to lose sales in lower income areas. Equally, consumers in the United States benefit from a vast and closely integrated market, which is reflected in intensely competitive supply and persistently low prices. In contrast, while Australia retains the current restrictions, it will be a small high-income market, easily cut off from the rest of the world, and one in which producers face few constraints on their pricing. Removing the restrictions is one effective means of integrating the Australian market into larger, more competitive markets such as the United States, and bringing the advantages of strong competition to the Australian market.

This in no way implies weakening or eroding copyright—far from it. It would be completely inaccurate to suggest that the changes we are proposing involve eliminating the right of copyright owners to a legitimate return. The international experience makes this clear—within the European Union, which is a strong and uncompromising supporter of copyright, there are no restrictions on parallel imports. Repealing the parallel import provisions is an effective way of ensuring that Australians do not pay *more* for copyrighted works than overseas consumers. Supporters of the restrictions assert that prices in Australia are already as low as they are elsewhere, so there is no basis for opposing a change which will make it clearer and more certain that market forces are at work.

The Committee consequently finds that repealing the parallel importation provisions of the Copyright Act is required under the criteria set down in the Competition Principles Agreement.

Recommendations

Parallel importation

The Committee recommends repeal of the parallel importation provisions of the *Copyright Act 1968*, with a 12-month transitional period allowed for books.

We also recommend that the Government consider a program aimed at informing the book industry of the changes and of the options created by the new environment.

One Committee member has expressed substantial reservations about lifting parallel import restraints and their views on this matter are contained in a dissenting opinion below.

Dissenting opinion on parallel importation

Mr John Stonier, a member of the Committee, has dissented from the Committee's findings in respect of parallel imports. His reasons are set out here:

In a recent presentation, *Innovation, The Only Way Forward*, to the Prime Minister's Science and Engineering Council (PMSEC), Australia's Chief Scientist, Dr Robin Batterham, stated:

*The world sees innovation as the key to competitiveness, job growth, prosperity and solving problems in the knowledge-based economy. A nation that excels at innovation will thrive.*¹¹⁶

An earlier presentation to PMSEC, entitled *The Role of Intellectual Property in Innovation*, emphasised the importance of intellectual property rights for all those involved in the business of innovation.¹¹⁷

Moreover, Professor Allan Fels, Chairman of the ACCC, has stated:

*It is now accepted that intellectual property laws do not clash with competition laws because they do not create legal or economic monopolies. Intellectual property laws create property rights and the goods and services produced using intellectual property compete in the marketplace with other goods and services. Only in particular cases will intellectual property owners be in a position to exert substantial market power or engage in anti-competitive conduct.*¹¹⁸

Reflecting this overview and focus, the *Copyright Act 1968* encourages, protects, and rewards creators, through the exclusive right to copy, to perform other acts, and to prevent the importing of copyright material into Australia for commercial purposes without the copyright owner's consent.

These general principles or rights have been restricted by legislation in respect of:

- *sound recordings*—effectively there are now no restrictions on parallel importing CDs and other sound recordings;
- *books*—parallel import restrictions are subject to the 30/90 day rules; and
- *non-copyright products*—the application of copyright packaging or labelling material will not trigger parallel import restrictions.

The Interim Report of Intellectual Property and Competition Review proposed that these exceptions be extended and apply to all copyright material, meaning that there would be international exhaustion, and hence no restrictions against parallel importing.

This conclusion reflects the judgement that:

- the parallel import provisions are a restriction on competition;
- the costs of parallel import restrictions exceed the benefits to the community; and
- there are alternative means to achieve the objectives of the Copyright Act.

It is true that the ability to restrict parallel imports gives rise to an economic rent in favour of the copyright owner. However this rent encourages innovation and investment, and is precisely the foundation on which copyright is based. Allowing parallel imports reduces the incentive to innovate or invest. It is submitted that the costs incurred in removing the restriction will exceed the costs (in economic terms) of retaining that power.

¹¹⁶ 2 June 2000

¹¹⁷ 7 June 1993

¹¹⁸ Prof. A Fels, *The Role of Competition Policy in IP*, above, n 17

The parallel import provisions restrict only intra-brand competition but not inter-brand competition. Even so, the power to block parallel imports is not *ipso facto* a restriction of competition and so it cannot be said that the Competition Principles Agreement requires repeal of the power, unless the resulting benefits to the community outweigh the costs.

Clearly, the copyright owner's power to prevent parallel imports is a power that enables them to restrict conduct, but not all restrictions on conduct are quantifiable restrictions on competition. For example, every contract restricts the parties' freedom of action. However, a contract, or its provisions, does not restrict competition unless there is an anti-competitive effect in a market.

Market power requires a consideration of the possibilities of substitution and barriers to entry.¹¹⁹ This should be assessed on a case-by-case basis. Moreover, in most cases individual copyright owners are unlikely to enjoy market power simply from the nature of copyright which, broadly speaking, protects only the expression of ideas, not the ideas themselves, and then only against copying. This in fact is the conclusion the courts have reached. The Prices Surveillance Authority's reports into Book Prices and Computer Software argue that copyright gave owners monopolies over individual titles or programs.¹²⁰ The courts have rejected such claims, however, and instead found that the market power necessary for a restriction on competition was lacking.¹²¹

Accordingly, unless an extremely narrow definition of the market is adopted, the power to prevent parallel imports does not constitute a restriction on competition except possibly in very particular situations. It would be preferable to ensure that such individual abuses are the specific objects of control. Moreover, there is the concern that treating the copyright in individual products as monopolies which give rise to restrictions of competition, might undermine other recommendations which the Committee is developing and which depend on the continued application of case law developed under the Trade Practices Act.

It is therefore not clear that the parallel import provisions restrict the competitive process, or that the costs of such restrictions exceed the benefits. It is also not clear that there are alternative cost-effective means of achieving the same goals.

This conclusion is particularly true for the book industry in Australia. There are over 250 publishers employing more than 4 000 people. In 1997–98 they sold more than 110 million books (60 per cent Australian) and published nearly 7 000 new Australian titles. Sales exceeded \$1 000 million, of which more than \$100 million were exported, mainly to the United States (\$40 million), New Zealand (\$25 million) and the United Kingdom (\$17 million).¹²² These figures are consistent with Australia having a thriving and competitive industry. They are also consistent with the view that parallel imports are not impeding or restraining the competitive process.

¹¹⁹ *Queensland Wire Industries Pty Ltd v Broken Hill Propriety Limited* (1988) 167 CLR 177

¹²⁰ Prices Surveillance Authority, *Final Report into Books; Final Report into Computer Software*

¹²¹ *Broderbund v Computermate* (1991) 22 IPR 215; *Tru-Tone Ltd v Festival Records Marketing Ltd* [1988] 2 NZLR 352

¹²² Department of Communications, Information Technology and the Arts, *Cultural Trends in Australia No 9: Australian Book Publishing 1997–98*, June 1999. (Report prepared with the assistance of the Australian Bureau of Statistics)

The arguments for and against maintaining parallel import restrictions are set out and discussed in the Interim Report, and need not be repeated. It is sufficient to comment here on the principal points raised when discussing the benefits and costs of removing parallel import restrictions.

One submission asserted that a potential benefit of removing parallel import restrictions is that the prices of books would be reduced. In this regard, the New Zealand experience is relevant.

The NZIER Report¹²³, while noting some pressures and improvements in the market place from the removal of parallel import restrictions as well as the impact of other factors, stated that the effect was ‘muted’ and that ‘tangible impacts on volumes and prices have been small’.

The position in Australia in respect of CDs is similarly ambiguous. Price reductions of up to \$7 were predicted, but the ACCC’s Professor Fels is reported as saying that prices have not fallen significantly. This was said to be due to the weaker Australian dollar, a conclusion disputed by the ANZ’s Chief Economist, Saul Eslake.¹²⁴

Professor Fels has said that, contrary to fears that the legislation would obliterate the local music industry, it has resulted in better quality CDs and money has been directed to the artists. On the other hand, the APA quotes Sony as advising that there are no new players within the industry, no new wholesalers have set up business, no increase has occurred in the range of available titles, and no cheaper prices are flowing to consumers in the open market.¹²⁵

Australian authors are published locally and, through the sale of rights, published overseas. Conversely, Australian publishers acquire rights for local markets from overseas authors and publishers. The number is not quantified, but the APA states: ‘A considerably large number of overseas authors, certainly many thousands, are currently published in Australia.’¹²⁶ The parallel import provisions provide the incentive and security for investing in local publishing, of Australian and overseas authors, for local and export markets.

The risk and the potential cost of removing the parallel import restrictions is that Australia would again not be regarded as a separate territory for copyright purposes. In particular this would mean reduced local publishing, forcing Australian authors to be published overseas. In view of the greater competition facing authors overseas it may be that, overall, fewer Australian authors would be published. In some ways this is the current position in New Zealand. The APA states that all major authors are published offshore. It says local publishers’ turnover is no more than \$NZ40 million, whereas the total industry turnover is approximately \$NZ500 million.¹²⁷

¹²³ NZ Institute of Economic Research, *Parallel Importing Review: The Economic Effects of Lifting the Ban in NZ*, Report to the Intellectual Property and Competition Review, February 2000 (attached at **Appendix 6**)

¹²⁴ Donovan P ‘CD Prices: Dollar Blamed’, *The Age*, 30 November 1999, p. 4

¹²⁵ Australian Publishers Association letter, 23 June 2000, p. 4

¹²⁶ Australian Publishers Association letter, 23 June 2000, p. 2

¹²⁷ Australian Publishers Association letter, 23 June 2000, p. 3

Other consequences of removing parallel import restrictions could be a reduction in that the wide availability of titles to the Australian consumer (150 000) and marketing support services such as the no sale/ return policy are reduced.

Internationally, the United States maintains stringent parallel import restrictions against copyright imports. The position is not so clear in Europe. Within the European Economic Community (EEC) there is national exhaustion, but individual member countries have the right to prevent importation from outside the EEC.

This position is currently adopted by the majority of countries. In these circumstances, and as the United States and Europe are valuable importers of Australian works, the benefit to Australia of removing parallel import restrictions is questionable.

Another concern is the possibility of retaliation by the United States and perhaps other major trading partners. The *Howe Leather* case, where Australia's wine exports were threatened, demonstrates the difficulty of predicting potentially serious developments or consequences. This remains so, even though the abolition of parallel import restrictions would be technically compliant with TRIPS.

The proposed alternative to parallel import restrictions is that Australian publishers could purportedly address the book remainder problem by revising their contractual relationships with United States and European publishers. There is considerable doubt that this is practical or that such restrictions would be legal and enforceable. However, even if practical, legal and enforceable, there would be high transaction costs.

In conclusion, considering the importance of innovation and intellectual property, and considering the view that the power to prevent parallel imports does not, in most situations, constitute a restriction on competition, and that, in the book industry at least, the benefits of parallel import restrictions exceed the costs, it is recommended that the existing parallel import restrictions be retained.

In regard to books, this recommendation is subject to a qualification that the time to satisfy local orders should be reduced from 90 to 30 days. Consumers will be better served and costs reduced, if they know sooner whether their order will be filled before parallel imports are permitted.

These recommendations are directed to the book industry, however much of the above could legitimately be said in respect of other copyright industries.

Finally, it is perhaps relevant and timely to note that in 1980, Stephen Stewart QC predicted that the next challenge which international copyright would face in the 1980s was:

...one which goes to the very root of copyright. It is a doctrine which is not new but which assumed much greater importance in the 1960s and the 1970s and will, I fear, gather strength in the 1980s as the economic recession develops. It is known as 'consumer politics'. Applied to copyright, the doctrine means the consumer should have the widest possible access to all copyright material at the lowest possible cost and, in many cases, free...and that the interests of right-owners should take second place.¹²⁸

¹²⁸ Sodipo B, *Piracy & Counterfeiting—GATT, TRIPS and Developing Countries* (1997), p. 1

Such a state of affairs would actually drive products out of the market, which is clearly against consumers' interests. If we insisted on free bread, what would encourage people to bake?

Copyright in packaging and labelling

Description of prohibition

In July 1998, legislation was passed to prevent owners of non-copyright products from using copyright material (such as artistic works reproduced on labelling) to prevent the parallel importation of competitors' products.¹²⁹ The legislation has now come into effect, after being delayed for 18 months to enable businesses that relied on this application of the law to arrange their affairs and respond to the change.

Problems the prohibition attempts to address

Prior to this amendment, businesses with exclusive distribution rights for non-copyright goods (such as toys, shoes, liquor, cosmetics and clothing) could assert copyright in the packaging and labelling of those goods and use this to stop other businesses from importing and reselling those goods.

The legislative amendments were made to prevent this, as it was never intended that copyright be used for this purpose.

Removing the ability to use copyright in this way eliminates one of the ways exclusive market access can be provided to certain distributors of packaged or labelled goods and implements a recommendation of the Copyright Law Review Committee (CLRC).

In 1988 the CLRC reviewed the importation provisions of the Copyright Act. It noted the ability to use copyright-protected material attached to, or used in relation to, goods that would not attract copyright protection in their own right, to gain control over the right to import and market such goods in Australia. The CLRC noted its fundamental objection to the use of copyright to assure exclusive distributorships for goods not protected by copyright, stating that this was not a valid use of copyright.

Cost-benefit analysis

Some industries argued at the time the Copyright Amendment Bill (No. 1) 1998 was introduced that it would have an adverse impact on consumer standards and would allow unfair free rider activities regarding advertising. They suggested, for example, that advertising for a particular liqueur by the exclusive distributor would be used by competitors who import directly. It was also suggested that competitors could import substandard models or products from sources currently not used, leading to greater potential for consumer harm and to higher product-servicing costs.

¹²⁹ *Copyright Amendment Act (No. 1) 1998 (Commonwealth)*

However, products, and the circumstances of their sale, are independently regulated through a range of other direct laws that provide for protection of consumers and public safety. These include food standards, product safety standards and product liability laws.

Importers and distributors of goods such as toys are concerned that the previous restrictions on parallel imports—based on the labelling of products—provided some sort of uniform legislative scheme to control the dissemination of faulty products, whereas there is not necessarily a great deal of confidence that state legislation will be enacted or enforced. There is a concern that state legislation will at best be a patchwork, comprising different standards of protection.

The Committee nevertheless believes that removing this power over importation has reduced the potential for over-protection in an area where competing considerations are not strong. Removing the restrictions has introduced the possibility of competition between importers in areas where product labelling has previously been a mechanism of maintaining exclusive control. Despite the concerns expressed by industry summarised above, each State and Territory does have in force a range of consumer protection and product safety legislation, and the Trade Practices Act also addresses many of the same issues.

The measures introduced via the *Copyright Amendment Act (No. 1) 1998* will not eliminate exclusive distributorships related to ownership of a trade mark or where a copyright artistic work is permanently affixed to the goods and is not a label.¹³⁰ Some further comments are made below on the potential use of trade marks law to secure exclusive distributorships.¹³¹

The reforms do not remove copyright protection from packaging and labelling that now qualify for such protection. They simply remove the right to use the copyright in ‘accessories’ to an article (i.e. packaging and labelling) to control the importation of that article. The amendments do not make legal labelling that is counterfeit or packaging that is pirated. Importation and sale of articles using counterfeit copies of works on the packaging or labelling is still illegal, and such material will remain liable to seizure at the Australian border and in the market. The Committee believes that these amendments have reduced opportunities to use copyright for collateral purposes (i.e. for restricting imports) and in conjunction with removing restrictions on parallel imports, they will reduce existing barriers on legitimate import competition.

Conclusion

The Committee is of the view that the amendments in the *Copyright Amendment Act (No. 1) 1998* preserve the rights legitimately granted by copyright, and reduce the possibility that copyright protection will be used for collateral purposes such as maintaining exclusive distributorships.

We agree with the view expressed by the ACCC (in its submission to the Senate Legal and Constitutional Legislation Committee on Copyright Amendment Bill 1997), that ‘restrictions on parallel importations are a particularly blunt instrument for dealing with health and safety issues’.

¹³⁰ Explanatory Memorandum to Copyright Amendment Bill 1997, (Impact Analysis), 18 June 1997

¹³¹ See section on *Parallel importation and the Trade Marks Act* at p. 188.

The consumer issues raised by industry groups such as the Australian Toy Association (ATA) are important, but these concerns should more appropriately be dealt with by State and Territory fair trading and health and safety legislation and, if necessary, through mandatory safety standards.

The Committee agrees with the changes to the Copyright Act that prohibit assertions of copyright in packaging and labeling as a means of preventing parallel importation of competitors' goods.

Copyright term

Description

Section 33 of the Copyright Act provides for the duration of copyright protection for original works. The duration of copyright protection varies according to the nature of the copyright material, and whether or not it has been published. Copyright for literary, dramatic, musical and artistic works generally lasts for 50 years from the year of the creator's death. Copyright for film and sound recordings lasts for 50 years from publication and for broadcasts it is 50 years from the year in which they were made.

The duration of copyright protection is longer than any other form of intellectual property (other than trade mark protection, which may theoretically continue indefinitely as long as there is active use of the mark).

International obligations

The Berne Convention imposes several obligations regarding minimum term of copyright protection that must be granted by member states:

- Article 7 provides that the term of protection granted by the Convention is the life of the author and 50 years after the author's death;
- Article 19 provides that the provisions of the Convention shall not preclude the making of a claim to the benefit of any greater protection which may be granted by legislation in a country of the Union; and
- Article 20 allows for special agreements among countries of the Union to grant authors more extensive rights than the Convention or contain other provisions not contrary to the Convention.

While the Convention sets out minimum standards, the issue has been raised as to whether Australia should extend the term of copyright protection to achieve parity with certain overseas trading partners. Several submissions argued in favour of extending the duration of the copyright term beyond the current formulation of 'life of the author plus 50 years'. These arguments reflect the recent extension of term in the United States and European Union.

International comparisons

European Union position

In 1995 the European Union extended the copyright term for its member states to the life of the author plus 70 years. This extension does not apply to sound recordings. The change is a consequence of a Directive of the European Commission in 1993, which required member states to increase their basic term of protection to this standard. Ostensibly, the purpose of the Directive was to harmonise the laws of European Union members, as national laws ranged from between life plus 50 years (the minimum Berne requirement), life plus 60 years (for example, Spain) and life plus 70 years (Germany). Rather than shifting down to the Berne standard, the Directive has gravitated to the term adopted under German law. It seems that this was done with limited substantive debate of the costs and benefits involved in adopting a longer term of protection.

United States position

The *Sonny Bono Copyright Term Extension Act* was passed by the United States Congress in 1998. The Act amends Title 17 of the United States Code. Prior to its enactment the basic term of copyright protection for ‘works’ (which under United States legislation is defined to include sound recordings) was 50 years after the death of the author. For ‘works made for hire’ the term was 75 years from the year of publication or 100 years from the date of creation, whichever was shorter. The Copyright Term Extension Act extends the term of protection for copyright works as follows:

- for works (other than works made for hire) created on or after 1 January 1978 the copyright subsists for the life of the author plus 70 years;
- for works made for hire created on or after 1 January 1978, the period of protection is the lesser of 95 years from the year of publication, or 120 years from the date of creation;
- for works created between 1923 and 1978, copyright lasts 95 years (provided copyright has been renewed where required);
- the legislation does not afford protection for works which at the time of its enactment were already in the public domain (i.e. registered or published prior to 1923).

The extension of term in the United States was also an effort to ‘harmonise’ with the European Union.¹³²

Cost-benefit analysis

The arguments put to the Committee in favour of extension of term pursue the general theme that Australia’s competitiveness is linked to maintaining parity with our trading partners in an increasingly globalised market.¹³³

¹³² See debates of *Sonny Bono Copyright Term Extension Act of 1998*, Pub L 105-298, 112 Stat. 2827, 141 CONG REC S3390 (daily ed, 22 Feb 1995).

¹³³ PPCA submitted that the ‘need for this cannot be overstated.’ interim report submission 42

The Copyright Agency Limited (CAL) stated that ‘Australia should extend the term of copyright protection to that which applies in the USA and the EU.

‘Increased globalisation and the Internet means that for Australian producers to remain competitive the term of protection of copyright in Australia should be harmonised with our major trading partners.’¹³⁴

Equally, the Australian Copyright Council stated in principle support for the extension of the term of protection from 50 to 70 years, and argued that ‘the main argument in favour of extending the term of protection in Australia is harmonisation of standards with Australia’s major trading partners. Australian rights owners would then benefit from the extended term of protection in the EU and the US’.¹³⁵ The Phonographic Performance Company of Australia (PPCA) also submitted that Australian industry is denied benefits of longer terms in our foreign markets because Australian law fails to give co-extensive protection.¹³⁶

Moreover, the Australian Publishers’ Association submitted that: ‘Extension will facilitate our position in the forthcoming WTO trade negotiations as Australia will be seen as a country which respects creativity and provides strong copyright protection in exchange for the invaluable contributions made by our creators.’¹³⁷ It also argued that as the Australian publishing industry really only ‘got underway’ in the 1970s, an extended period of copyright protection will allow the works to remain in print longer, and a relatively new canon of literary works will be made available to future generations.¹³⁸

However, other submissions argued strongly against such an extension of term, expressing concern over possible anti-competitive effects. The Queensland University of Technology suggested that longer copyright duration ‘is anti-competitive and monopolistic. It locks up access to works, prevents the creation of derivative works, the building upon prior work, and can even recall material from the public domain. Proponents of longer terms advance arguments about longer life expectancies for authors and creators, but these are specious; most copyrights with any commercial potential are owned by publishers, not individuals.’¹³⁹

Submissions were also put that such an extension would be ‘anti-competitive and monopolistic’¹⁴⁰ and that the additional period would impose unnecessary transactional costs for business and ultimately consumers—it would create significant barriers to access and innovation.¹⁴¹

The Australian Digital Alliance submitted that there is no good case for any extension of the term of copyright protection, and that Australia should not follow the European or United States’ lead in doing so.¹⁴²

¹³⁴ Issues Paper Submission 56, p. 7

¹³⁵ Issues Paper Submission 64, p. 7

¹³⁶ Issues Paper Submission 42

¹³⁷ Issues Paper Submission 56

¹³⁸ Interim Report Submission 29

¹³⁹ Issues Paper Submission 23, p. 2

¹⁴⁰ Interim Report Submission 45

¹⁴¹ Interim Report Submission 20

¹⁴² Issues Paper Submission 32; Interim Report Submission 17

The benefits to copyright owners from an extension of protection are negligible, particularly when balanced against the detriment to competition and innovation.

It is hard to perceive how a term of 'Life plus 70 years' provides any stronger incentive to individual creators than 'Life plus 50 years'.

The latter is a very substantial period of protection and remuneration. It is even harder to believe that business would increase its current investment in intellectual property on the basis of an extra twenty years or so of protection. What is easier to perceive is the difference that the extra time will make in terms of a negative impact upon access and, ultimately, further creative innovation.¹⁴³

During consultation, the Committee specifically sought from the Australian Copyright Council (which argued for an extension of the copyright term) evidence that an extension would confer benefits in excess of the costs it would impose. No such evidence has been provided. We also note the finding of the Office of Regulatory Review that increased protection:

- would represent an unjustifiable redirection of funds (rents) from Australian consumers without commensurate benefit;
- would result in net royalty flows to overseas authors and publishers; and
- that there is no evidence that it would provide incentive to produce works not already being produced.¹⁴⁴

The Committee notes that the Net Present Value of any change in the income that rights owners—currently deciding on the scale of their output—could expect to obtain as a result of the extension of term would be trivial. This is because it would be discounted at the relatively high private rate of time preference. It is highly questionable whether there would be a material supply response. However, as protection would be extended on the existing stock, the near-term infra-marginal transfers associated with extension would be significant. A substantial share of these transfers would flow overseas, and take the form of an effective deterioration in Australia's terms of trade.¹⁴⁵

Given this, the Committee does not see merit in the proposals that the term of copyright should be extended. Rather, in the Committee's view, Australia's general policy orientation should adhere to, but not exceed, TRIPS requirements.

¹⁴³ Issues Paper Submission 32, p. 8

¹⁴⁴ Office of Regulation Review, *An Economic Analysis of Copyright Reform*, Submission to CLRC, Canberra 1995, [also attachment to IPCRC issues paper submission 47], p. 5

¹⁴⁵ Additionally, while the supply response will depend on the NPV of the change in the income stream, discounted at the **private** rate of time preference, the net costs to society should be discounted at the lower, social rate of time preference.

Recommendations

Copyright term

The Committee is not convinced of the merit in proposals to extend the term of copyright protection, and recommends that the current term should not be extended.

We also recommend that no extension of the copyright term should be introduced in future without a prior thorough and independent review of the resulting costs and benefits.

The Digital Agenda Act—copyright in the Digital Age

The *Digital Agenda Act 2000*

The Digital Agenda Bill was passed by both Houses of Parliament on 17 August 2000, and received Royal Assent on 4 September 2000. The commencement date for the operation of the Act is 4 March 2001 (six months after Royal Assent). The purpose of the six-month delay is to allow affected parties to re-negotiate, where appropriate, current arrangements in light of the comprehensive amendments that the Act makes to the *Copyright Act 1968*.

The Committee notes that the Government has also proposed the operation of the legislation is reviewed within three years of its commencement (i.e. by March 2004).

History of the Digital Agenda Act

Following the release of a discussion paper in 1997, an Exposure Draft of the Bill was released. Significant comments were made on this Exposure Draft. The Copyright (Digital Agenda) Bill was first introduced into the House of Representatives in 2 September 1999. It was referred to the House of Representatives Standing Committee on Legal and Constitutional Affairs (the Andrews Committee). The Andrews Committee tabled an Advisory Report on the Bill in the House of Representatives on 6 December 1999.¹⁴⁶

The *Digital Agenda Act 2000* introduces a number of significant amendments to the Copyright Act, including the creation of a right of communication to the public, and the appropriate extension of existing exceptions to this new right.

A number of Government and Opposition amendments were made before the House of Representatives passed the Bill on 28 June 2000. Some amendments to the Bill made in the House of Representatives implemented the Government's response to the Advisory Report of the Andrews Committee, while others ensured that the Bill most effectively implemented the policy of the Digital Agenda reforms.

¹⁴⁶ The Standing Committee on Legal and Constitutional Affairs Committee report is available at <http://www.aph.gov.au/house/committee/laca/digitalagenda/contents.htm>.

As a result of further scrutiny of the Bill, and in response to additional concerns raised by interested parties, more amendments were made in the Senate. The majority of these amendments were technical in nature.¹⁴⁷

The Explanatory Memorandum for the Digital Agenda reform states that the central aim of the reforms in the Act is to ensure that copyright law continues to promote creative endeavour, while allowing reasonable access to copyright material on the Internet and through new communications technologies.

The Committee recognises that the Government undertook wide-ranging consultations when developing and amending the Digital Agenda Bill. Industry and other interests provided significant input to the Government regarding the Bill during its development. Therefore, the Committee does not propose to comment at length on the Act itself. The Committee further notes that the Bill was amended during the course of the inquiry, and various concerns expressed previously in submissions to the Committee have either been resolved or a compromise reached.

We did deal with several issues arising from the Digital Agenda Bill in our interim report, and revisit here those areas that retain their relevance, notably because they raise broader questions of policy.

Fair dealing

A number of general arguments have been put to the Committee regarding the operation of the Copyright Act in the digital environment—both in the context of the Digital Agenda Bill and Part I of the CLRC *Simplification Report* regarding exceptions to the exclusive rights of owners. It is convenient to discuss both the Digital Agenda Act and the CLRC report here.

Throughout the public consultation process, and in written submissions, it was put to the Committee that an extension of the existing ‘fair dealing’ exceptions to the digital environment, both in general and as contained in the (then) Digital Agenda Bill, would have a detrimental effect on the rights of copyright owners. Concerns were expressed particularly in relation to the library and archives provisions in the Digital Agenda Bill,¹⁴⁸ and the effect these amendments might have on developing online markets.

It was argued, in particular, that they would have a significant impact on competition in online markets for the sale or licensing of copyright works, and would allow libraries to compete directly, and implicitly unfairly, with copyright owners in the sale or licensing of copyright material in the digital environment.

What does the Copyright Act currently provide in relation to fair dealing?

The Copyright Act provides that certain copying is allowed as a limitation on the rights of copyright owners. In the current Act there are four fair dealing purposes:

- research or study (ss. 40 and 103C);
- criticism or review (ss. 41 and 103A);

¹⁴⁷ The amended Bill and explanatory material are available on the Parliament House web site at <http://www.aph.gov.au/legis.htm>. Copies of the Parliamentary debates, including the second reading speech can be found at <http://www.aph.gov.au/hansard/index.htm>.

¹⁴⁸ See the amendments to ss. 49 and 50 Copyright Act contained in Items 48–66 of the Digital Agenda Bill.

- reporting of news (ss. 42 and 103B); and
- professional advice given by a legal practitioner or patent attorney (s. 43(2)).

The most commonly used, and perhaps the most widely debated, aspect of fair dealing relates to the provisions regarding research and study. Fair dealing for research and study is determined by a set of non-exclusive factors, which are to be taken into account in determining whether a dealing is fair. For example, s. 40(2) states that the following will be considered to determine whether a dealing is fair for the purposes of research and study:

- a) of the purpose and character of the dealing;*
- b) the nature of the work or adaptation;*
- c) the possibility of obtaining the work or adaptation within a reasonable time at an ordinary commercial price;*
- d) the effect of the dealing upon the potential market for, or value of, the work or adaptation; and*
- e) in a case where only part of the work or adaptation is copied—the amount and substantiality the part copied taken in relation to the whole work or adaptation.*

The determination of a fair dealing in the context of research and study also includes the ‘quantitative test’ in s. 40(3) of the Act. That section currently states that, notwithstanding anything in s. 40(2), a dealing will be taken to be fair for the purposes of research or study:

- a) if the work or adaptation comprises an article in a periodical publication—of the whole or a part of that work or adaptation; or*
- b) in any other case—of not more than a reasonable portion of the work or adaptation.¹⁴⁹*

What does the Digital Agenda Act provide?

The Digital Agenda Act aims to appropriately extend both the fair dealing provisions and the ‘reasonable portion’ or quantitative test to online uses of digital material. However, the quantitative test has been modified in its application to literary and dramatic works in electronic form.

The Act introduces a new exception to the exclusive right of reproduction and copying for temporary copies, made as part of the technical processes of making a communication such as temporary copies made while transmitting material or viewing it on a screen.

The exception applies only to non-infringing communications and to temporary copies which have little or no independent economic significance.

In addition to the general provisions outlined above, the new Act extends existing exceptions which allow libraries, archives, galleries and museums to reproduce material in their collections for preservation and internal management purposes without obtaining the rights holder’s permission to the digitisation of material, and to making it available on an intranet for staff use only. Again, this is subject to safeguards for owners’ rights.

¹⁴⁹ Where there is a published edition of a literary, dramatic or musical work of not more than 10 pages, a ‘reasonable portion’ is up to 10 per cent of the number of pages, or if the work is divided into chapters, not more than 10 per cent or one chapter: s. 10(2) Copyright Act.

Cultural institutions are currently able to reproduce copyright material for preservation purposes. The new Act extends this to allow institutions to make these preservation reproductions in electronic form. It also allows institutions to display these preservation reproductions when the original work has deteriorated, been lost, or become so unstable that it cannot be displayed without risk of significant deterioration. However, these reproductions may also be displayed in circumstances where a user cannot copy or communicate the reproduction. The provisions which allow cultural institutions to supply any works for specific purposes (e.g. in response to a request by a user for the purposes of research or study) will now allow the electronic copying and transmission of that material, provided the librarian (or other relevant officer) is satisfied that another copy of the material is not available within a reasonable time at an ordinary commercial price.

If, however, the material supplied is less than 10 per cent of the original, the librarian will not be required to make any inquiries about the commercial availability of the work. The Digital Agenda Act extends existing exceptions, which allow cultural institutions to only supply works for specific purposes (e.g. in response to a request by a user for the purposes of research or study), to the new right of communication. Institutions may therefore exercise the exceptions by the electronic copying and transmission of material.

Currently, the library and archives exceptions in the Copyright Act contain safeguards to protect the markets of copyright owners. For example, if a user requests more than a reasonable portion of a work, a library may not fulfil that request unless the work is not commercially available (i.e. is not available within a reasonable time at an ordinary commercial price). The Act maintains that position in relation to works in hard copy format.

The Act applies the commercial availability test to supplying material in electronic form in response to a request for inter-library supply. For example, before supplying a reasonable portion of a work in electronic form, a library must ascertain that the particular portion (along with a reasonable amount of other material) is not available within a reasonable time at an ordinary commercial price. The same commercial availability test applies to the supply of an article in electronic form.

In addition, a library or archive must destroy any digital copy made for the purpose of meeting a request by a user or other library or archive. The stated policy objective behind this amendment is to prevent the accumulation of a free collection of copyright material in electronic form by libraries through the inter-library 'loan' system.

If material is acquired in electronic form, as part of an institution's collection, it may be made available online within the premises of the institution for viewing or printing out only.

Cultural institutions will still need to obtain the explicit permission (license) from copyright rights owners to:

- make material which was originally acquired in hard copy form generally available online to the public (irrespective of whether the making available occurs on the institution's premises); and
- make material acquired in electronic form generally available online to users not on the institution's premises or on the premises without the prescribed technical restraints on use.

Statutory licences for educational use under the Digital Agenda Act

The current statutory licences in Part VB and VA of the Copyright Act allow educational institutions to reproduce copyright material (without seeking explicit licence from a rights owner) for educational use—provided equitable remuneration is paid to the designated copyright collecting society, which should then remit it to the copyright owner. This amount may be set by the copyright collecting society and individual educational institutions, or by the Copyright Tribunal.

The Digital Agenda Act extends this statutory licence to the online environment to include copying material electronically and making it available to staff and students over an intranet for example.

The amended Act preserves the exceptions for insubstantial portions and temporary reproductions, and extends the educational statutory licence for broadcasts to the new communication right. The implementation of the Act will ensure that educational institutions can access, and promote access to, copyright material in an online environment.

If the amount of remuneration cannot be agreed between the institution and the Copyright Agency Limited (CAL) and/or Screenrights as the relevant collecting society, the Copyright Tribunal has jurisdiction to make a determination regarding the amounts payable.

Aside from this licence, educational institutions will still be able to negotiate licences directly with relevant copyright owners (which might include their own academic staff).

Library and archives

In our Interim Report, we expressed serious concerns that the library and archives restrictions may hinder libraries and archives from fully discharging their important function as disseminators of information in an online world. We recognised however, that the (then) provisions of the Bill might provide a reasonable balance between competing interests of rights holders and users.

International considerations

As stated above,¹⁵⁰ Australia has not signed the WIPO ‘Internet treaties’. However, the Government has indicated broad support for the aims of the Internet treaties, and in light of increasing globalisation and harmonisation efforts, the Committee considers that the broad international framework provides helpful context for a discussion of these issues.

The preamble to the WIPO Copyright Treaty (WCT) recognises the need to maintain a balance between the rights of authors and the wider public interest in education, research and access to information. The WCT redefines rights of reproduction and communication to the public, taking into account the advances of digital technology. It established several norms about applying copyright law in the digital environment,¹⁵¹ including:

¹⁵⁰ See ‘International obligations’ in *Copyright* above at p. 37

¹⁵¹ WIPO Copyright Treaty, available on line at <http://www.wipo.int/eng/diplconf/distrib/94dc.htm>. See Samuelson P, *The U.S. Digital Agenda at WIPO*, (1997) 37 VA. J. INT’L L. 369 (discussing the digital agenda WIPO treaty provisions), and Samuelson P, ‘Intellectual Property and the Digital Economy: Why the Anti-Circumvention Regulations Need to Be Revised’ (1999) 14 Berkeley Tech. L. J. 519, available online at http://www.sims.berkeley.edu:80/~pam/papers/Samuelson_IP_dig_eco.htm

- copyright owners should have an exclusive right to control the making of copies of their works in digital form;¹⁵²
- copyright owners should have an exclusive right to control the communication of their works to the public;¹⁵³
- countries can continue to apply existing exceptions and limitations, such as fair use, as appropriate in the digital environment, and can create new exceptions and limitations appropriate to the digital environment;¹⁵⁴
- merely providing facilities for the communication of works should not be a basis for infringement liability;¹⁵⁵
- it should be illegal to tamper with copyright management information insofar as this would facilitate or conceal infringement in the digital environment;¹⁵⁶ and
- countries should have ‘adequate legal protection and effective legal remedies against the circumvention of effective technological measures’ used by copyright owners to protect their works from infringing uses.¹⁵⁷

Consideration of the issues

There has been much debate surrounding the Digital Agenda reforms. Much of this debate centres on the desirability of extending the current exceptions for copying by libraries to the digital environment. The crux of the debate is that copyright owners believe that in a digital environment, libraries will compete in a developing market for digital material with the owners of copyright (either directly, or through licensing bodies).

As a copyright owner may be able to sell work online, charging a fee for material, owners perceive as ‘unfair’ the scope that libraries may have to supply this work without payment of any royalties or remuneration to the copyright owner under s. 49 of the Copyright Act.

It has further been argued that a library may be able to bypass the owner or rights holder altogether, and obtain a copy of that work from another library without payment under the provisions of s. 50—undermining the existing market and/or a developing market for copyright material online.

In other words, it has been argued that the library provisions of the Digital Agenda Bill (contained in the Exposure Draft of the Bill) had the potential to unduly limit the market for

¹⁵² An explicit provision on the reproduction right in the draft treaty was initially considered at WIPO, however, the provision did not gain consensus because of its inclusion of ‘temporary reproductions’, which was highly controversial. Instead, the diplomatic conference agreed on certain statements of interpretation of the treaty which included a provision on the reproduction right: see further, Samuelson P, ‘Intellectual Property and the Digital Economy: Why the Anti-Circumvention Regulations Need to Be Revised’ (1999) 14 Berkeley Technology Law Journal p. 519, footnote 46.

¹⁵³ WIPO Copyright Treaty, Art. 8. The Digital Agenda Bill introduces an exclusive right of ‘communication to the public’ into the *Copyright Act 1968*.

¹⁵⁴ Agreed Statements Concerning the WIPO Copyright Treaty, adopted by the Diplomatic Conference on Dec. 20, 1996, WIPO Doc. CRNR/DC/96 (Dec. 23, 1996) [‘Agreed Statements’], p. 1, 2

¹⁵⁵ Agreed Statements, above n 220, p. 2

¹⁵⁶ WIPO Copyright Treaty, Art. 12

¹⁵⁷ WIPO Copyright Treaty, Art. 11

copyright works to one sale. It has been claimed that this would ultimately lessen competition by restricting the growth of online transactions in copyright materials.

Two amendments specifically designed to address these concerns were inserted into the version of the Bill that was introduced into Parliament. As noted in our Interim Report, these amendments:

1. limited the supply of material in electronic formats by libraries to their existing holdings (i.e. rather than those acquired in future); and
2. introduced a modified ‘commercial availability’ test in relation to works in electronic form in a new s. 50(7B),¹⁵⁸ designed to alleviate the concerns of copyright owners and collecting societies regarding free inter-library supply of electronic material.

The Andrews Committee subsequently indicated its support for the extension of s. 49 to the online environment, and accepted the argument that libraries using current technologies are unlikely to be able to compete with commercial publishers, by virtue of the limited exceptions provided under the proposed amendments to s. 49.

However, the Andrews Committee believed that, given the pace of technological change, there is reason to expect that within a short time the particular arguments regarding the capacity of libraries to act as commercial publishers might no longer be sound.¹⁵⁹

Some observations on the role of libraries

The Committee believes libraries are more, not less, important in an information age. We are also convinced of the fundamental importance of allowing Australia’s libraries to act as a system built on a base of resource sharing and cooperation, if the goal of widespread access to information is to be achieved. It has long been the case that no library could aspire to an all-embracing collection and acquire all relevant material for users. If anything, new technologies, and the continued rapid growth in the knowledge base make it even more unlikely that such an aspiration could be fulfilled. As Sir Anthony Mason has said:

*The old expectation that a national library can maintain a comprehensive collection spanning all disciplines and subjects to satisfy the requirements of scholars is no longer sustainable.*¹⁶⁰

However, while undermining the classical notion of libraries as a comprehensive store of knowledge, the development of the ‘digital library’ creates new scope for libraries to provide effective access to widely dispersed information. As Sir Anthony Mason observes:

Australian libraries, in common with libraries elsewhere, are now participating in the technological advances which are taking place in computing and communications. Those technologies can provide secondary bibliographic resources, information about information and access to the holdings of other institutions. The technologies are

¹⁵⁸ Note that the existing s. 50(7A) already contains the commercial availability test.

¹⁵⁹ The Andrews Committee felt that s. 49 should not apply to the ‘first digitisation’ of works.

¹⁶⁰ Sir Anthony Mason, AC, KBE, *Reading the Future* Australian Library and Information Association (ALIA) Australian Library Week Oration, 1 May 1996, <http://www.nla.gov.au/nla/staffpaper/mason.html#now>

*expanding access to documents and information and are expediting the delivery of services, making materials available to a wide range of users throughout Australia, either directly or through other libraries and institutions.*¹⁶¹

*Electronic texts may not be as dominant outside the realm of information, though they will play a large part in the dissemination of ideas and in teaching where they can be easily combined with sound, movement and graphics.*¹⁶²

Sir Anthony further notes that:

*Today, throughout the world, libraries are contending with a variety of constraints upon their capacity to develop collections in an era where publications are expanding across an ever-widening landscape of subjects and forms. These constraints range from endemic funding limitations and storage inadequacies to the increased cost of acquisitions and subscriptions due to the pricing structure of very large international publishing and information groups... These structures have been reinforced by the merger of very large publishers. This has lifted the price of books and particularly serials way beyond the rise in inflation. The future of serials is in the balance. Technology may result in the article displacing the journal as the unit of library currency.*¹⁶³

Overall, Sir Anthony Mason states the core issue well when he says that the:

*...accessibility of electronic text on screen does, however, offer to libraries a potential solution to the growing problem of meeting the service demands of users. That would be a great improvement. But there may be copyright hurdles.*¹⁶⁴

It is these ‘hurdles’ that the Digital Agenda Bill sought to address.

Submissions

The Committee has been instructed to look at any restrictions on competition contained in any of the legislation covered by the Terms of Reference.¹⁶⁵ The mere fact that impediments to competition are identified, however, is not sufficient for us to recommend altering the status quo. It is necessary to also look at the costs and benefits, to business (including small business) and the economy generally, associated with those restrictions.¹⁶⁶

Several submissions strongly endorsed the Committee’s view in the Interim Report¹⁶⁷ that the balance historically struck between owners and users of copyright remains correct, with respect to fair dealing in the digital environment.¹⁶⁸ Fair dealing and copyright exceptions are

¹⁶¹ *Ibid*, <http://www.nla.gov.au/nla/staffpaper/mason.html#new>

¹⁶² *Ibid*, <http://www.nla.gov.au/nla/staffpaper/mason.html#age>

¹⁶³ Sir Anthony Mason, AC, KBE, *Reading the Future* Australian Library and Information Association (ALIA) Australian Library Week Oration, 1 May 1996, <http://www.nla.gov.au/nla/staffpaper/mason.html#now>

¹⁶⁴ <http://www.nla.gov.au/nla/staffpaper/mason.html#age>

¹⁶⁵ Terms of Reference paragraph (1)(b)

¹⁶⁶ Terms of Reference paragraph (1)(e)

¹⁶⁷ Interim Report, pp. 58 and 65

¹⁶⁸ Interim Report Submission 15; Interim Report Submission 17

a key part of the copyright balance, and have long played an important role in promoting access to information and ideas, particularly for purposes such as research and study. New technology does not change the importance of that balance, nor is it a reason for winding back the scope of fair dealing.¹⁶⁹ It is important to provide library users such as students and researchers with free but well-defined access to knowledge and information within the new communications environment.¹⁷⁰

Some submissions suggested that the fair dealing exception was not ‘fair’ in the digital environment, and that ‘digital is different’. One submitted that there should be a *presumption* that a dealing is not fair where more of the work is available (electronically or otherwise) within a reasonable time at an ordinary commercial price. It maintained that Government proposals to extend existing fair dealing and library provisions into the new digital marketplace are contrary to the WIPO Copyright Treaty, lacking in analysis, damaging to copyright commerce, and premature (given that industry licensing models are not yet fully developed).¹⁷¹

Effects of the library and archives provisions of the Digital Agenda Act

In 1996, Sir Anthony Mason pointed to the potential for competition between the library and the online service provider, saying that from ‘a commercial viewpoint, there could be no reasons why a particular provider would prefer not to make its service available through a library.

The new technology could bring about a direct relationship between author and user and exclude the publisher, unless the publisher can demonstrate that it has added value to the author’s text.’¹⁷²

Sir Anthony Mason also alerted us to some dangers this may prompt on the part of publishers: ‘There is a possibility that the publisher, whether copyright owner or holder of rights from such an owner, may make the electronic text available only to a particular institution and on terms whereby the text is not to be made available to other users. Whether there will be any greater incentive to follow such a course in the electronic age than there has been in the past remains to be seen.’¹⁷³

However, an examination of the limits in the Digital Agenda Act suggests to the Committee that on a proper reading of the amendments to ss. 49 and 50, libraries will probably not in fact be able to compete in the emerging market for the online delivery of copyright material.¹⁷⁴

Section 49 allows a library, on the request from a person requiring copyright material for the purposes of research and study, to supply:

- an article, or part of an article, contained in a periodical publication; or
- the whole or part of a work (other than an article contained in a periodical publication).

¹⁶⁹ Interim Report Submission 17; Interim Report Submission 20

¹⁷⁰ Interim Report Submission 20

¹⁷¹ Interim Report Submission 29

¹⁷² <http://www.nla.gov.au/nla/staffpaper/mason.html#age>

¹⁷³ <http://www.nla.gov.au/nla/staffpaper/mason.html#age>

¹⁷⁴ By this we mean that libraries will not be in a position to materially constrain the market behaviour of rights owners and more generally of publishers.

However, a library may not supply a copy of a work, or part of a work, that contains *more* than a reasonable portion of the work, if the person making the request can obtain a copy of the work within a reasonable time at an ordinary commercial price. Moreover, in the Act, the commercial availability test has been extended, as far as material in digital form is concerned, to an article, or part of an article, contained in a periodical publication.

The following limitations apply to libraries in their supply of works without infringing copyright:

- libraries can only copy for users who sign a declaration that they will use the copy for research or study;
- libraries can only supply an article from a periodical publication;
- libraries can only supply a reasonable portion of other works;
- libraries must destroy any intermediate digital copies made in the course of supplying to a user;
- libraries can only charge a cost recovery fee for their service; and
- penalties apply to breaches of these restrictions.

A library may therefore only supply two categories of material under s. 49: a reasonable portion of work or an article (or part of an article) contained in a periodical publication. (A library may supply more than a reasonable portion of work if it is not available within a reasonable time and at an ordinary commercial price).

A reference to a ‘periodical publication’ in the Copyright Act is to be read as reference to an issue of a periodical publication, and a reference to articles contained in a periodical publication is to be read as a reference to articles contained in the same issue of the periodical publication.¹⁷⁵

Much of the debate surrounding the extension of s. 49 to the online environment has concerned arguments that the supply of articles and portions of works is, or is becoming, a primary market in the digital environment.¹⁷⁶ A question arises as to whether, on a correct reading of s. 49, libraries can in fact compete in this primary market, even without the extension of the commercial availability test.

There is some question about whether an article, or series of articles marketed on a web site, are in fact an ‘article in a periodical publication’. It seems likely that an article contained in an e-journal or similar publication would be held to be an ‘article in a periodical publication’. In the Committee’s view, there is a strong argument that articles ‘published’ in an e-journal, or electronic periodical publication, should be treated in the same manner as traditional hard copy periodical publications.

¹⁷⁵ *Copyright Act 1968* s.10(3)(k)

¹⁷⁶ This has in fact been suggested by Sir Anthony Mason, AC, KBE, in Australian Library and Information Association (ALIA) Australian Library Week Oration, 1 May 1996, <http://www.nla.gov.au/nla/staffpaper/mason.html>

However, it seems more likely that a copyright owner who markets articles, or a series of articles on an individual web site independently of, or at least distinctly from the sale of subscriptions to a publication, would not in fact be held to be dealing with material conforming to the definition of an ‘article in a periodical publication’. In other words, such articles may be treated as individual ‘works’ for the purposes of the Act.

If an article is not ‘in a periodical publication’, it would be characterised as a ‘work’ for the purposes of the Copyright Act. Assuming this to be the case, a library could only supply a copy of the work in its entirety if the work was not available within a reasonable time at an ordinary commercial price.

If, as copyright owners argue, supply of these articles forms a primary online market, it is doubtful that a library would therefore be entitled to supply more than a reasonable portion of a work. The Committee therefore questions whether s. 49 does in fact give libraries the capacity to either harm or distort this emerging market.

In the Committee’s view, it is appropriate that people should have access to a reasonable portion of works for the purposes of research and study. Under s. 40(3) of the Copyright Act, a person is entitled to copy for the purposes of research and study, an article in a periodical publication, or not more than a reasonable portion of a literary or dramatic work. As discussed above, unless an article is held to be ‘in a periodical publication’, a library could not supply it in its entirety without infringing copyright.

Under the Digital Agenda Act, 10 per cent of the number of words constitutes a ‘reasonable’ portion of a work in electronic form. The Committee believes it is appropriate that libraries be allowed to supply electronic material for the purposes of research and study on this basis, which is in line with the Government’s stance on technology neutrality. Librarians, students and researchers rely on exceptions to access material in limited circumstances. In making this material available, they contribute to the dissemination of ideas, which is a foundation for a competitive economy, and promote continuing innovation. Reshaping this balance should not occur under the guise of technological innovation, absent compelling evidence that such a change in the balance would enhance community welfare.¹⁷⁷

Under the current provisions of the Bill, libraries may only employ the inter-library supply privileges granted by s. 50 in respect of material in electronic form if the copyright material concerned is not available within a reasonable time at an ordinary commercial price.¹⁷⁸

It is the Committee’s view that this provision will not harm or distort online markets, as libraries may obtain copyright material by virtue of s. 50 only if the material is not ‘commercially available.’¹⁷⁹

¹⁷⁷ See in support, Beard K, above n 109

¹⁷⁸ The commercial availability test will apply to all inter-library supplying of material in electronic form only, it does not and will not apply to inter library supplying in hard copy of articles from periodicals or up to a reasonable portion of a work.

¹⁷⁹ Several other submissions supported the Committee’s view that the provisions will not have the effect of destroying an emerging online market for articles and portions of works: Interim Report Submission 17; Interim Report Submission 15.

The Australian Digital Alliance (ADA) suggested that copyright collecting societies would enjoy a larger licensing monopoly if libraries could no longer rely on copyright exceptions to provide their services to researchers and students.¹⁸⁰

The Australian National Library refuted the assertion that libraries are in direct competition with rights owners for supply of digital material, and noted that such claims have not been based on any economic modelling. The commercial availability test limits supply, and the limitations contained in the provisions may in fact have an adverse impact on the ability of libraries to supply materials. In this respect, the Australian Library and Information Association (ALIA) noted that the Digital Agenda Bill goes further than ss. 49 and 50, as it restricts document supply to existing holdings—the practical effect being that a library cannot supply an article from the Internet or an article that is not contained in a periodical publication.

It also noted that the Digital Agenda Bill imposes heavy penalties for libraries in breach of copying provisions within the legislation.

The Government accepted in principle the recommendation of the Andrews Committee regarding digitisation, and has introduced stricter penalties for offences and infringements involving first digitisation. However it appears to the Committee that the Government has also sought to carefully preserve the operation of the existing fair dealing exceptions to the *Copyright Act 1968*.

CAL suggested that the library provisions in Copyright Act and Digital Agenda Bill are a ‘blunt instrument’ which allow systematic free riding access to works, and which is not legitimately subject of public interest exceptions.

CAL proposed a statutory licence which would operate in the same manner as educational statutory licence, as an alternative where there is a need to supply copyright material to consumers. The Copyright Tribunal could determine remuneration and license terms for this, and different fees might apply to different users (e.g. corporations). Alternatively, free library copying exemptions should always be subject to a test of their effect on the market.¹⁸¹

Cost-benefit analysis—fair dealing in the Digital Environment

Intellectual property rights, like other property rights, are created subject to limitations, which are imposed for a range of social, political and economic reasons. One of the factors taken into account when providing for some limitations is the economic and social desirability of promoting access to, and the wide dissemination of, information.

The Committee’s view is that the concerns expressed, notably by CAL, on the provisions of the Digital Agenda Act with respect to libraries, are overstated. As mentioned above, stringent safeguards apply to limit the material that can be supplied electronically and the purpose for which it can be supplied.

We believe that the provisions of the Digital Agenda Act will not, as has been claimed, have the effect of destroying, harming or distorting an emerging online market for articles and portions of works. In coming to this view, we note the comment in the Andrews Committee

¹⁸⁰ Interim Report Submission 17

¹⁸¹ Interim Report Submission 40

report that there is insufficient evidence at this time to suggest that libraries have the capacity to compete in the market for online document supply.

Under the terms of the Competition Principles Agreement, any effects on competition need to be assessed in the light of their costs and benefits. Given that:

- a) society already provides substantial direct and indirect subsidies to the creation of copyright material;
- b) the Committee does not believe that any direct dilution effect arising from these provisions would be sufficient to reduce the output or availability of copyright material;
- c) creators and the wider community have a longer-term interest in promoting the use of, access to, and dissemination of, information; and
- d) libraries and archives play a central role in the dissemination of information and in the system of education and research, which provides the indispensable basis for an open and competitive economy;

the Committee is not convinced that the costs of any indirect distortion outweigh the benefits to society as a whole.

In the short term, limitations placed on the rights of owners may seem to affect the income stream available to rights holders. However in the long term, it must be substantially in the interests of rights holders as a group to have a population and an economy capable of making productive use of ideas and information, thereby generating the income needed to cover the costs of developing new ideas. The dynamic effect of these limitations on the demand and value of rights, and/or the total stock of rights, is therefore likely to be substantially positive.

The Committee notes that the balance struck affords equity benefits for certain users. For example, the right to digitise information will permit students with a disability to access information that at present is inaccessible to them.¹⁸² A statutory licence is provided for organisations assisting people with print or intellectual disabilities and educational institutions to put copyright material into digital form.¹⁸³

Conclusions

It may be the case that, as technology changes, the balance struck in the grant and limitation of rights should also alter. However, this has always been a concern, and is not new to the digital environment. In the Committee's opinion it would be greatly premature—in the face of the many factors which will affect, or potentially affect, the market for copyright works in the digital environment—to alter the balance struck in the Copyright Act between owners and users of copyright material.

It is the Government's policy that the current balance in the Copyright Act is the appropriate balance to be extended into the digital environment. The Committee feels that there are no demonstrable reasons at this stage for altering this stance. However, as part of its three-year

¹⁸² Innes G, Deputy Disability Discrimination Commissioner of HREOC, Letter to Editor, 'Attorney-General Take a Bow', *The Australian*, 29 August 2000, p. 49

¹⁸³ This has been applauded: see D. Mason, Letter to Editor, 'Copyright Bill a Winner', *The Australian*, 29 August 2000, p. 49.

review of the Digital Agenda Bill, the Committee recommends that the Government examine whether the development of technology and new markets has altered the balance to detrimentally affect rights holders. It should also at the same time consider whether there is scope, without undermining the legitimate interests of rights owners, to remove some of the stringent restrictions the current legislation imposes on libraries and archives. The potential for the development of ‘digital libraries’ in Australia ought not to be compromised by unnecessary legislative prohibitions. The review should provide an opportunity to reconsider these issues in the light of emerging evidence as to the actual functioning of information markets and supply in an online environment.

The resolution of the balance between copyright owners and users is also relevant in considering the CLRC’s simplification reference, which recommends a more open-ended concept of ‘fair use’.

The Committee considers that elegance and simplicity of drafting should not replace the certainty that has emerged from the debate surrounding the Digital Agenda Act.

Definition of ‘library’

The APA¹⁸⁴ noted that if the Andrews Committee recommendation to delete the definition of ‘library’ in the Digital Agenda Bill was adopted, then unauthorised royalty-free electronic publishing would be open to corporations and other organisations without meeting any clear policy objective.

However the Australian Consumers Association expressed concern that the definition of library in the ‘Bill potentially alters the cost structure of libraries with possible ripple effects of degraded service and impaired collections for all consumers of library services, particularly students and consumers on the information poor side of the “digital divide” ... a stronger recommendation is warranted in this respect’.¹⁸⁵

We note that the Andrews Committee recommended, and the House of Representatives accepted the recommendation in passing the Digital Agenda Act, that the proposed definition of ‘library’ be removed from the Bill. The definition would have excluded the libraries of for-profit organisations from the library fair dealing exceptions.

Copyright users and libraries expressed concern that the proposed definition would disrupt many longstanding resource and information-sharing relationships that support Australia’s economic development.

However, copyright owners and producers argued for an even narrower definition of ‘library’ than the one originally introduced into the Digital Agenda Bill, and are concerned that the concept of ‘commercial library’ is absent from the operation of the fair dealing exceptions.

The Committee notes that the Government has left this issue to be further considered in the context of its response to the CLRC Report on *Simplification of the Copyright Act 1968*, but has ensured that the existing exceptions under the Act continue to operate.

¹⁸⁴ Interim Report Submission 29

¹⁸⁵ Interim Report Submission 2

The Committee is satisfied with the approach adopted under the Digital Agenda Act. It does not believe this approach should be varied without more substantive economic evidence than has been put to date. We recommend that, to the extent to which substantial evidence indicating a need for change becomes available, this issue should be revisited as part of the three-year review of the Digital Agenda Act.

Right of first digitisation: consideration of issues

In its report to the Government the Andrews Committee proposed a right of first digitisation.¹⁸⁶ The right has been adopted in principle by the Government, and was supplemented by the inclusion of heavier penalties for copyright infringements involving digitisation. However, the right is subject to fair dealing exceptions, and is therefore somewhat different from the right recommended by the Andrews Committee.

Many submissions endorsed the Committee's view, expressed in our Interim Report,¹⁸⁷ that the Bill be adopted *without* incorporation of the Andrews Committee's proposed right of 'first digitisation.'¹⁸⁸

However, the Act does provide that the copyright owner has the exclusive right to convert copyright material into electronic form, although it might well be argued that this has always been part of the exclusive right to reproduce copyright material.

This is discussed further below in the section dealing with the *Standing Committee on Legal and Constitutional Affairs Report into Enforcement of Copyright*.

This proposed right of first digitisation concerned users who argued that print-to-digital reproduction will play a major part in future information delivery. The National Library of Australia¹⁸⁹ noted that digital copies are often made as means of timely and cost-effective delivery to end users and are 'always destroyed immediately after transmission'. It argued that any exclusive right of first digitisation would prevent libraries using digital transmission and will have a severe effect on timely provision of material (for example, to students for study).

The Committee also questions the concept of first digitisation. It is not clear to us that the concept of first digitisation is outside recognised grounds of infringement by reproduction. Proposed s. 21(1A) of the Digital Agenda Bill stated that the conversion of copyright material from print to electronic form constitutes a reproduction for the purposes of the Copyright Act. Therefore, if such a conversion occurs without the permission of the copyright owner, it is already an infringement of the copyright owner's exclusive right of reproduction.¹⁹⁰

The effect of the first digitisation proposals, as set out by the Andrews Committee, was therefore to seek to narrow the fair dealing exceptions in the Copyright Act in circumstances

¹⁸⁶ see further discussion below

¹⁸⁷ Interim Report, p. 64

¹⁸⁸ Interim Report Submission 2; Interim Report Submission 45; Interim Report Submission 15; Interim Report Submission 17; Interim Report Submission 20

¹⁸⁹ Interim Report Submission 15

¹⁹⁰ This may not fully exhaust all aspects of the proposed right of communication to the public—that extends the ability to make reproductions under the fair dealing provisions to the right of communication to the public (which includes 'making available online').

where the exercise of the exceptions involves the conversion of copyright material from print to digital formats.

The Andrews Committee itself pointed out that the recommendation on first digitisation may have unforeseen effects, and agreed that it is vital that ‘the balance between the interests of copyright owners and users be reviewed in three years time, as the Government proposes.’¹⁹¹

On the other hand, publishing interests, such as APA, were in strong agreement with the Andrews report and recommended adoption of the right of first digitisation. The APA suggested that any decision to convert a work from analogue to digital form must be the copyright owners’. This, it was said, is required to (for example) ensure that a work could be published in a suitable format that includes rights-management information attached to it.¹⁹²

Recommendations

Fair dealing and the Digital Agenda Act

The Committee believes the Digital Agenda Act strikes a reasonable balance between the interests of copyright owners and the interests of users of copyrighted material. We stress the importance to the Australian community of ensuring that libraries can discharge their functions as disseminators of information in an online world. The Committee does not believe that the libraries and archives provisions of the Act will detrimentally affect the capacity for development of online markets.

However, we recommend a thorough examination of the effects of the library and archives provisions on markets, including libraries and archives, and end-users of copyrighted material as part of the Government’s proposed three-year review of the operation of the Digital Agenda Act. We also recommend that the operation of the new right of first digitisation and its effects on the market place and on consumers be considered in the three-year review.

Anti-circumvention rules

The Act makes provision for anti-circumvention rules. These implement the obligations Australia would have if it signs the WIPO Copyright Treaty.

Copyright interests have expressed concern that because of the ‘permitted purposes’ exception to circumvention devices, there will be a black market for such devices. Purchasers of circumvention devices are required merely to sign a declaration that the intended use is a permitted purpose. This concerns some interests because there are no controls other than creation of the offence of making false declaration, and no controls at all in relation to

¹⁹¹ Andrews Committee Report para 1.33

¹⁹² Interim Report Submission 29

selling second hand. It has consequently been put that the permitted purposes exemption should be removed.¹⁹³

However, others have suggested that although the Government has heeded some concerns of digital economy firms by including certain exceptions to authorise certain types of ‘legitimate circumvention’, those exceptions may be too narrow or specific. They should be supplemented by a more general ‘other legitimate purposes’ exception.¹⁹⁴

International considerations

Article 11 of the WCT and Article 18 of the WIPO Performances and Phonograms Treaty (WWPT) require that there be ‘adequate protection and effective legal remedies against the circumvention of effective technological measures’.

What does the Digital Agenda Act provide?

Existing exceptions in the Copyright Act allow users to lawfully carry out activities such as reproducing parts of work for purposes of research or reproducing a computer program for the purpose of IT security testing. A limited number of these exceptions have been preserved in relation to circumvention devices and services to enable copyright users to continue to have legitimate access to protected works in some circumstances.

The provisions allow access to circumvention devices to reproduce computer programs for the purposes of making interoperable products, security testing or error correction. Libraries may have access to these devices to lawfully reproduce works for users, or for purposes of supplying inter-library loans.

Use of circumvention devices may also be allowed in educational institutions, in those institutions assisting people with a disability and for the services of Government.

Consideration of issues

Copyright law strikes a delicate balance between users and owners. Some owners are taking matters into their own hands by increased use of technological means to ‘lock up’ works, for example by relying on encryption devices. Access devices assist in circumventing these locks, and are sometimes used by libraries to preserve electronic documents and information for future generations.¹⁹⁵

The Australian Consumers Association has stated: ¹⁹⁶

[rights holders use of the term] ‘the end of copyright’ suggests some kind of free for all. However the opposite is more likely. The end of copyright is likely to be the far more rigorous control of access, not using copyright law, with its guarantee of

¹⁹³ Interim Report Submission p. 29

¹⁹⁴ Oral submission made to the Committee (at Copyright roundtable). This point has also been raised in relation to the exceptions contained in the US Digital Millennium Copyright Act: see Samuelson P, ‘Intellectual Property and the Digital Economy: Why the Anti-Circumvention Regulations Need to Be Revised’ 14 Berkeley Tech. L. J. 519 (1999).

¹⁹⁵ Beard K above n 109

¹⁹⁶ Interim Report Submission 2

consumer rights, but via technology and contract, leaving a much slimmer margin for consumer interests. There are many threats to consumer rights of access to material in the digital future. Intrusive rights management systems, pay per view environments and comprehensive monitoring of usage with accompanying violations of privacy are all serious concerns...Therefore serious review of intellectual property regimes...[is] essential before the balance is tipped away from consumers.

The Committee recognises that circumvention devices are useful for systems administration, security checking and software development. However, their use can also include allowing access to copyright material without meeting obligations set out in the virtual lock.

The Government has recognised that there is a need to limit who can purchase circumvention devices and to implement regulation procedures for such purchases. At the same time, the Government has enacted in legislation strong penalties for misuse or wrongful purchase. It could be said that a ban of trafficking in circumvention devices is more effective and practical than a ban on the activity of circumvention itself. The Government's view is that proscribing use of devices and services would be difficult to enforce and would intrude unnecessarily into the private sphere.

Recommendations

Technological locks

The Committee is broadly satisfied that the Government's approach to the issues associated with technological protection measures preserves a reasonable balance between competing interests. However, we would be concerned if the use of technological locks, perhaps accompanied by greater reliance on contract, were to displace or in any way limit the effectiveness of fair dealing provisions. As a result, the Committee urges that the review of the provisions of the Digital Agenda Act encompass a careful consideration of the evolving role of technological measures in the copyright system.

Copyright protection of computer software

A computer program is afforded protection under the Copyright Act as a 'literary work', which is defined in section 10 of the Act to include:

- (a) a table, or compilation, expressed in words, figures or symbols (whether or not in visible form); and*
- (b) a computer program or compilation of computer programs.*

A 'computer program' in turn means:

...an expression, in any language, code or notation, of a set of instructions (whether with or without related information) intended, whether directly or after either or both of the following:

- (a) conversion to another language, code or notation; or*

*(b) reproduction in different material form;
to cause a device having digital information processing capabilities to perform a particular function.*¹⁹⁷

The Copyright Amendment (Computer Programs) Act 1999

The amendments to the Copyright Act introduced by the *Copyright Amendment (Computer Programs) Act 1999* ('Computer Programs Act') provide incentives for copyright owners of computer programs to make information about their programs available for the purposes of making compatible products and for security testing computer networks. If this information is not reasonably available, the amendments allow others to decompile programs for the specified purposes. Decompilation will also be allowed to correct errors in a program if an error-free version is not reasonably available.

Amendments to the Act do not permit decompilation for any other purpose (such as producing software which replicates the original product). Information derived through decompilation can only be used for specified purposes. These changes do not weaken existing sanctions for computer software piracy.

Amendments were also made to the existing provisions of the Act allowing back-up copying of computer programs, and allowing copying of computer programs that occurs in the course of their normal use and to study their ideas and operation when running them.

The amendments now allow the owner or licensee of a copy of a computer program (or a person acting on their behalf) to make the following reproductions of computer programs without such a reproduction constituting an infringement of the copyright in the program:

- a reproduction during the normal use of the program (i.e. in the course of running a copy of the program for the purposes for which it was designed). This does not apply if such a reproduction would be contrary to an express direction or licence from the copyright owner (s. 47B(1) and (2));
- a reproduction in the course of running a lawful copy for the purpose of studying the ideas behind the program and the way it functions (s. 47B(3));
- a back up copy of a computer program (s. 47C); or
- a reproduction for the purpose of correcting an error in the original copy that prevents it from operating as intended by the author, or in accordance with specifications. The reproduction must only be made to the extent necessary to correct the error, and only if an error-free version is not available within a reasonable time at an ordinary commercial price.

¹⁹⁷ Note: the Digital Agenda Bill replaces the definition of 'computer program' with the following definition: 'a set of statements of instructions to be used directly or indirectly in a computer in order to bring about a certain result.' Item 47AB of the Digital Bill defines computer program (in respect of Division 8) as including 'any literary work that is (a) incorporated in, or associated with, a computer program; and (b) essential to the effective operation of a function of that computer program'.

The Computer Programs Act also provides for the reproduction or adaptation of computer programs for the purposes of interoperability, without such a reproduction constituting an infringement of the copyright in the program. Section 47D provides that to be exempt, a reproduction or adaptation:

- a) *must be made by or on behalf of, the owner or licensee of the copy of the computer program;*
- b) *must be made for the purpose of obtaining information necessary to enable the owner or licensee to make independently another program, or an article, to connect to and be used together with, or otherwise to interoperate with, the original program or any other program;*
- c) *must be made only to the extent reasonably necessary to obtain the information referred to in (b).*

Section 47D also provides that, to the extent that the new program reproduces or adapts that original program, it must do so only as far as necessary to enable the new program to connect to and be used together with, or otherwise to interoperate with, the original program or the other program [s. 47D(d)]; and that the information referred to in paragraph (b) is not readily available from another source when the reproduction or adaptation is made.¹⁹⁸

Decompilation for the purposes of interoperability

Interoperability of software, and the ability to create new products or compatible products, is a matter of great concern to the software industry. This involves important issues related to competition.

Competitive conditions in the supply of software are affected to a greater or lesser degree by what economists refer to as ‘network effects’.¹⁹⁹ A network effect exists when, other things being equal, consumers would rather join a larger than a smaller network. The most direct way in which a network effect arises is when consumers obtain value as other users adopt the same service, or compatible ones. The classic example of a network effect is that telephone users benefit from being connected to the same network as others: there is little point having a telephone if one is unable to reach, or be reached, by others. Similarly, computer users value the fact that others use the same computer operating system (such as Windows) since this makes sharing files possible. As a result, consumers will, all other things being equal, place a greater value on joining whichever network is larger—for example, choosing Windows over other competing programs because Windows allows them to interact with a greater base of other users. One consequence of this is that where network effects are significant, and are appropriable by individual producers (for example, through ownership of intellectual property rights), competition can become ‘tippy’, with a supplier gaining dominance not because of the inherent merit of their goods or services but because they attains a critical mass which consumers—who would otherwise have purchased from a

¹⁹⁸ Note: the Digital Agenda Bill includes acts permitted under the Computer Programs Act as ‘permitted purposes’ for which circumvention devices may be supplied. This should operate to prevent copyright owners using technological measures to prevent the operation of the decompilation provisions contained in the Computer Programs Act.

¹⁹⁹ A useful overview of this concept is presented in Liebowitz and Margolis (1999) *Winners, Losers and Microsoft: Competition and Antitrust in High Technology*.

competitor—shift towards in large numbers.²⁰⁰ The resulting equilibrium can be difficult to change if challengers to the dominant standard trying to attract users, need to compensate them for foregoing the benefits of the incumbent network.²⁰¹

In these circumstances, intellectual property rights could impose significant efficiency costs, by precluding competitors from offering products compatible with those supplied by the incumbent. To begin with, the standard allocative efficiency loss will be greater than is conventionally the case. This is because the higher price the incumbent (sheltering under the protection of the intellectual property right) can charge imposes welfare losses not only on marginal users, but—through foregone network effects—on infra-marginal consumers as well. Additionally, there may be dynamic efficiency losses as products that are superior may take longer to displace less meritorious products, if they can displace them at all. An argument with obvious implications for copyright protection of software flows from these observations: that intellectual property protection should be weaker for products in which network effects predominate.²⁰²

Without endorsing this proposition as a general matter, it provides strong grounds for ensuring that copyright protection is not used to prevent competition by precluding new programs from inter-working with those already in the market.

Reflecting these considerations, section 47D of the Computer Programs Act is designed to allow the reproduction or adaptation of a computer program to make a product which is interoperable with the original.

The Committee has considered whether these provisions should in some way be linked to a test for market power—that is, whether the requirement of allowing decompilation for the purpose of inter-operability ought to be limited to software where the exclusion of such inter-operability has the effect or likely effect of substantially lessening competition.

The Committee believes there is an argument for such a restriction in the scope of the provisions. However, it notes that the provisions at issue are relatively new, and their effect is still to be determined. It also notes that the Copyright Act generally places great weight on providing certainty about the scope of the rights and obligations that arise under the Act.

We see merit in that certainty, as is apparent from the approach we have adopted to fair dealing, in that it reduces the compliance and enforcement costs associated with the rights. While such an approach may be under or over-inclusive—relative to the reach of provisions that would be determined in a world where the costs of determining appropriate compliance was zero—it represents a reasonable compromise in an environment where those costs can be relatively high.

²⁰⁰ The concept of tipping was set out in Schelling (1978) *Micromotives and Macrobbehaviour* and its consequences for collective action are well explained in Elster (1989) *Nuts and Bolts for the Social Sciences*, 101ff.

²⁰¹ See, for example, Owen and Wildman (1992) *Video Economic*, 260ff.

²⁰² See Farrell (1995) *Arguments for weaker intellectual property protection in network industries*, 3 *Standard View* 46, and, more generally Church and Ware (1999) *Network Industries, Intellectual Property Rights and Competition Policy*.

As a result, the Committee is not convinced that there is merit at this time in limiting the reach of the provisions through reliance on a case-by-case competition test.

Recommendation

Copyright protection of computer software

The Committee supports the introduction of amendments to the Copyright Act to allow decompilation for the purposes of interoperability. We recommend that the Government review the operation of the Computer Programs Act to ensure that the wording of the amendments permits all legitimate acts necessary to allow the creation of interoperable products.

The High Court and decompilation: *Data Access v Powerflex*

In September 1999, the High Court handed down judgment in the *Data Access v Powerflex* case.²⁰³ Perhaps the two most significant findings in this case were that:

- commands contained in a computer program did not constitute a computer program for the purposes of the Copyright Act; and
- a compression table contained in a system of computer programs could be a literary work for the purposes of the Copyright Act.²⁰⁴

The first finding is largely consistent with the policy objectives behind the interoperability provisions introduced into the Copyright Act by the Computer Programs Act.

However the finding regarding the compression table may raise problems for developers of interoperable products in Australia.

The High Court found that the compression table contained in the Dataflex system was a protected literary work, and that Powerflex had reproduced it in breach of the Copyright Act, notwithstanding that it had not copied it, but rather devised an ingenious process to replicate it.²⁰⁵

The High Court commented on the potential impact of the decision regarding compression tables on the development of interoperable products in Australia. The Court stated: ‘The finding that the respondents infringed the appellant’s copyright in the Huffman table embedded in the Dataflex program may well have considerable practical consequences. Not only may the finding affect the relations between the parties to these proceedings, it may also have wider ramifications for anyone who seeks to produce a computer program that is compatible with a program produced by others. These are, however, matters that can be

²⁰³ *Data Access Corporation v Powerflex Services Pty Ltd & Ors*, High Court of Australia, HCA 49 (30 September 1999), M113/1997

²⁰⁴ Such a compression table could be a ‘table or compilation, expressed in words, figures or symbols (whether or not in visible form)’ and therefore meet the definition of a ‘literary work’ in s. 10(1)(a) of the Copyright Act.

²⁰⁵ Issues Paper Submission 53, p 14

resolved only by the legislature reconsidering and, if it thinks necessary or desirable, rewriting the whole of the provisions that deal with copyright in computer programs'.²⁰⁶

Consideration of issues

Submissions called for clarity in the protection afforded to computer technology and practical solutions.

Some submissions suggested that the current Copyright Act (as amended by the Computer Programs Act) is too wide, and 'may be widened for no other reason than that interoperability is the desired policy outcome'. It was refuted that entire reproductions or adaptations of works should be permitted for achieving 'first generation product' as this would 'completely and irreparably undermine copyright in computer programs.'²⁰⁷

However the ADA rejected the submission that the amendments devalue the level of copyright protection in Australia, and stated that 'the 1999 amendments now make it possible for Australian developers to create innovative, interoperable products without the risk of unreasonable claims of copyright infringement from existing dominant vendors in the software industry.'²⁰⁸

Some submissions raised the *Connectix* case, as an illustration of possible shortcomings in the Australian legislation. That particular (United States) case dealt with the reverse engineering of a product to make a substitute product (functional equivalent):

... if the type of issues that arose in the Connectix case came before an Australian courts, it is possible that an emulator developer would have cause for concern. As the recent Powerflex case demonstrated, reverse engineering rights are very difficult to establish under Australian copyright law. It is doubtful whether recent amendments to the Copyright Act would change this situation.

*Under s 47D of the amended Act, a person may reverse engineer copies of a program owned by someone else, but only if they intend to make a product that interoperates with that program...the right would not be available to Connectix in Australia because the VGS does not interoperate with the PlayStation console code. It is a substitute for it...In Australia, it would appear that the development of emulators such as the VGS is not fair play under current laws. This has serious implications for Australian software developers as they cannot compete in the international market in the same way as their overseas counterparts can.'*²⁰⁹

Possible solutions²¹⁰ to overcome the negative consequences of the High Court's finding on the compression table in the *Powerflex* case include:

- amending s. 47D(d) to cover program-to-*file* interoperability (which arose in the *Powerflex* case), not merely program-to-*program* interoperability; and

²⁰⁶ *Data Access Corporation v Powerflex Services Pty Ltd & Ors*, High Court of Australia, HCA 49 (30 September 1999) per Gleeson C J, McHugh, Gummow & Hayne J J at p. 42

²⁰⁷ Interim Report Submission 25

²⁰⁸ Interim Report Submission 17

²⁰⁹ Interim Report Submission 1

²¹⁰ Interim Report Submission 17

- including a provision modelled on 17 U.S.C. s. 112(b), confirming that, where idea and expression merge in a functional element of a computer program (e.g. a compression table), that element is treated as unprotectable for copyright purposes.

The Committee believes, and has received submissions in support²¹¹, that the Government should review the computer programs provisions to ensure they permit all legitimate acts necessary to achieve interoperability.

Compilations and databases

In our Interim Report, we posited the removal of compilations from the category of literary works. IBM has submitted²¹² that compilations should *not* be removed from the definition of literary works. Australia would otherwise be out of step with law in other jurisdictions.

IBM argues that the definition of ‘compilation’ is important to the development of databases and intellectual property protection in e-commerce.

Telstra v Desktop Marketing Systems

We note that Telstra is taking action against a Melbourne software company, Desktop Marketing Systems Pty Ltd (DtMS) in the Federal Court. It has alleged breach of copyright in Telstra’s White and Yellow pages. DtMS is producing a CD-ROM directory service, and Telstra has asked the company to desist from this activity. DtMS in turn is accusing Telstra of anti-competitive conduct in the directories industry (which it alleges involves revenues in the order of \$100 billion a year). DtMS says that copyright does not subsist in any data in the White/Yellow pages and that there is no copyright applying to the information, which is merely constituted by facts in the public domain.

Further, it alleges that Telstra cannot claim copyright as it is required by law to produce the directories. Telstra argues that copyright subsists in literary works, which include compilations (even if copyright does not exist in individual entries), and that it does not have to prove that information in the White and Yellow pages is original or inventive.

The Committee notes that no judgment has been handed down at the time of this report, but anticipates that this case may clarify the position with respect to copyright protection of databases in Australia.

²¹¹ Interim Report Submission 17; Interim Report Submission 1

²¹² Interim Report Submission 25

Recommendation

Protection of compilations and databases

We recommend that Australia's position in negotiations on the issue of protection of compilations and databases—as part of WIPO negotiations and the Agreement on Trade-Related Aspects of Intellectual Property Rights 1994 (TRIPs)—be determined by a cost/benefit analysis to Australian society.

Caching—temporary reproductions

Description of the right

The Digital Agenda Act inserts a new s. 43A(1) into the *Copyright Act 1968*, which provides that:

*...the copyright in a work, or an adaptation of a work, or an adaptation of a work, is not infringed by making a temporary reproduction of the work or adaptation as part of the technical process of making or receiving a communication*²¹³

Some have argued that it is unclear whether 'forward' or 'proxy' caching would be covered by this exception. This type of caching involves a deliberate choice on the part of the ISP, and is often done for economic reasons. As a result, it may not form part of the technical process of making material available online. Although untested in the courts, there is a strong argument that these caching practices may amount to an infringement of copyright. The electronic reproduction of a web site and storage on a server is likely to infringe the copyright owner's reproduction right.

There are many different types of caching. In the context of a PC, to cache something means to improve the speed of access to it by moving it nearer to the central processing unit.²¹⁴ Forward or proxy caching involves the deliberate selection of web sites to be loaded into an ISP's proxy server. For example, a 'cache server' is a dedicated network server or a service within the server that caches web pages to speed up access to information that has already been reviewed by a previous user.²¹⁵

ISPs can also engage in 'permanent proxy caching' where a popular web site is stored on the ISP's server, making access to the site easier and quicker for its customers.²¹⁶

This type of caching can provide significant benefits to Internet users, including improved network capacity, reduced connectivity times, and increased speed of access to sites. Given that consumers in the Internet market often use speed of connection as a criterion in selecting

²¹³ Current Subsection 43A(2) *Copyright Act 1968* states that s. 43A(1) does not apply if the making of the communication is an infringement.

²¹⁴ Tech Encyclopedia, <http://www.techweb.com/encyclopedia>

²¹⁵ Tech Encyclopedia, <http://www.techweb.com/encyclopedia>

²¹⁶ See Garlick M and Nicoll R, 'Proxy Caching—The New Fair Dealing? Proxy Caching Explained' (1999) 3 *Telemedia* 13.

an ISP, caching may be of significant commercial benefit. However, the practice may have implications for owners of rights in web sites in terms of: accuracy of the cached site; the effect on advertising revenue measured by the number of ‘hits’ on a site; the currency of any advertising material displayed on the cached site; and the capacity of the web site owner to implement effective risk management procedures if online liability issues arise.

The Committee has received a number of submissions on the issue of caching, suggesting that legislation ought to be introduced to clarify (or amend) the legal position of this type of caching under the Copyright Act.

Some submissions argue that if this type of caching provides an economic benefit to ISPs, then copyright owners should be remunerated for the reproductions of the web sites involved. Others argue that caching provides an important service for Australian Internet users, allowing faster connection times, reduced bandwidth requirements and allowing the efficient development of e-commerce in Australia.

International approaches to proxy caching

Although it has not been signed by Australia, and still requires 30 signatures to come into effect, the WIPO Copyright Treaty established several norms about applying copyright law in the digital environment.²¹⁷

Those relevant to the issue of caching include:

- copyright owners should have an exclusive right to control the making of copies of their works in digital form;²¹⁸
- copyright owners should have an exclusive right to control the communication of their works to the public;²¹⁹
- countries can continue to apply existing exceptions and limitations, such as fair use, as appropriate in the digital environment, and can create new exceptions and limitations appropriate to the digital environment;²²⁰ and
- merely providing facilities for the communication of works should not be a basis for infringement liability.²²¹

²¹⁷ WIPO Copyright Treaty is available on line at <http://www.wipo.int/eng/diplconf/distrib/94dc.htm>. See generally Samuelson, P, *The U.S. Digital Agenda at WIPO*, (1997) 37 VA. J. INT'L L. 369 (discussing the digital agenda WIPO treaty provisions), and Samuelson P, 'Intellectual Property and the Digital Economy: Why the Anti-Circumvention Regulations Need to Be Revised' (1999) 14 Berkeley Tech. L. J. 519, available online at http://www.sims.berkeley.edu:80/~pam/papers/Samuelson_IP_dig_eco.htm

²¹⁸ An explicit provision on the reproduction right in the draft treaty was initially considered at WIPO, however, the provision did not gain consensus because of its inclusion of 'temporary reproductions', which was highly controversial. Instead, the diplomatic conference agreed on certain statements of interpretation of the treaty which included a provision on the reproduction right: see further, Samuelson P, *Intellectual Property and the Digital Economy: Why the Anti-Circumvention Regulations Need to Be Revised* (1999) 14 Berkeley Tech. L. J. 519, footnote 46.

²¹⁹ WIPO Copyright Treaty, Art. 8. The Digital Agenda Bill introduces an exclusive right of communication to the public into the *Copyright Act 1968*.

²²⁰ Agreed Statements Concerning the WIPO Copyright Treaty, adopted by the Diplomatic Conference on Dec. 20, 1996, WIPO Doc. CRNR/DC/96 (Dec. 23, 1996) ['Agreed Statements'], at 1, 2

²²¹ Agreed Statements, above n 220, at 2

United States: *Digital Millennium Copyright Act 1999*

Title II of the Digital Millennium Copyright Act adds a new s. 512 to the United States Copyright Act to create additional limitations on liability for copyright infringement for service providers.

To be eligible for the benefit of the limitation, the service provider must adopt and implement a policy of terminating accounts of repeat infringers, and must accommodate and not interfere with standard technical measures.

In general terms, s. 12(a) limits liability of service providers where the provider is merely a data conduit, and covers acts of transmission routing, or providing connections for the information, as well as the intermediate and transient copies made automatically in the operation of the network. The party relying on the s. 512(a) limitations must be a 'service provider.'²²²

In relation to caching, s. 512 (b) limits the liability of service providers for retaining *for a limited time* copies of material that have been made available online by a person other than the provider, and then transmitted to a subscriber on demand.

The service provider retains the material so that subsequent requests for the same material can be fulfilled by transmitting the retained copy, rather than retrieving the material from the original source on the network.

The liability limitations in the Digital Millennium Copyright Act only apply where a service provider meets the Act's specific requirements. Where they do not, the service provider will risk liability under direct, contributory and vicarious liability for copyright infringement.

European Commission: directive on copyright and related rights in the information society

The European Union reached a political agreement on 8 June 2000 on a Directive on Copyright and related rights in the information society.²²³

The European Union Directive provides an exception to infringement for service providers, telecommunications operators and certain others in limited circumstances for particular acts of reproduction, which are considered technical copies.

Those acts of reproduction must form an essential part of a technological process and take place in the context of a transmission in a network.

²²² i.e. 'an entity offering the transmission routing or providing of connections for digital online communications, between or among points specified by a user, of material of the users choosing, without modification to the content of the material as sent or received.' For the other three limitations in s. 512, a service provider is defined as 'one who provides online service or network access or the operator of facilities thereof'.

²²³ O.J. 17.7.00 L178/1. The Directive must be implemented by 17 January 2002. Procedurally, the proposed Directive will now be the subject of a formal Common Position, due to be adopted by the Council without discussion and then go to the European Parliament for a second reading under the co-decision procedure.

The Directive seeks to ensure that there will be effective operation of the World Wide Web for those who place copyright material on the net and those who transmit or carry such material.

The European Union has adopted an ‘exhaustive’ list of exceptions to the reproduction right and right of communication to the public, rather than open-ended defences. This means that no other exception may be applied. Adopting the exceptions is optional at the national level, (i.e. member states may adopt any or all of them) provided that copyright holders receive fair compensation for particular exceptions and in certain circumstances.

Cost-benefit analysis and discussion

The Committee recognises that web sites are capable of attracting protection under the Copyright Act. As such, *prima facie* it is an infringement of copyright to reproduce such sites without the permission of the copyright owner. We also note the introduction of new s. 43A and s. 111A into the Copyright Act by the Digital Agenda Act. These are designed to address temporary reproductions.

In our view, the practice of forward caching is, in general, unlikely to be considered creating ‘temporary reproductions’, and hence potentially attracts liability under the Act.

A number of arguments have been raised to suggest that copyright owners may suffer harm due to proxy caching practices by ISPs. However, it has also been argued that technological solutions are, or will soon be, available to enable web site creators to prevent unwanted caching on their sites, or to impose technological restraints on how their sites may be cached.

Most submissions on this topic acknowledged that caching improves the efficiency of the Internet²²⁴ Caching is economically efficient: it reduces waiting time and bandwidth requirements, allowing greater efficiency in using finite network resources, and reducing costs. It provides important benefits to Internet users and to the development of e-commerce in Australia.²²⁵

Several submissions expressed a concern that although s. 43A will provide some protection, it may not solve the issue of forward or proxy caching, as this kind of ‘caching’ is unlikely to fall within the ‘temporary reproductions’ exception introduced by the Digital Agenda Bill.²²⁶ The Australian Consumers Association pointed out that:

...temporary or ephemeral copies may be found [e.g.] in the anti-jog buffers of portable music equipment, in caching arrangements for CD playing on PCs, inside digital photocopiers, all of which are copies made in the course of the legitimate enjoyment of a work and are not made with any intent to infringe. As consumer equipment becomes increasingly digital, such temporary copies abound. Legal uncertainty in this area is not helpful in developing consumer confidence in new technology...the Bill [should] state that temporary copies necessarily made in the process of using or facilitating the use of a digital work and which do not persist in an

²²⁴ Interim Report Submission 17

²²⁵ Interim Report Submission 26

²²⁶ Interim Report Submission 2; Interim Report Submission 17; Interim Report Submission 26

*end-use form after the use of the work are not reproductions in material form. This would cater for cache usage in communication and otherwise.*²²⁷

IBM²²⁸ submitted that caching should be handled through an approach similar to that adopted in the United States' *Digital Millennium Copyright Act*.

Microsoft²²⁹ submitted that the current non-regulatory regime is most appropriate, and that the Copyright Act should not be altered to deal with caching. Microsoft believes there is an implied license to reproduce work for purposes of caching, and cites in support the United States situation. Microsoft submitted that the current system allows copyright owners to determine whether or not they wish their works to be cached.

The Ministerial Council for Education, Employment, Training and Youth Affairs (MCEETYA) submitted that copyright owners wanting to prevent their web sites being cached should rely on technical solutions rather than legislative protection to prevent this. Telstra submitted that while relying on technological solutions 'may be true at some point in the future, it is not the case now nor will it be so in the foreseeable future. Consequently, the enactment of the [Digital Agenda Bill] without appropriate exemptions will leave ISPs vulnerable to action for copyright infringement.'

Telstra submitted that the proposals put forward (in its earlier Submission 62) remain the clearest way forward. It also said that one option is for legislation to be amended to provide an exception for caching, provided that it is conducted in accordance with industry codes. Industry codes could then provide the means to accommodate the technical detail.

The Australian Digital Alliance²³⁰ submitted that Telstra's suggested solution to the caching problem at pages 82–83 of our Interim Report (conditional defence) may be an acceptable compromise solution, but noted that it is technology-specific. The ADA suggested that an open-ended fair use style defence (as suggested by the CLRC Simplification Report Part 1) might provide a more satisfactory technology-neutral solution. It would be open to the courts to develop an exception for proxy caching which balanced the competing arguments in a flexible and practical way. By applying well-articulated principles of 'fairness' courts would be able to treat certain types of caching as non-infringing, without the need for a complicated legislative solution.

²²⁷ Interim Report Submission 2

²²⁸ Interim Report Submission 25

²²⁹ Interim Report Submission 44

²³⁰ Interim Report Submission 17

Recommendations

Temporary reproductions

The Committee recognises that, at least at present, caching appears to be of considerable significance to the efficiency of the Internet; and that the transaction costs to secure licences to cache could be prohibitive for ISPs. As a result, Government policy should help ensure that an efficiency-enhancing activity is not prohibited.

If there is evidence that the defence in the new ss. 43A and 111A inserted by the Digital Agenda Act does not sufficiently cover caching, then the Act should be amended to rectify this. For example, s. 43A of the Digital Agenda Act should be modified to include ‘other works temporarily made merely as an element in and so as to enhance the efficiency of the technical process of making or receiving a communication’.

Crown ownership of copyright

Rights granted

The Copyright Act provides that the Crown owns the copyright in any works made ‘under the direction or control of’ the Commonwealth or a State (s. 176). This section places the Crown in a more favourable position than other contractors or employers, who only become copyright owners under an assignment in writing, or subject to the terms of a contract of employment (implied or otherwise). The Crown is therefore not subject to normal contractual negotiations.

Cost-benefit analysis

The principles of competitive neutrality as set out in s. 3(1) of the Competition Principles Agreement provide that:

The objective of competitive neutrality policy is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities: Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership. These principles apply only to the business activities of publicly owned entities, not to the non-business, non-profit activities of those entities.

Section 183 of the Copyright Act provides for equitable remuneration to be paid for use of material in the service of the Crown. However, this applies in situations where the Government ‘appropriates’ material for its own purposes (i.e. is not already the owner).

Several submissions supported the move to amend s. 176 to leave the Crown in the same position as other parties.²³¹ In the specific case of architects, this would allow architects to negotiate a term in contracts that would either prevent the Crown re-using the designs, or require the Crown to pay an appropriate price for such re-use.

²³¹ e.g. Interim Report Submission 4 5; Interim Report Submission 29; Interim Report Submission 49

One submission pointed out that Government might find, in charging its legal and constitutional responsibilities, that it may be in the public interest to rely on s. 176 when dealing with contractors. It was noted that the position under s. 176 can always be varied under s. 179 of the Copyright Act. This would allow architects to ‘negotiate a term in contracts that would either prevent the Crown reusing designs, or require the Crown to pay an appropriate price for such reuse’.²³²

The Department of Defence²³³ pointed out that it is sometimes difficult to establish that performance of some tasks is in the course of Reservists’ Defence employment, and thus there is a greater possibility of dispute. Accordingly, reports containing sensitive information or advice might be subject to use of s. 176, which is not used lightly. It pointed out also that specific issues arise from the increasing use of Professional Service Providers (PSP) by government agencies. Solutions are either to provide draconian intellectual property clauses in all employment related contracts or to rely on s. 176(2). The Department of Defence submitted that s. 176 is narrowly interpreted. It recommended that the section be retained as a less complex and unwieldy solution than blanket provisions of intellectual property ownership in all PSP contracts.

Recommendation

Crown ownership of copyright

The Committee does not believe that the Crown should benefit from preferential treatment under the Copyright Act as compared with other parties. As a result, we recommend that s. 176 of the Copyright Act be amended to leave the Crown in the same position as any other contracting party.

Broadcast fee price capping (s. 152)

The regulation of broadcast fees through price capping has been raised as an area of concern, with claims that it creates distortions and market inefficiencies, is inequitable and runs counter to competition policy. The provisions that relate to price capping are covered under s. 152(8) and s. 152(11) of the *Copyright Act 1968*. This price ceiling is specific to s. 152 of the Act and does not apply to any other copyrighted articles.

In considering this issue, the Committee referred to a report, *The Regulation of Copyright Fees for Broadcasters’ Use of Sound Recordings*, prepared by the Allen Consulting Group for the Phonographic Performance Company of Australia (PPCA) and the Australian Record Industry Association (ARIA). This report states:

The pricing of copyright fees for the broadcasting of sound recordings is regulated in a number of ways:

- *firstly, where parties cannot agree on an appropriate fee the Copyright Tribunal has the power to determine such a fee. This determination is made taking into account*

²³² Interim Report Submission 27

²³³ Interim Report Submission 39

all relevant matters and so aims to set a fair price that, in theory, should represent the true market value. This approach is used with respect to other rights attaching to copyright, minimises transaction costs associated with individuals enforcing their own copyright, overcomes information asymmetries and constrains any market power that collecting societies may have. As such, this regulatory tool is not considered problematic and is not the focus of this paper;

- *secondly, the Copyright Act incorporates a general cap on the level of licence fees that broadcasters may have to pay for broadcasting sound recordings. This cap, set at one per cent of a broadcaster's gross revenue, limits the Copyright Tribunal's ability to set a price equivalent to that which would be determined by the market;*
- *thirdly, as a result of the reservation regarding first publication (hereafter called 'national treatment') in the International Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organisations (hereafter called the Rome Convention), the Copyright Act protects the broadcast of US music differently to the broadcast of music from most other countries. As a result, in effect, fees for the broadcast of US sound recordings are not recoverable by the Australian owner/marketer of those recordings. In effect, it can be said that the broadcast of US music is capped at a maximum price of zero percent of broadcasters' revenue; and*
- *fourthly, the Act treats the Australian Broadcasting Corporation (ABC) differently to all other broadcasters licensed under the Broadcasting Services Act 1992, including SBS, and sets a cap for broadcast fees at 0.5 cents per head of population.'*

The report further claims:

There may be times when price caps advance economic efficiency by correcting market failures. However, in this case there is no market failure related justification for existing price caps. Rather, the caps appear to be provided on the basis that they are a form of subsidising broadcasters, or, as was argued in 1969, to protect broadcasters from an unbudgeted expense. Given the profitability of the industry, and the indirect nature of the subsidy, it is reasonable to suggest that even if the price caps provide no direct harm, there would be better ways of subsidising broadcasters (e.g. direct government subsidy funded through the progressive tax system).

Cost-benefit analysis

The Committee accepts that the current caps were implemented to ease the burden imposed on the radio broadcasting industry by payments for the broadcasting of sound recordings. However, since the time of their introduction, the economic circumstances of the commercial radio industry have evolved, and the Committee does not believe capping remains warranted. No public policy purpose is served by this preference, which may distort competition (for example, between commercial radio and diffusion over 'Internet radios' of sound recordings), resource use, and income distribution.

As for the price capping related to the ABC under s. 152(11), the Committee is not inclined to support any change to the current price capping arrangement. More specifically, we do not accept that continuing the current treatment of the ABC would distort competition or competitive neutrality.

PPCA submitted that the ABC is a participant in the relevant market, in that it competes with other radio stations for audiences. The Allen Consulting Group report²³⁴ states that the ABC can be shown to be competing in both input and output markets. PPCA argued that the default approach should be for the Copyright Act to treat the ABC on equivalent terms to other broadcasters, with any deviation from this needing to be justified ‘in the public interest’, as required under national competition policy.

We believe there is a clear public interest in the operation of the ABC, and that this public interest underpins the support successive governments have given to the ABC. With regard to competitive neutrality, the Committee considers that the ABC is not a commercial participant in the relevant markets for commercial broadcasting activity.

As the ACCC and the courts have found on numerous occasions, the output market is one in which commercial broadcasters compete to provide audiences to advertisers. The ABC does not operate in this market—rather, it is budget funded.

In terms of the claim that the ABC competes in an input market for sound recordings, this appears to the Committee to be somewhat misconceived. Sound recordings are non-rivalrous, and the caps do not permit the ABC to obtain exclusive licenses to any such recordings. As a result, the ABC’s demand for these recordings does not affect their availability to other broadcasters, as is implied by the claim of competition in input markets.

As a result, the Committee does not believe that considerations of competitive neutrality require any change in the current arrangements as they relate to the ABC.

Recommendation

Broadcast fee price capping

To achieve competitive neutrality and remove unnecessary impediments to the functioning of markets on a commercial basis, the Committee recommends that s. 152(8) of the Copyright Act be amended to remove the broadcast fee price cap.

We recommend that no change be made in relation to the ABC under s. 152(11) of the Copyright Act.

²³⁴ attachment to Interim Report Submission 42

Statutory licences

Discussion of statutory licences

Unlike the Patents Act,²³⁵ there are no explicit compulsory licensing provisions in the Copyright Act. However, the fair dealing exceptions operate to some degree to allow for uncompensated use/reproduction of reasonable portions of materials for certain policy reasons such as reporting news, or research. This is similar to a compulsory licence and is imposed to achieve public policy ends.

However, there is also a statutory licences regime. Two such regimes are contained in Part VA (copying of transmissions by educational and other institutions) and Part VB (copying of works by educational and other institutions).

These could be designated as compulsory licences, in that the parties benefiting from them (e.g. educational institutions or institutions for persons with a disability) are permitted to copy or reproduce the material (whatever the subject of the licence may be) without the permission of the copyright owner, as long as they undertake to pay equitable remuneration (usually through a collection society). In this sense, there are some analogies between statutory copyright licences and compulsory licensing under the Patents Act. However, the scope of the statutory copyright licences is limited and importantly they do not apply in respect of most commercial uses. There are also several other provisions which could be construed as granting ‘quasi compulsory licences’. For example:

- s. 104 Copyright Act—acts done for purposes of judicial proceeding, or for receiving/giving legal advice also receive an immunity from infringement (i.e. effectively an unremunerated ‘compulsory licence’ for this public interest purpose); and
- s. 183 also allows the Crown to ‘appropriate’ copyright material ‘for the services of the Crown’ on the ground that compensation is paid, and is therefore a compulsory licence of types. The ‘licence’ is on terms to be agreed, or in absence of an agreement, being reached by the parties, as set by Copyright Tribunal.

International obligations

Article 9(2) of the Berne Convention states that it is a matter for legislation in member countries to permit reproduction of works in certain special cases—provided that such reproduction does not conflict with a normal exploitation of a work and does not unreasonably prejudice the legitimate interests of the author.

Article 15 of the Rome Convention covers exceptions to the rights of performers, phonogram producers and broadcasting organisations. They apply only if provided for in the legislation of the country where protection is claimed.

²³⁵ See page 132.

Article 13 of TRIPS provides that members shall confine limitations or exceptions to exclusive rights to certain special cases, which do not conflict with a normal exploitation of the work and do not unreasonably prejudice the legitimate interests of the author. This provision extends the test in Article 9(2) to apply to all rights of authors of literary and artistic works, and not just to the reproduction right.

Committee consideration

The Committee recognises the important role of the statutory licences regime within the copyright system. We believe these licences can act to reduce the transactions costs that would otherwise arise in negotiating licence conditions between rights owners and users.

We do not consider that changes to the relevant provisions are needed or warranted at this time. However, we are concerned about the implementation of collective administration of rights that is associated with these licences. These concerns are set out in our consideration of the operation of collecting societies, which follows below.

Recommendation

Statutory licensing scheme

The Committee recommends that the current statutory licensing scheme remain unchanged at this time.

Collecting societies

Description of role of collecting societies

Having set an appropriate threshold for protection and balance of rights, the copyright system should also seek to minimise the net costs of enforcing copyright. One of the ways in which the Copyright Act makes provision for this is through a system of declared collecting societies.

Collecting societies provide creators with an administrative option for more effectively enforcing rights, in relation to copyright use and for the collection and distribution of copyright licence fees. The Arts Law Centre of Australia submitted that: ‘Without these collective agencies there would be very little return for artists and creators, given their lack of finances to police and enforce copyright, and the cost of pursuing copyright infringements.’²³⁶

One commentator has stated that ‘the interaction of copyright law and markets in the arts and cultural industries, propelled by technological developments that have both reduced the cost of copying and vastly extended markets, have led to the growth and formation of collecting societies. They are natural monopolies and their operations have added to existing concerns regarding the statutory monopoly created by copyright law.

²³⁶ Arts Law Centre of Australia, issues paper submission 75, p. 8

Their monopoly power is tolerated however because they assist the working of the market by collective licensing and also enable individuals to secure royalties and other benefits. While that decreases some costs it increases others.²³⁷

Various collecting societies have mandates from the Copyright Act to act as the ‘declared society’ for educational (and some other) statutory licensing. For example, in the educational context, CAL licenses the collection of remuneration in respect of reproductions of text material, and Screenrights licenses reproduction or other copyright acts in respect of audiovisual material.

Voluntary collecting societies (those not declared by the Copyright Act as having exclusive functions in relation to a particular statutory licence) include VISCOPY, which administers the copyright in artistic works. VISCOPY cooperates with CAL to licence artistic works copied by educational institutions. Some collecting societies, particularly CAL, have extensive activities outside their statutory licence area and have extended their activities into licensing copying by the corporate world, government departments, and other users of copyright.²³⁸

The Copyright Act balances the rights of copyright owners to exploit their works and the public interest in the ability of users to have access to those works.

In the Committee’s view, if a proper balance is struck in defining copyright rights, it is then desirable to have effective mechanisms for enforcing those rights including, as appropriate, through collective management and enforcement mechanisms.

International obligations

The international aspects of copyright and its enforcement have been a driving force in creating collecting societies. Expanding international trade in copyright material has multiplied royalty earnings and enforcement costs. From the outset, national collecting societies collaborated through private reciprocal agreements to act for foreign authors. This has now been formalised via international agreements, such as the Berne Convention and the Rome Convention, culminating in the TRIPS agreement.²³⁹

Art 5(3) of the Berne Convention provides ‘when the author is not a national of the country of origin of the work for which he is protected under this Convention, he shall enjoy in that country the same rights as national authors.’

Any discrimination against the works of foreign nationals, where those works fall under the protection of the Berne Convention, would amount to violations of both Berne and TRIPS. Collecting societies therefore collect and remit some royalty payments to overseas authors. This requires collecting societies to remit royalties to foreign nationals.

²³⁷ Towse R ‘Copyright as an Economic Incentive’ (1999) *Copyright Reporter* Vol 17:1, p. 15

²³⁸ For an overview of the activities of Australian collecting societies, see Ch 4 of CLRC Draft Report, *Jurisdiction and Procedures of the Copyright Tribunal*, February 2000.

²³⁹ Towse R ‘Copyright as an Economic Incentive’ (1999) *Copyright Reporter* Vol 17:1, p. 16

Screenrights has pointed out that ‘if a statutory licence under the Copyright Act adopted a form similar to the parochial nature of the Public Lending Right Scheme (in which only Australian are eligible recipients) Australia would unambiguously violate the Berne Convention and TRIPS.’ It further asserts that by ‘introducing collective administration of copyright in audio-visual material in Australia, Screenrights has been able to represent Australian rights holders in the collection of royalties owing to them by societies in other territories including North America and Europe. This creates a clear reciprocal benefit for rights holders.’

International comparisons

A 1996 European Commission report, which formed a precursor to the recent TRIPS violation dispute against the United States by the European Union, noted that notwithstanding the number of collecting societies in the United States, their ability to license the public performance of music was in a ‘straight jacket’. Consequently, licensing tariffs were low in the United States when compared to those in the European Union. The report also noted that in spite of the high market share of European Union music played on United States radios, less than five per cent of the revenues of United States performance rights organisations were remitted to the European Union. This was considered to be due to those societies’ use of ‘royalty distribution and calculation methods that disadvantage foreign artists’.

Collecting societies and competition policy/cost-benefit trade-offs

Concern about alleged ‘super-monopoly’ aspects of collecting societies has been evident from a very early stage.²⁴⁰ Competition issues raised about the operation of collecting societies include the potential abuse of market power to extract higher licence fees (as the only licensors of certain types of copyright material), and the inability of negotiating parties to derive a market value for the unit cost of new services in the digital environment.²⁴¹

The Australasian Performing Rights Association (APRA) decision

APRA is a copyright collecting society involved in managing performance rights for sound recordings. In June 1999, the Australian Competition Tribunal handed down a decision on APRA’s application for authorisation under the *Trade Practices Act 1974* of certain aspects of its operations as a collecting society.²⁴² This involved a determination of the costs and benefits of arrangements offered by APRA and any possible effects on competition involved in APRA’s arrangements.

The Tribunal found that certain aspects of APRA’s system of collective administration constituted a natural monopoly, but pointed out that the mere fact of a natural monopoly does not constitute a public detriment: the key issue is regulation of its operations to ensure that it does not take advantage of its monopoly power.

²⁴⁰ *Report of the Royal Commission on Performing Rights* (1933) (The Owen Committee)

²⁴¹ See, for example, Issues Paper Submission 33; Interim Report Submission 45.

²⁴² *Re Applications by Australasian Performing Right Association* [1999] Australian Competition Tribunal 3 (16 June 1999)

The Tribunal interpreted ‘public benefit’ broadly to include benefit to market participants as well as to society at large.²⁴³ It found that the monopoly existed for the purposes of licensing and enforcing copyright in music composition.

The Tribunal found that the correct approach was to ask whether the particular elements of APRA’s Articles and Rules were essential to the operation of APRA as an efficient collecting society. In so far as aspects of the system were essential, authorisation should be granted. However, to the extent that any anti-competitive aspects of APRA’s operation could be modified to lessen or remove the potential for public detriment, authorisation should be granted on terms which bring about those modifications.

Notwithstanding the fact that there are certain anti-competitive detriments, the Tribunal found that the public benefits arising from APRA’s operation outweigh those detriments. The input and output arrangements in particular were held to underpin the functioning of APRA, and the Tribunal considered that, without the essential elements of the input and output arrangements, the likelihood is that APRA could not continue to operate. On the other hand, authorisation was granted on terms which would bring about modifications the Tribunal found would reduce competitive detriment. These changes largely reflected views that had been put forward by the ACCC in its consideration of the authorisation.

Are there other alternatives, including non-legislative alternatives?

As technology has advanced, there have been moves towards individual transactional or direct licensing. One alternative to collecting societies would be to make users negotiate directly with copyright owners. However, this would be inefficient as it would increase transaction costs involved in the negotiation of individual licences—with several licences often needed to use one piece of material. It may also disadvantage copyright owners, since the transaction costs for collecting small amounts of royalties from any particular user could outweigh the benefits in collecting the royalty. Users might be disinclined to ascertain copyright ownership to pay royalties due for use of the work, leading to enforcement difficulties.

It appears that at present it is still far easier for users to deal with collecting societies, and indeed educational institutions have expressed a preference for doing so.

It has been argued that in the case of statutory licences this is virtually imperative, despite the provisions in the Copyright Act allowing copyright owners to deal directly with institutions.²⁴⁴ However, major organisations representing users have argued that the market power of collecting societies has resulted in a degree of inefficiency and restriction of competition. It has also been put forward that collecting societies should compete with each other for membership of copyright owners.

Overall, collecting societies will face substantial challenges in the decade ahead, as the growth of information transmission over the Internet shifts the location of copyright transactions and alters their technical form. Some of the resulting changes could erode the position of the collecting societies, as direct contracting becomes more feasible.

²⁴³ *Ibid*

²⁴⁴ See, for example, s.135ZZF *Copyright Act 1968*.

Nonetheless, these trends are not likely to bite for some time, and the collecting societies will remain pivotal to, and retain considerable power in, the copyright system. The Committee therefore believes that effective means need to be in place to ensure that the collecting societies do not abuse any market power they may have.

The roles of statutory versus non-statutory societies

The principal copyright collecting societies in Australia are private companies which collectively licence copyright on behalf of their various members and, as such, operate independently of the Government. In particular, APRA²⁴⁵ and PCCA (whose activities were the exclusive focus of the *Don't Stop the Music!* report) operate independently of the Government. The Government has a limited supervisory role over particular collecting societies in relation to their operation as societies, declared by the Attorney-General to administer the statutory licences under Parts VA and VB of the Copyright Act for copying by educational and other institutions.

The Committee accepts that there can be significant benefits in the collective administration of copyright, subject to that administration being effective and efficient, and meeting the requirements of Government policy. Statutory licences, that are acceptable under international treaty obligations, can be important instruments for ensuring efficient and timely access to copyright material—and may provide a useful context for the negotiation of voluntary licences. However, collecting societies must be subject to appropriate safeguards governing any market power they may possess.

United States' developments

The Committee notes that the United States Department of Justice and the American Society of Composers, Authors and Publishers (ASCAP) agreed to revise a 59-year-old court order to update the licensing of music for performance for the Internet age. The original court order,²⁴⁶ entered in 1941 and amended several times including in 1950, requires ASCAP to provide performance licenses to music users upon request, and to distribute the fees from those licenses to its members.²⁴⁷

The parties agreed on four modifications to improve competition in music licensing and update procedures for settling fee disputes. These modifications:

- expand and clarify ASCAP's obligation to offer certain types of music users, including background music providers like Musak and Internet companies, a genuine alternative to a blanket license;
- eliminate many detailed restrictions on ASCAP's relations with its members;

²⁴⁵ The Australasian Performing Right Association (APRA) was established in 1926 by owners of copyright in musical works to exercise their rights of public performance and broadcasting. APRA's members assign to it the public performance and broadcasting rights in their works, and in return receive from APRA payments proportionate to the public performance and broadcasting of their works.

²⁴⁶ The original court order resolved an antitrust case brought by the division charging that ASCAP and certain of its members agreed to restrict competition in licensing of performance rights and discriminated against certain members in managing those rights.

²⁴⁷ See article at <http://www.techserver.com/noframes/story/0,2294,500247409-500367722-502177489-0,00.html>.

- ensure that ASCAP members can switch to another performing rights organization without penalty; and
- streamline license fee determination proceedings.

These proposed modifications are aimed at: increasing competition in the licensing of music performance rights; reducing unnecessary administrative burdens; and improving music users' ability to resolve rate disputes with ASCAP. The Government asked the court to allow 60 days for public comment before implementing any revisions.

Discussion of issues

In the Committee's view, the main issues that need to be addressed are the dividing line between statutory and non-statutory collecting societies and the role of the various regulators, including the ACCC, in ensuring that collecting societies properly fulfil their functions.

What regulation is there at present, and what regulation should there be?

The statutory schemes provided for in the Copyright Act include guidelines for declaring societies as collecting societies in relation to particular classes of rights, and also for reviewing the performance of declared societies (and revoking their declared status).

Statutory societies

There are currently three levels of control that could in principle be exercised in respect of statutory scheme collecting societies:

- ministerial revocation of a declared status in respect of the statutory licence;
- the operation of the Copyright Tribunal which controls output arrangements of statutory societies; and
- ACCC authorisation for input arrangements (with a right of appeal to the Australian Competition Tribunal), should a society decide to seek such authorisation.

Non-statutory societies

Where economies of scale or scope confer substantial market power on non-statutory societies, there is little in the way of specific regulation or guidelines to control the exercise of that power, especially in light of the protection that might currently be afforded the societies and the activities they undertake by virtue of s. 51(3) of the Trade Practices Act.

Cost-benefit analysis

It has been put to the Committee that collective copyright administration may have an adverse effect on the competitive performance of related markets—including those for goods and services carrying copyright material (books, sound recordings, videos, software and electronic media) and vehicles for carrying the items (computers, broadcasting, retail channels of distribution). The reason given is that those arrangements could cause higher prices and profits, and a smaller volume and range of output of goods and services in related markets than would otherwise occur.

Distortion in related markets due to copyright arrangements will not ensure appropriate payment levels and distribution to creators, or the right amount or direction of investment in creation in the long run.²⁴⁸

Education sector users have themselves expressed a preference not to deal with multiple collecting societies in respect of one act of copying.²⁴⁹ One declared society, as a single point of Part VA administration, has been seen as fundamental to the promotion of ready and efficient educational access to copyright subject matter as a feature of Part VA.²⁵⁰

Screenrights pointed out that educational ‘institutions largely sought the creation of Part VA because copies of broadcast programming were sought for educational purposes but no market mechanism existed for their general obtainment. The enactment of Part VA effectively created a market and an exchange of value where none previously existed. Screenrights is unaware of any private supplier of audio-visual content that has comprehensively obtained the rights to licence educational institutions to reproduce the programming. Any ad hoc voluntary licensing of audio-visual material to educational institutions may still occur under the terms of Part VA.’²⁵¹

Collecting societies perform valuable, indeed essential, services for their members. In addition, the collecting societies play an advocacy role for their members, representing owners’ interests in public debate and lobbying for relevant changes to copyright laws.

Discussion of review mechanisms for the operation of collecting societies

In its recent Draft Report on the jurisdiction and procedures of the Copyright Tribunal, the CLRC recommended that the Attorney-General should retain the power to declare a collecting society for the purposes of Parts VA and VB (and the new statutory licence for retransmission of broadcasts introduced by the Digital Agenda Act), and that the Attorney-General should have the discretion to refer the matter to the Copyright Tribunal if considered appropriate in the circumstances. The Committee agrees with this recommendation.

In endorsing this continuing role, the Committee believes that it is essential that appropriate mechanisms for reviewing the operation of the societies be in place.

As matters currently stand, there are a number of different mechanisms by which collecting societies may be reviewed. Importantly, the declaration of a declared society as such may be revoked if the body is not functioning adequately as a collecting society, is not acting in accordance with its rules or in the best interests of its members, has altered its rules in a way that is inconsistent with the Copyright Act, or fails to report properly on activities and accounts.²⁵²

²⁴⁸ Issues Paper Submission 81 p. 5

²⁴⁹ A CLRC issues paper published in 1997 sought views on whether the scheme for educational copying found in ss.35 and 36 of the United Kingdom *Copyright, Designs and Patents Act 1988* should be adopted in Australia to replace the existing statutory licence schemes. The CLRC noted that their proposal was not considered ‘a satisfactory way to deal with educational copying in Australia’.

²⁵⁰ Interim Report Submission 47

²⁵¹ Interim Report Submission 47 p. 3

²⁵² See s. 135Q *Copyright Act 1968*. The Part VB licence also has a similar provision.

This provision for revoking the declaration of a body as a collecting society for the purposes of one of the statutory licences does not, however, address the broader issue of review of the practices of collecting societies as they relate to activities in the marketplace.

However, while mechanisms exist for reviewing collecting societies, these may be inadequate or cumbersome, and in any event ‘any contemporary attempt to review copyright administration has to confront the inadequacy of information.’²⁵³ The Department of Communications, Information Technology and the Arts (DOCITA) has submitted that there is a dearth of information on a number of activities of collecting societies. For example, it is not possible to assess the reach and range of payments by individual users and the level, comprehensiveness and spread of the distribution of payments to individual rights holders or the level of payments to Australian creators and rights owners compared with overseas counterparts who may face choice or different arrangements. There is no way of knowing the extent to which payments match usage, how many creators operate outside the collecting society structure, and how many publishers are making available to users a range of rights through contractual agreements.

In the Committee’s view, two related changes are desirable in this context.

To begin with, the grounds for revocation should be extended to cover every aspect of the conduct of the declared society.

At the same time, to provide clarity to the society regarding the Government’s expectations of its conduct, the Government should issue, to each collecting society, guidelines setting out these expectations. These guidelines would encompass the main elements material to the evaluation of the society’s conduct, including in terms of the information the society should disclose. These guidelines would be of a definite duration, and hence subject to periodic review.

The output arrangements of declared collecting societies (licensing arrangements between the society, and the licensees, or potential licensees, of copyright material it administers²⁵⁴) can be reviewed by the Copyright Tribunal. The CLRC has formulated a draft recommendation that the jurisdiction of the Tribunal extend to all collectively administered licence schemes (whether administered under a voluntary or statutory licence) concerning all types of copyright material and copyright uses.²⁵⁵ DOCITA submits that one ‘of the main difficulties in determining the rights of collecting society members is the legal divide between “declared” and “undeclared” collecting societies. Whilst the behaviour of declared collecting societies is limited by both legislation and regulation, there are no such restrictions under the Copyright Act on undeclared societies.’

The Committee accepts that there may be instances in which it would be desirable for the Copyright Tribunal to review output arrangements of schemes other than those implemented under a statutory licence. However, to avoid unnecessarily increasing the burden on the Copyright Tribunal, it believes that the jurisdiction of that Tribunal should only be engaged in instances where commercial negotiation is unlikely to succeed.

²⁵³ Issues Paper Submission 81 p 6

²⁵⁴ CLRC, Draft Report, *Jurisdiction and Procedures of the Copyright Tribunal*, above n. 238 p 62

²⁵⁵ CLRC, Draft Report, above n. 238, p 64

As a result, the Committee recommends that the ACCC should be given powers to act as a ‘gate keeper’ in determining whether a reference should be made to the Copyright Tribunal. This determination would be based either on the application by a collecting society or from an actual or potential licensee, and the ACCC, in coming to a decision, would be required to take account of:

- any market power that can be exercised by the collecting society;
- whether there are alternative means of dispute resolution that could be used and that would impose less burden on the public; and
- the public interest in balancing public access to copyright material with the legitimate commercial interests of copyright owners.

This would ensure that the resources of the Tribunal were not diverted to adjudicating disputes which could be settled by commercial means.

To the extent that rights owners would otherwise compete individually, a system of collective definition and enforcement of fees can serve to reduce the potential for that competition. In the Committee’s view, the operation of such systems should be subject to the provisions of the TPA and hence, when a substantial lessening of competition may be effected, subject to authorisation. Reflecting this, it is the Committee’s view that the societies, whether declared or not, should generally be subject to the scrutiny that the TPA’s authorisation procedures allow. This should, in the Committee’s view, follow naturally from the changes it proposes to s. 51(3) of the TPA. If it does not, or if those changes are not implemented, the Government should secure this outcome through direct legislative amendment.

In assessing the activities of collecting societies and determining authorisation of those activities, the ACCC should have regard to information concerning input arrangements, distribution patterns, relative size of copyright payments as between rights holders and creators and administrative costs relative to distribution to rights holders. More generally, consistently with the APRA decisions and recent overseas developments, it should examine opportunities for reducing any anti-competitive detriment associated with the operation of each society.

Finally, the Committee has considered the matter of dispute resolution. One of the results of the APRA case is that APRA is required to develop a simplified dispute resolution procedure. In its draft report on the jurisdiction and procedures of the Copyright Tribunal, the CLRC has presented a draft recommendation that collecting societies adopt alternative dispute resolution for the resolution of disputes with members, and with users and potential users.²⁵⁶ It also recommended that the Copyright Tribunal should have the power to compel parties to take part in alternative dispute resolution processes where appropriate.²⁵⁷

²⁵⁶ CLRC, Draft Report, above n 238, p 160

²⁵⁷ CLRC, Draft Report, above n 238, p 160

Recommendations

Collecting societies

The Committee recommends that:

The grounds for ministerial revocation (s. 135 ZZC of the Copyright Act) should be broadened to cover all collecting society arrangements, both input and output, including the disclosure of information to members and the public. Relevant ministers should issue guidelines to each collecting society, in the spirit of a contract between the society and the community, that specify the government's expectations regarding the society's conduct, including in terms of the information required to be disclosed and the process for disclosure.

Assuming a continued role for the Copyright Tribunal over the output arrangements of statutory societies in respect of compulsory licences, there should be scope for the Tribunal to play a similar role in respect of other licences. The required mechanism should be for the ACCC to determine whether a reference should be made to the Copyright Tribunal based either on the application by a collecting society or from an actual or potential licensee, taking account of:

- any market power that can be exercised by the collecting society;
- whether there are alternative means of dispute resolution that could be used and that would impose less burden on the public; and
- the public interest in balancing public access to copyright material with the legitimate commercial interests of copyright owners.

If the Committee's proposed changes to s. 51(3) of the Trade are accepted, then collecting societies would have to seek authorisation from the ACCC for those activities that fall within the scope of the prohibitions in Part IV of the Trade Practices Act. If the Committee's proposed changes to s. 51(3) of the Trade Practices Act are not accepted, the Government should ensure a requirement for such authorisation through specific legislative amendment. In the Committee's view, the ACCC should ensure that such authorisations are reviewed periodically (for example, every three years).

CLRC report—simplification of the Copyright Act 1968

Background to the CLRC report

In December 1996, the CLRC was asked to investigate the simplification of the *Copyright Act 1968*. Having specific regard to international obligations, the CLRC was required to inquire into and report on:

- how to simplify the Copyright Act to make it able to be understood by people needing to understand their rights and obligations under the Act, with particular attention to the simplification of the exemption provisions;
- whether the existing exclusive rights can realistically be reduced to a smaller number of broadly based rights and, if so, what these rights should be;

- implementation of the distribution right contained in the WIPO Copyright and Performances and Phonograms Treaties; and
- whether a more practical and suitable categorisation of protected subject matter can be devised, and, if so, how those categories should be described.

The CLRC was also asked to consider a number of outstanding issues from the CLRC *Computer Software Protection Report 1995* and the Copyright Convergence Group (CCG) 1994 report *Highways to Change*.

We do not believe our Terms of Reference require us to have a view on the majority of these incidental aspects of the *Simplification Report*. Some of these issues attracted only the recommendation that no action be taken. Many issues have already been determined in the context of the Government's Digital Agenda reforms, and other identified issues are being reviewed as part of the CLRC's current reference into the jurisdiction of the Copyright Tribunal. One outstanding issue—the treatment of multimedia—can be included in the discussion of the CLRC's recommendations regarding subject matter in Part II of the *Simplification Report*.

The aspects of the *Simplification Report* most relevant to the IPCRC are the recommendations in Part I relating to fair dealing, and the recommendations regarding the categorisation of exclusive rights and subject matter in Part II. The two parts of the CLRC's report must be read together and in context.

Part I: exceptions to the exclusive rights of copyright owners

As discussed,²⁵⁸ the 'fair dealing' exceptions in the Copyright Act have effectively allowed copyright material to be reproduced without the permission of the rights owner for certain recognised purposes (e.g. research and study or reporting news). Users currently need to consider a number of technical factors to fall within the ambit of the defences, including the commercial availability of the copyright material and the effect of the intended use on its potential market.

The Act provides broad guidance to users in the form of a quantum test—where only 10 per cent of a work is copied for research and study purposes, exemption is automatic, and the other technical factors do not need to be considered.

Part I of the CLRC report made a number of specific recommendations about the fair dealing provisions in the Act. It recommended that the fair dealing provisions be simplified by consolidating the current provisions into a single section and adopting a modified quantitative test.²⁵⁹

²⁵⁸ See discussion of *Fair Dealing* at p. 85

²⁵⁹ The CLRC also made recommendations regarding absorbing the provisions relating to acts done for the purpose of professional advice in relation to subject matter other than works within fair dealing; removing the fair dealing provisions that specifically apply to external students; and removing the provisions that require sufficient acknowledgment in relation to fair dealings for the purpose or reporting news.

The CLRC recommended the expansion of fair dealing to an open-ended model that would specifically refer to the current purposes (i.e. reporting the news, criticism and review, professional legal advice, research and study) but would not be limited to these purposes.

The current determinative factors regarding copying for research and study would apply generally to all fair dealings.

The CLRC also recommended that the quantitative test (i.e. reasonable portion test) be treated separately from the concept of a 'fair dealing' since there is no requirement for recourse to the criteria of 'fairness'.²⁶⁰ However the Government appears not to have accepted this recommendation, and the Digital Agenda Act extends the 'reasonable portion' test to the digital environment. The Committee endorses the Government's approach to this issue, as it provides greater certainty, facilitates compliance and is likely to reduce the cost of settling disputes.

Consideration of fair dealing issues

As discussed above, the Committee believes that the current balance between owners and users of copyright should be extended to the digital environment.

The Committee notes that the current 'balance' in the Copyright Act between copyright owners and users has been worked out in the context of the present rules on fair dealing. If this concept changes with the development of the market for copyright material along different lines, imposing greater restrictions on the availability of material for fair dealing purposes, there may be serious competition implications. Because they are relatively open-ended, the factors recommended by the CLRC will require careful judicial construction. The Committee does not believe that offsetting benefits have been identified to justify bearing the costs and uncertainties this entails. More generally, we believe that the current arrangements reduce the transactions costs involved in operating the copyright system, and make for enhanced efficiencies.

Recommendation

CLRC report on fair dealing

The Committee recommends that, in considering the CLRC report on fair dealing, the Government should ensure the balance between owners and users remain clear and certain. We do not believe there is a case for removing the elements of the current Copyright Act which define certain types of conduct as coming within the definition of fair dealing.

²⁶⁰ CLRC, Simplification Report Pt I, p. 8

Part II: categorisation of subject matter and exclusive rights, and other issues

Context for the CLRC recommendations

The Copyright Act has never been regarded as ‘simple’. The subject matter in the Act is currently divided into Part III ‘Works’ (covering literary, musical, dramatic and artistic works) and Part IV ‘Subject matter other than Works’ (covering cinematograph films, sound recordings, broadcasts and published editions of works).

Part IV governs copyright material which is ‘entrepreneurial’ in nature, recognising effort in production rather than originality in putting material together.

The division of subject matter in the current Copyright Act reflects the distinction between authored works and other subject matter as contained in the Berne Convention for the Protection of Literary and Artistic Works, as well as the Rome Convention on Performers, Producers of Phonograms and Broadcasting Organisations. However, the international agreements provide that member countries can decide how the rights contained in the conventions are implemented.

The categories of subject matter in the Copyright Act have been criticised for being too narrowly defined, leading to protection based on physical form rather than on the creative endeavour involved in producing the protected output. There have also been criticisms of the technology-specific nature of existing copyright categories. The majority of the CLRC stated that the current Act represents ‘unnecessary legislative complexity, some instances of unjustifiable differential treatment of subject matter, and an undesirable degree of technological specificity of protected subject matter and exclusive rights.’²⁶¹

In the context of the Digital Agenda reforms, the Government is committed to a principle of technological neutrality. For example, in the Second Reading Speech on the introduction of the Copyright Amendment (Digital Agenda) Bill 1999, the Attorney-General stated that the centrepiece of the reforms is a ‘new broadly-based technology-neutral right of communication to the public.’²⁶² He also stated that being ‘a technology-neutral right, it will also mean that the development of new technologies such as “Internet broadcasting” will not require repeated technology-specific changes to the Copyright Act.’²⁶³

A technology-neutral organisation of copyright categories appears to be consistent with this policy objective.

What did the CLRC recommend?

Part II of the CLRC report recommended an approach to simplify both the categories of protected subject matter under the Copyright Act, and the exclusive rights granted to

²⁶¹ CLRC, *Simplification Report Pt II*, p. 45

²⁶² The Hon Daryl Williams AM QC MP Attorney-General, Second Reading Speech, Copyright Amendment (Digital Agenda) Bill 1999, 2 September 1999

²⁶³ *Ibid*

copyright owners. (It also considered the outstanding issues from the Copyright Convergence Group Report.)

The majority of the CLRC recommended a new approach to categorising subject matter and rights under the Act, which would involve adopting:

- two categories of protected subject matter, to which different levels of protection would apply ('creations' and 'productions');
- two exclusive economic rights of 'reproduction' and 'dissemination to the public'; and
- two exclusive moral rights of integrity and attribution.

Categories of subject matter

The report's central recommendation is to replace the eight current categories of subject matter (literary works such as books and computer programs, artistic, dramatic and musical works, films, sound recordings and television and radio broadcasts) with two new categories: 'creations' and 'productions'. Different levels of protection would apply to each category. A 'creation' would be a tangible or non-tangible embodiment of subject matter in the literary or artistic domain that is the result of a significant intellectual effort by the person who undertakes its creation. A 'production' would be a tangible or non-tangible embodiment of subject matter in the literary or artistic domain that is the result of the application of time, effort and resources by the person who undertakes its production. A higher level of protection would apply to 'creations'.

Categories of rights

The existing exclusive economic rights (the rights to reproduce, adapt, perform, broadcast, transmit and publish) would be replaced by two broad categories of rights: the 'right of reproduction' and the 'right of dissemination to the public'. The economic rights would apply to all subject matter. However the moral rights recommended by the CLRC would only apply to creations.

Dissenting report

The dissenting Member of the CLRC agreed that the division of protection of subject matter between Parts III and IV of the Act is unnecessary. However, the Member felt that the majority approach 'pays insufficient regard to the open-ended nature of the existing categories, and that their incapacity to adapt to new technological developments has not been established'.²⁶⁴ The dissenting report advocates retaining the existing categories of works and other subject matter, but the redesignation of films as 'audiovisual works' and the introduction of a new category of 'collective works'.²⁶⁵ The existing protection of tables and compilations would be covered by this category.

²⁶⁴ CLRC, Simplification Report Pt II, p. 88

²⁶⁵ CLRC, Simplification Report Pt II, pp. 90–1

Committee comments on Part II

The majority of the CLRC stated that its aim was to propose an approach which both simplified the Act and improved its ability to accommodate technological change, while generally maintaining the current level of protection provided to copyright subject matter.²⁶⁶ The CLRC also stated that its approach is illustrative only, and in particular should not be seen as the only way these principles should be implemented.²⁶⁷

It was clear to the Committee that many organisations are still in the process of considering their response, and will be in a better position to comment on the CLRC report when formal submissions are called for. As a result, the Committee has not formed a considered opinion on the CLRC's proposals at this time.

However, we recommend that the Government take into account the following comments in formulating a response to the CLRC's recommendations.

On one hand, the proposals to rework the definitions of subject matter and reduce the categories from eight to two are reasonable suggestions and accord with a conceptual view of the subject matters, rather than the artificial categories existing at present. The categories suggested are also intended to be 'technology neutral'. On the other hand, the simplifications proposed by the CLRC seem to go beyond rewording and reorganising, to changing the substantive law itself by replacing the existing structure of the Copyright Act with a less complex framework. Care needs to be taken that simplification does not become a goal in and of itself, regardless of the consequences. This is not to diminish the weight that should be given to the CLRC's detailed and measured proposals, based as they are on careful thought and research. However caution is clearly needed when altering arrangements that have evolved over considerable time.

In the Committee's view, there is merit in attempting to simplify the Copyright Act and introduce a conceptually consistent definition of what is protected by copyright. Simplicity in the definition of property rights can reduce the transaction costs involved in asserting rights, in complying with them and in allocating rights to their most highly valued uses. Technology-neutrality yields additional benefits, as it allows new uses and new forms of existing uses to readily gain the protection the system of intellectual property rights provides. The model suggested by the CLRC provides an innovative, technology neutral proposal which, if implemented, may assist in achieving greater simplification of the Copyright Act. However, it is unclear whether the benefits associated with any simplification would outweigh the costs of the uncertainty that could potentially be created by adopting the CLRC's proposal. The court system has demonstrated an ability to adapt existing categories of protected material to the demands of new technologies, and it is unclear whether there is a demonstrated need for a wholesale re-organisation of the Copyright Act in the manner proposed by the CLRC.

Although the CLRC commented that existing jurisprudence could apply to the proposed new categories,²⁶⁸ it is likely, in the Committee's view, that significant litigation would be required to establish a working jurisprudence to interpret the proposed changes. The Committee is

²⁶⁶ CLRC, *Simplification Report Pt II*, p. 49

²⁶⁷ CLRC, *Simplification Report Pt II*, p. 53

²⁶⁸ Office of Regulation Review, *An Economic Analysis of Copyright Reform*, 1995, p. 7

also concerned about the future operation of a moral rights regime and the new definitions of ‘creations’ and ‘productions’.

Recommendation

CLCR report Part II

The Committee does not believe that it would be appropriate, at this stage, to proceed with the CLRC’s Part II recommendations. This is because we are not convinced that the benefits to the community as a whole would be outweighed by potential costs, due to uncertainty surrounding the operation of a new regime.

PATENT ACT

The present patent system and its effects on competition

Description of patent rights and the patent system

Under current Australian patent law (*Patents Act 1990* and associated regulations and case law), a patent may be granted on a new, non-obvious and useful invention, including improved products and processes. A patent gives the patentee the exclusive right, during the term of the patent, to ‘exploit’ the patented invention in Australia, including the right to make, hire, sell, use or import the invention, and/or authorise another person to do so. In Australia, a standard patent lasts for 20 years, although annual renewal fees are payable from its fifth year. A petty patent may last up to six years, and the proposed innovation patent will have a maximum term of eight years.

Applications for patents must be filed with the Patent Office, which forms part of IP Australia. The application in its ‘specification’ must fully describe the invention, and state the scope of the desired patent rights. This often involves a lengthy description of the problem the invention is trying to solve. In contrast to the situation in some other countries, applicants for Australian patents are not currently required to disclose all previous attempts they know have been made to solve the specific problem or related problems involved (the ‘prior art’).

The description of the invention included in the application must also describe the applicant’s solution to the problem, in sufficient detail that a person familiar with (‘skilled in’) the technology (the ‘art’) could perform the invention without undue experimentation. The description must include the best method known to the applicant for performing the invention. These requirements are often characterised as part of the bargain (*quid pro quo*) between the applicant and society—in return for the applicant’s limited exclusive right, society gains through the disclosure of the invention which allows others to build on it or work around it during the exclusion period and to use it directly after the exclusion period expires.

The area of exclusivity (‘scope’) of the patent is defined by the claims of the specification. To be patentable, the claims must satisfy threshold tests required by the Act, the most important of which are:

1. the invention must be a ‘manner of new manufacture’ within the meaning of s. 18 of Act and relevant case law;
2. the invention must be novel in the sense that someone else should not have performed or published it; and
3. the invention must be inventive and not merely an advance that would be obvious to a person skilled in the field of the invention.

These tests set a higher level of threshold to obtain patent rights than that required for other IP rights, because the scope of the patent right is generally greater.

Patents allow the right holder to claim more than one manifestation of an idea, unlike copyright, which protects only a particular expression of an idea.

The Patent Office acts as the initial broker in forming the contract between the applicant and society for the grant of exclusive patent rights.²⁶⁹ The threshold tests are used as a rough proxy for the benefits of the claimed invention to society, since it is usually not possible to do a detailed cost-benefit analysis for each patent, partly because the value of new inventions is generally difficult and expensive to predict. Patent examiners frequently reject an application at least once, usually because the scope of the claim is either unclear or too broad (usually because it is not ‘fairly based’ on what is disclosed in the description or because it transgresses what is already known in the prior art). Applications may also be rejected because they are not sufficiently inventive, although this can be difficult to prove during examination, particularly when an applicant disputes that the examiner is a person suitably skilled in the art. Applicants may modify their specification, provided it is fairly based on what was originally disclosed, and resubmit the application up until 18 months from the beginning of the examination process.

In contrast to the situation in many other countries, examiners in Australia are required by decisions taken by the High Court (in the *Microcell* case) to give the applicant the benefit of the doubt when considering a patent application. If the application is nonetheless finally rejected by an examiner, the applicant can appeal to the Commissioner for re-examination. The Commissioner appoints a senior examiner not previously involved in the case to re-examine the application *ex parte*. Recently, there has been only a small number of re-examinations (typically two or three per year).

If accepted by an examiner, the granting of the patent is delayed for three months after notification in the Patent Office Gazette, to allow third parties to lodge oppositions on grounds such as:

- lack of novelty and inventive step;
- insufficient disclosure of the invention; and
- claims which are not sufficiently clear or fairly based on what is disclosed in the description.

Opposition hearings are conducted by the Patent Office by a delegate of the Commissioner, usually a senior patent examiner who has knowledge of the technology but has not been involved in the prior examination process, and who has been trained in the process of managing hearings. These hearings are *inter parte* and have prescribed time periods to prevent either party from benefiting from delays. There are normally fewer than 100 such hearings per year.

Decisions of the Patent Office, depending on their type, can be appealed to the courts or to administrative tribunals. The courts, generally presided over by a single judge of the Federal Court, also hear cases alleging infringements of granted patents. Because of the technical issues involved, such cases usually require calling expert witnesses who act as ‘persons skilled in the art’. These court proceedings are often very costly. The full bench of the Federal Court and the High Court only hear matters of law when appeal is allowed. Very few court cases involve IP Australia as a party.

²⁶⁹ Thomas J R ‘The Question Concerning Patent Law and Pioneer Inventions’ *Berkeley Technology Law Journal* No.10:1 (www.law.berkeley.edu/journals/btlj/articles/vol10.html)

Objectives of the patent system

The main objectives of the patent system can be summarised by the following quote from the Second Reading Speech on the *Patents Amendment Bill 1981*:

*The main purpose of a patent system is to stimulate industrial invention and innovation by granting limited monopoly rights to inventors and by increasing public availability of information on new technology. Patent procedures must achieve a balance among competing interests while remaining administratively workable.*²⁷⁰

Furthermore:

*The essence of the patent system is to encourage entrepreneurs to develop and commercialise new technology...Since a patent confers a limited monopoly over the use of the patented technology, the patent owner has the opportunity to make a profit from it, gaining a return on investment in innovation. The international character of the patent system makes a patent a useful tool in penetrating export markets.*²⁷¹

Overall, the patent system aims to promote investment in innovation by providing the inventor with temporary exclusivity over the use of an invention. For the purposes of the patent, the invention is defined by reference to a series of claims, set out in the patent, that specify the advance made by the inventor over the prior art, while ‘use’ is the broad set of exclusive rights the patentee obtains. As a counterpart to this protection, the inventor is required to disclose the invention to the public.

Problems patent rights attempt to address

As with other types of intellectual property, the principle problem which patents attempt to address is the threat of free riding on investment of intellectual effort. Unless kept secret, inventions and ideas can often be cheaply copied or imitated by competitors. Without patent protection it would be impossible to prevent free riding by persons who did not contribute to the original investment. This makes it impossible for the investor to recoup the cost of the investment required to secure the advance. Market incentives for investment in invention would consequently be deficient. As discussed in more detail under the section on *Alternatives*, the patent system attempts to solve these market failures through an essentially market-oriented mechanism, unlike possible alternatives such as direct government subsidy.

As with patents, contracts and trade secret laws can be used to reduce free riding by making it a breach to disclose confidential knowledge. Trade secret laws can also reduce transaction costs by reducing the protective measures which knowledge owners must expend to maintain control over an invention. However, trade secret law cannot reduce transaction costs to zero, for at least two reasons. Firstly, there is still the cost to both parties of acquiring information about the current state of knowledge before entering the contract. (The lack of disclosure making this cost all the greater). Secondly, trade secret law can only be used where the bargainers (producers and users of the knowledge) are well defined.²⁷²

²⁷⁰ The Hon David Thompson Minister for Science and Technology, April 1981 *Second Reading Speech, Patents Amendment Bill 1981*

²⁷¹ Hon Simon Crean, Minister for Science and Technology, *Second Reading Speech, Patents Bill 1990*

²⁷² Schlichler J W *Patent Law: Legal & Economic Principles* CBC (1992)

In addition, such contractual arrangements are in many situations very difficult and/or costly to make and enforce—for example, where the population of potential users is widely dispersed (for example, as between possible cancer patients and cancer researchers). In these situations, transactions and bargaining costs are likely to be high, and private negotiations cannot solve the problems free riding creates for efficient resource allocation.

Patent laws try to solve these problems by assigning the first producer exclusive rights for a limited period. By making patent law similar to real property law, the rights may be traded (sold or licensed) so that the knowledge can be transferred to its most efficient users. Bargaining issues are reduced and transaction costs are likely lower than with pre-production contracts or trade secrets. This is because the cost of identifying owners of knowledge and negotiating agreements with these owners is likely to be reduced and also because the cost of detecting violations is likely to be smaller (since all unauthorised users are violators).

The standard optimal conditions of welfare economics require equalisation between marginal *social* costs and marginal *social* benefits in every market, including that for innovation and knowledge. If marginal social cost in this market is less than the marginal social benefit, then increasing the amount of innovation will increase overall economic welfare, and conversely. However, the actual level of production of innovation in a market system will occur where production where the marginal *private* cost to an innovator (individual or company) equals the marginal *private* benefit. Assuming that private and social costs are equal (the opportunity costs of resources to their production) but that the marginal private benefit (value) of invention is less than its marginal social value, too little innovation will be produced. This is likely to be the case in the absence of a system of IP rights, as investors in creative effort could not prevent others from appropriating the fruits of that investment.

Research quoted by Revesz suggests that the private value of research and development (R&D) is much less than the social value (see table below).

Comparison of the private value of R&D to social value

Author	Country	Private return (%)	Social return (%)
Bernstein (1989)	Canada	24 – 47	29 – 94
Bernstein & Nadiri (1988)	USA	12 – 24	16 – 129
Goto and Suzuki (1989)	Japan	25	105
Mansfield (1977)	USA	34	78
Foster (1978)	USA	38	103

The social return on R&D generally far exceeds the private return. If returns are measured at the margin, it can be assumed that investment in innovation may be suboptimal for the innovator. Revesz concludes that by and large ‘the main economic problem that has been identified is one of inadequate rewards rather than excess windfall gains from patent protection.

Provided patents are granted for real innovations (as stipulated in the legislation) there is no conflict between patents and competition from the welfare economics perspective, because patents stimulate inventive activity that usually would have been more costly to induce by other means'.²⁷³

Under a patent system, it is unlikely that private and social costs will be equal. Indeed, the social costs will more often exceed the private costs (though both of these should be no greater than the resulting social benefits) because of:

- administrative costs of the Patent Office, though these can be internalised by fees;
- enforcement costs where the court system is subsidised by the public; and perhaps most importantly
- social costs due to the temporary market distortions caused by the exclusive right.

The patent system is not the only incentive to innovation (as further detailed in the *Alternatives* section below). Governments use other systems in parallel, including subsidy of knowledge production costs, either through direct grants and/or through indirect taxation relief. These systems interact, often pulling each other in different directions, making the economic and benefits analysis of the private and social costs more difficult.

Nature of the restrictions on competition

A patent excludes others from the area of technology defined by the scope of the claims for the duration of the grant. This exclusivity may enable the patentee to charge higher prices and make greater profits than would be possible if the ideas were freely available. Also, efficiencies gained as a result of the invention will be temporarily less widely available in society. Granting patents can therefore lead to losses in allocative and productive efficiency—the extent of these losses depends on the market power of the patentee and on the patentee's ability to price discriminate. In practice, however, a patent holder can rarely act as a pure monopoly, because of the availability of alternative and substitute products and processes, and also because some scope for imitation almost always exists.

Another effect of the temporary exclusive patent right is that it may inhibit innovation based on the ideas involved—this is because these ideas are not freely available for others to use. Kauffer²⁷⁴ suggests that these 'dynamic' costs are potentially greater than the 'static' deadweight costs, though they are likely to occur only when the scope of the patent is broad.

Similarly, Scotchmer²⁷⁵ states that until recently 'economic theories of IP have assumed that innovations are isolated events with no bearing on future innovations. That view limits how well the theory can be applied to modern controversies, especially those involving biotechnology and computing hardware and software. These technologies have a high degree of 'cumulateness'. This has implications for the social value of innovations and the ease with which firms can be given incentives to create them. Scotchmer continues by saying that cumulateness 'makes it especially difficult to turn social value into private value as must be

²⁷³ Revesz J 'The Economics of Patents' BIE Occasional Paper No. 18 AGPS Canberra 1994

²⁷⁴ Kauffer E 'Economics of the patent system' Harwood Press 1989

²⁷⁵ Scotchmer S 'Cumulative Innovation in Theory and Practice' (February 1999) GSPP Working Paper 240, U.C., Berkeley <http://socrates.berkeley.edu/~scotch/cum-r&d.pdf>

done if firms are to have incentives to innovate. Later products can supplant the earlier ones, reducing their profitability. A solution is to give broad protection so that licensing is necessary. However, this may stifle the second-generation products.’

To some extent dynamic losses are counteracted by the disclosure of ideas as part of the *quid pro quo* of granting a patent and by the fact that the patent system itself (by defining an assignable and enforceable property right) facilitates the use of licensing (in this case the use of cross-licensing between the original inventor and those that improve upon the invention).

International obligations

As the world economy becomes increasingly integrated, the international characteristics of the patent system are becoming more important. For innovation to play a major role in Australia’s future, the ability of Australian innovators to gain property rights in export markets such as the United States and Europe is crucial. By the same token, innovators in other countries will increasingly seek patents in Australia. Indeed, the majority of applications for standard patents made in Australia are from overseas. The Committee notes that the balance between the social benefits generated by the patent system and this system’s cost to the community, is affected by whether the beneficiaries of the patents granted are in Australia or overseas. If the income transfers resulting from the system stay within Australia, then (all other things being equal) the social cost to the Australian economy of the system is potentially less and the net benefit correspondingly greater.

It might be simple to infer from this that Australia ought to seek easily obtainable protection in foreign markets while maintaining a system that restricts the availability of patent protection domestically. However, given the long-term reciprocal nature of the patent system, a ‘beggar thy neighbour’ approach is unlikely to be sustained—indeed, preferential treatment of domestic applicants has long been prohibited by the Paris Convention for the Protection of Industrial Property, and recently reinforced by TRIPS.

No less important is the fact that effective patent protection facilitates trade in technology, both domestically and internationally. An effective patent system, accessible to foreign technology suppliers, allows Australian firms to import technology that would otherwise be unavailable, or would only be available at higher cost. This increases productivity and enhances competition in the Australian economy. The importance of technological imports is illustrated by the more than 90 per cent of patents registered in Australia, which are owned by foreigners. In addition, there are more indirect cross-border spill overs through importing of goods which embody innovations and which may be used as intermediate inputs or sold directly to end-users.

Reflecting the important international dimension of the patent system, Australia has entered into a number of international legal instruments that impose obligations with respect to the patent system.

These include:

Paris Convention for the Protection of Industrial Property (1891)

This treaty applies to ‘industrial property’ in the widest sense, including inventions, trade marks, industrial designs, utility models, trade names, geographic indications and the repression of fair competition. It covers national treatment (preventing discrimination against non-residents), right of priority provisions (for subsequent applications in contracting states) and some common rules. For patents, the most significant of the common rules cover independent assessment of patent eligibility by contracting states; maintaining national administrations including a special industrial property service with a central office for the communication with the public of patents, marks and industrial designs; and limitations on compulsory licensing provisions with respect to patents.

Patent Cooperation Treaty (PCT) (1970)

The PCT enables patent protection for an invention to be sought simultaneously in member states designated by the applicant. An international search is conducted by one of the 10 major patent offices, of which Australia is one, and the report lists citations of prior art which are relevant to the novelty and inventiveness of the application. The applicant can optionally ask for an ‘international preliminary examination report’, which gives a preliminary but non-binding opinion about the patentability of the claimed invention. However, after time periods specified by the PCT, the application must be filed with national offices where they are processed against the same national standards as any other application, though taking into account the results of the PCT search and examination.

Agreement on Trade Related Aspects of Intellectual Property Rights (1995)

The main features of TRIPS relevant to patents are:

- the requirement to have a patent system to be a member of the WTO;
- a minimum patent term set at 20 years;
- the requirement to protect artificially developed new varieties of micro-organisms through patents;
- no areas of technology are to be excluded from patent protection, with the optional exceptions of medical methods for the treatment of humans, and of new life forms above the micro-organism level;
- the requirement to protect new plant varieties, within the patent system or with a separate system of breeder’s rights, or both;
- the imposition of limitations to the application of compulsory licensing and government use of patents, and the requirement for adequate compensation;
- reversal of the burden of proof for process patents, and prohibition of any distinction in patent rights based on whether goods are locally produced or imported; and
- the requirement to develop a legal system for protecting trade secrets from unfair disclosure in accordance with principles of fair competition.

Australia was complying with most of the current requirements of TRIPS before they were adopted and so only relatively minor adjustments to the Patents Act were required to make it TRIPS-compliant, the most important being the extension of the maximum patent term from 16 to 20 years.

Patent Law Treaty (2000)

Recently, WIPO has been discussing the need for a Patent Law Treaty. After long negotiations, it was agreed that for the time being the treaty will not harmonise substantive issues such as the threshold tests of novelty and inventive step but will harmonise mainly administrative issues such as filing procedures. The treaty was adopted on 1 June 2000 by a Diplomatic Conference, including Australia, but has yet to be ratified.

Alternatives to patents, including non-legislative means

Apart from patents there are other mechanisms for commercial appropriation of the benefits of innovation. An empirical survey by Levin et al²⁷⁶ found that the following methods were used by firms to protect their competitive advantage from innovations:

- patents;
- secrecy;
- lead time;
- moving quickly down the learning curve; and
- distinctive sales and service to customers.

A report by the OECD²⁷⁷ quoted similar findings from more recent studies. A study of American manufacturing (Cohen et al, 1996), for example, showed that secrecy was ranked first in terms of importance (over patents, lead time, service etc.) in 14 out of 43 industries (33 per cent) among the means adopted to protect product innovation, and among 28 industries out of 43 (65 per cent) for product innovation. Similarly, in a 1994 survey of German small to medium enterprises with in-house R&D (Fest, 1996), only about one-third of respondents used patents to protect their IP. Another third relied on secrecy, pointing to the high cost of litigation. The remaining third introduced innovations faster than their competitors, indicating that the life cycle of their products is not much longer than the time it would take to obtain an European Patent Office (EPO) patent (2.5 to 3.5 years). Another survey, carried out in France by the Industry Ministry, revealed that only 10 per cent of innovating firms regarded patents as very important.

The main alternative to the patent system is trade secrets. Trade secret law is dominated by the common law action of breach of confidence. A successful action of breach of confidence requires that the disclosed information had sufficient quality of confidence, that it must have been imparted in circumstances giving rise to an obligation of confidence, that the disclosure must have been authorised and that some detriment must have been suffered as a

²⁷⁶ Levin R, Klevorick A K, Nelson R and Winter S G (1987) 'Appropriating the Returns from Industrial R&D' Brookings Papers on Economic Activity, Washington DC

²⁷⁷ OECD 'Patents and innovation in the international context' OCDE/GD (97) 210

consequence. Trade secrets and know-how may also be protected contractually. Unlike patents, there is no registration system involved for trade secrets.

In contrast to patents, where the innovator has exclusive rights, trade secret law allows others to duplicate an innovation, provided they do it independently or by reverse engineering. This puts a limit on the value of trade secrets. On the other hand, trade secrets have the potential to protect an innovation indefinitely, while patents give a maximum protection of 20 years.

Patents require sufficient disclosure. This disclosure provides social benefits by promoting diffusion of knowledge, but by the same token, it imposes a private cost on innovators by alerting competitors of the new ideas and facilitating ‘inventing around’. Compared to patents, a primary social cost associated with trade secret law is the reduced diffusion of information. In addition, the property right associated with trade secret is less certain and may severely discourage trade in the innovation being protected. This in turn may impede or slow the transfer of new ideas to those who can put them to best use. Finally, because trade secret does not rule out independent invention, it may encourage duplicative investment in invention, resulting in some element of pure waste.

Thus the two systems—patents and trade secrets—have different advantages and disadvantages and can be seen as complementary. They give innovators a choice. Levin et al²⁷⁸ found that trade secrets are preferred when the innovation is a method of manufacture or a product that cannot be reverse engineered. Patents are preferred by innovators for product innovation that can be easily copied. Each system has its cost and benefits, both from society’s and from the innovators’ point of view. In practice, many licensing agreements rely on both systems.

Other incentive mechanisms have been used by governments to encourage innovation, by reducing the gap between private and social benefits. By and large, these centre on providing direct incentives to invention and innovation, through some combination of subsidies and of intra-mural conduct of R&D.

In theory, direct incentives to invention and innovation should allow for greater efficiency than the grant of exclusive rights. Thus, one of the pioneers of modern economics, Frank Knight, viewed patents as an ‘exceedingly crude way of rewarding invention’.²⁷⁹ He concluded that ‘it would seem to be a matter of political intelligence and administrative capability to replace artificial monopoly with some *direct* method of stimulating and rewarding research’.²⁸⁰ The Nobel laureate in economics, Kenneth Arrow, echoed this view some 40 years later in his classic article on the economics of R&D.²⁸¹

²⁷⁸ Levin R, Klevorick A K, Nelson R and Winter S G (1987) ‘Appropriating the Returns from Industrial R&D’ Brookings Papers on Economic Activity, Washington DC

²⁷⁹ Knight (8th impression, 1957) *Risk, Uncertainty and Profit*. Knight believed that most of the rewards from patents went to those who put the ‘finishing touch’ on ideas, rather than the genuine risk-takers.

²⁸⁰ *Ibid*

²⁸¹ Although often cited by those who support strong IPR’s, suggesting that as with so much economic literature, it is far more often cited than read, Arrow’s main conclusion is that ‘for optimal allocation [of resources] to invention it would be necessary for the government or some other agency not governed by profit-and-loss criteria to finance research and invention.’ Arrow (1962) ‘Economic welfare and the allocation of resources to invention’ in *The Rate and Direction of Inventive Activity: Economic and Social Factors*, 623.

These arguments, compelling though they may be, rest on the assumption that governments, in implementing Knights' 'direct method' of stimulation, will make fewer or less costly errors in allocating resources to creative effort than are caused by the market-oriented mechanism of intellectual property rights. This assumption has merit when applied to pure research, but must surely fail at the application end of the spectrum. To begin with, it requires a greater degree of omniscience (and perhaps of omni-benevolence) from public decision-makers than is safe to assume. Additionally, it underestimates the incentives even owners of monopoly rights have to expand output, say through price discrimination, and therefore likely overstates the costs of an alleged monopoly. Finally, it wrongly assumes that intellectual property rights serve only to fund investment in creative effort. In practice, they also act to promote the disclosure of new ideas (particularly where secrecy is a viable alternative), and by allowing well-defined rights to be traded, they facilitate the allocation of the ownership of creative works to those who can put them to their most highly valued use. Since no 'direct method' of stimulation has yet been found that comes close to matching these effects, calls for a wholesale retreat from patents are poorly based.

Conclusions

In the Committee's view, there is little doubt that the social gains from investment in new ideas can exceed the private gains investors would secure from that investment in the absence of public intervention.

The patent system does not, and cannot, provide a perfect or complete answer to this problem. However, it has strong advantages relative to alternatives—such as trade secret and government subsidisation—even though these alternatives have an important role to play in promoting innovation.

Overall, the Committee agrees with Scherer²⁸² that "the patent system is recognised to be an imperfect instrument. Nevertheless, it may be the best solution policy man can devise to the difficult trade-off between, on the one hand, maintaining incentives for investment and, on the other hand, fostering the diffusion of new technology's benefits to consumers and to those who might make leapfrogging inventions. Its imperfections include uncertainty as to which of several contending parties will receive patent protection and how much protection patents will afford, the costs of concomitant legal services, and the ease in most cases (but not in pharmaceuticals) of 'inventing around' existing patents."

The issue then is how to maximise the net social benefits that can be obtained from the patent system. This involves carefully examining the system itself, and identifying areas where benefits can be increased or costs reduced.

Two areas are of particular importance in this regard:

1. The Committee is convinced that Australia would gain from ensuring, to a greater degree than is currently the case, that patents are not granted where it is likely that reasonable threshold tests for securing a valid patent will not be met. The Committee accepts that there are costs involved in screening applications, but believes, for reasons discussed

²⁸² Scherer F M 'New perspectives in economic growth & technological innovation' British Institution Press 1999.

below in this section, that these costs are outweighed by the costs society bears when patents that ought not to be granted, are granted.

2. The Committee believes that subject to greater and more stringent control over their grant, those to whom a patent has been granted should have a reasonable degree of confidence in the validity of the rights they have obtained.

These broad considerations, which need to be addressed in terms of many more detailed aspects of the patent system, are elaborated on in this section.

Improving the patent system

The Committee has considered more detailed ways in which the present patent system, both the legislation and its administration, can be reformed to enhance its social benefits and reduce its social costs. These are discussed in this section. It must be emphasised that the patent system must be viewed as a totality, which has checks and balances between producer and consumer interests and which balances the needs of initial innovators with those of innovators that follow.²⁸³ The recommendations for improving the patent system made here need to be considered in this light.

As discussed, the patent system embodies a complex trade-off between costs and benefits resulting from its effects on innovation and competition. Within the patent system, there are two main elements that allow adjustment of where the net benefit of this trade-off falls.

These are:

- the threshold tests (particularly of inventiveness) necessary for a patent to be granted; and
- the term of the patent.

TRIPS sets the term of the standard patent at no less than 20 years. The Committee does not believe that a case has been made for further extending the maximum patent term, and therefore takes it as given. There may be some scope for reducing the effective length of the patent term, so that less innovative patents are likely to extract lower economic rent, by using more steeply rising renewal fees.²⁸⁴ The Committee recommends that the scope for, and impact of, implementing more steeply rising renewal fees should be considered by IP Australia.

The proposed ‘innovation patent’ offers another means of balancing the benefits to society with the costs to society by trading-off lower levels of innovation with a shorter maximum term. Recent work on regulatory economics suggests that firms should be offered a menu of incentive contracts to overcome the problems of asymmetric information that arise when firms typically have much more information about their invention and its likely commercial value than government agencies, even ones with technical expertise such as patent offices.²⁸⁵ The choice that will be available between the standard patent and the innovation patent seems consistent with this approach to efficiency in regulation.

²⁸³ Ordovery ‘A patent system for both diffusion and exclusion’ *Journal of Economic Perspectives* Vol 5 (1991), p. 43–60

²⁸⁴ Cornelli F and Schankerman M ‘Patent renewals and R&D incentives’ *Rand Journal of Economics* 30 (1999) 197– 213

²⁸⁵ Josh Lerner ‘150 years of patent office practice’ Harvard University and NBER working paper (1999)

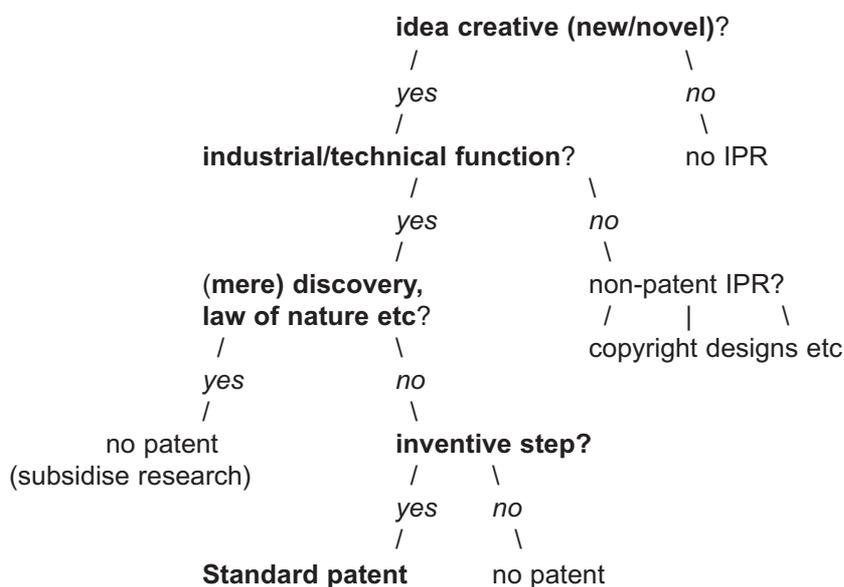
For the standard patent, the main area with significant scope for change is with the threshold tests. For both domestic and foreign applicants, the costs to Australian society will be minimised by having threshold tests that are sufficiently high to ensure that only inventions with social benefits greater than social costs (including costs arising from the patent system itself) are protected. In implementing this, the Committee believes that Australia should aim to set the threshold for a standard patent at a level no less than the highest threshold set by any country with which we conduct substantial technology trade.

The Committee considers how the threshold tests for granting a patent should be improved in the first part of this section.

In the second part, we consider how the administration of the patent system can be made more effective.

Improving the tests for granting a patent

To be granted a patent in Australia, an application is examined by patent examiners against a number of requirements set down in the Patents Act. Many of these requirements are formal criteria, which can be met through good drafting of an application. Threshold tests, on the other hand, relate more to the nature and scope of the patent right claimed and therefore its economic value. These are included in s. 18 of the Patents Act. The decision-tree model below provides a summary of the threshold tests used during examination.



Other substantive requirements included in s. 40 of the Patents Act must be met during examination, and these can limit the scope of the claims granted.

Examples include:

- clarity and succinctness—so that the scope claimed may be reliably ascertained;
- sufficiency of description: the description must fully describe the invention so that a skilled addressee can reliably reproduce the invention without undue experimentation; and
- fair basis—the scope of the right must not go beyond that which is disclosed, as part of the ‘contract’ between the applicant and society.

Manner of new manufacture test

The first two tests (new/novel and industrial/technical) were part of the original ‘manner of new manufacture’ criterion of s. 6 of the *English Statute of Monopolies 1623*, which generally outlawed ‘monopolies’ except for patents of limited life to promote innovation. Reference to s. 6 of the *Statute of Monopolies* is still explicitly included in s. 18(1)(a) of the *Patents Act 1990*.

New or novelty test

The ‘new’ part of the ‘manner of new manufacture’ criterion has been largely replaced by the ‘novelty’ criterion separately included in s. 18 of the 1990 Patents Act. However, because the word ‘new’ was not placed in ‘manner of manufacture’ in s. 18(1)(a) of the 1990 Act, it was argued before the High Court in *Philips v Mirabella*²⁸⁶ that there is no longer any ‘residual requirement of newness’ imposed by the retention of the Statute of Monopolies definition.

A three to two majority of the High Court imported the earlier case law back into the 1990 Act through the term ‘invention’ used in s. 18(1). Invention is defined in Schedule 1 to mean ‘manner of new manufacture’. Thus, the Court said there is a bare minimum threshold established by s. 18(1)(a) that must be met before it is worth considering whether an application satisfies s. 18(1)(b) on novelty and inventiveness. Recent cases, however, appear to have qualified the *Mirabella* interpretation.²⁸⁷ The Committee is aware that these decisions have created considerable legal controversy.²⁸⁸ We are not convinced, however, that they represent a competition issue—the costs and benefits of granted patents should ultimately depend on the higher specific hurdles of novelty and inventiveness, not on a bare minimum threshold test for invention.

The specific novelty test in the 1990 Act asks whether prior art documents or acts, either singly or as a combination which a person skilled in the art would treat as a single source of information, teach all the essential features of the claim(s). Following a recommendation of the 1984 Industrial Property Advisory Committee (IPAC) Report, the prior art base for novelty for a standard patent was extended to include all documents or workings anywhere in the world, and not just in Australia, as had previously been the case.

²⁸⁶ *N V Philips Gloeilampenfabrieken v Mirabella International Pty Ltd* (1995) 183 CLR 655

²⁸⁷ *Advanced Building Systems Pty Ltd v Ramset Fasteners (Aust) Pty Ltd* (1998) 40 IPR 243; *Bristol-Myers Squibb Co v F H Faulding & Co Ltd* [2000] FCA 316

²⁸⁸ Padbury M ‘Inventiveness apart from Novelty and Inventive Step—The High Court’s Decisions on Manner of Manufacture in Philips and Mirabella’ AIPJ vol 9 (1998) 161

Industrial or technical function test

As can be seen from the listing of cases in the table below, there has been an inexorable expansion over time in what is regarded as a ‘manner of manufacture’ in Australia. This expansion was affected initially through Australia’s links with the British legal system. More recently, the impetus to continued expansion has come from domestic sources.

Evolution of the meaning of ‘manner of manufacture’

Year	Case	New coverage
1819	<i>Rex v Wheeler</i>	Cheaper or more efficient processes
1842	<i>Crane v Price</i>	Better, cheaper articles
1914	C&W’s Application	Extracting lead from humans
1943	GEC Application	Any vendible product
1947	Rantzen Application	Non-material effects (generating radio waves)
1951	Standard Oil	Agricultural processes (killing weeds)
1954	Lenard’s Application	New plant varieties
1957	Elton & Leda	New and useful effects (fog precipitation)
1961	Swift & Co.	All agricultural processes, including treating animals
1961	NRDC	All artificially created situations of utility in the economic area
1972	Joos	Cosmetic treatments of humans
1976	Rank Hovis McDougall	Micro-organisms
1991	IBM	Applications of mathematics, including computer programs
1994	Rescare	All treatment of humans
1994	<i>CCOM v Jiejeng</i>	All computer software with commercial application

This evolution is perhaps best summed up in *NRDC’s Application* [1961] RPC 134 where the High Court said it is a mistake to enquire whether a given process or product is a ‘manner of manufacture’ in the everyday sense of making tangible goods by hand or machine. The High Court stated that the ‘right question is: “Is this a proper subject of letters patent according to the principles which have been developed for the application of s. 6 of the Statute of Monopolies?”...The purpose of s. 6, it must be remembered, was to allow the use of the prerogative to encourage national development in a field which already, in 1623, was seen to be excitingly unpredictable. To attempt to place upon the idea the fetters of an exact verbal formula could never have been sound. It would be unsound to the point of folly to attempt to do so now, when science has made such advances that the concrete applications which were familiar in 1623 can be seen to provide only the more obvious, not to say the more primitive, illustrations of the broad sweep of the concept.’

The High Court went on to suggest a requirement that there be ‘a mode or manner of achieving an end result which is an artificially created state of affairs of utility in the field of economic endeavour’.

Other countries have different approaches, reflected in different forms of words. For example, the Supreme Court of the Federal Republic of Germany has held that:

A patentable invention is defined as a technical instruction to a human being on how to methodically utilise controllable natural forces to achieve a causally predictable result.

This result is the direct result of said controllable natural forces without the necessity of the inference of (further) human intellectual activities.

In practice, definitions such as this mainly transfer the problem to defining the meaning of terms such as ‘technical’, ‘industry’, ‘useful’ and ‘natural forces’. Partly reflecting this, some jurisdictions, notably the European Patent Office, attempt to define what is not patentable by a codified list. In principle, this gives greater certainty of patentability, but also imposes the cost of some degree of arbitrariness.

Almost all submissions to the Committee argued for retention of the current Australian definition of what is patentable as ‘manner of manufacture’. For example, the Institute of Patent Attorneys and Trade Mark Attorneys²⁸⁹ said that ‘IPTA considers that the current test of what is patentable subject matter as set out in s. 18 of the *Patents Act 1990* is suitable both for the needs of established technologies and for the needs of newly emerging technologies...Application of this principle has allowed development of the concept of patentable subject matter to move with the advance of technology over the years to encompass biological processes and other aspects of biotechnology, as well as computer software and so on. IPTA considers this position is far preferable to the position which exists in some other countries which have a static, more precise definition of patentable subject matter, as this latter situation has resulted in many of these other countries struggling to develop the concept of patentable subject matter with the advance in technology.’

Telstra²⁹⁰ agreed: ‘Telstra strongly endorses the retention of the concept of manner of manufacture within the meaning of s. 6 of the Statute of Monopolies as the test of patentable subject matter. As explained by the High Court in the NRDC case and applied in *IBM v Commissioner of Patents*, this test has demonstrated sufficient flexibility to meet the demands of technological changes appropriately constrained by society’s needs. Telstra submits that this flexibility is extremely important in a time when some technologies are being developed at extremely rapid rates. For example, the European Patent Convention adopted a very prescriptive approach to patentable subject matter particularly in relation to computer programs and biotechnology. These rules have in many respects been overtaken by unforeseen technological development and have led to extremely complicated, technical and artificial distinctions about what is and is not patentable.’

One of the few submissions to argue the contrary view was Orbital, which argued that ‘reference to “manner of manufacture” and “Statute of Monopolies” is a sign of a cop-out and is unacceptable in this day and age...even though steps were taken during drafting of the 1990 Act to make greater use of “plain English”, the Act is still considered too difficult to interpret for the “average man off the street”’.²⁹¹

As a general matter, the Committee accepts that reliance on an open-textured standard, such as that currently used to define the bounds of ‘manner of manufacture’, can impose costs as compared to a more prescriptive approach based on the detailed formulation of *ex ante* rules. In particular, *ex ante* rules can reduce uncertainty as to eligibility, and hence may reduce the need for scrutiny in individual instances.

²⁸⁹ Issues Paper Submission 24 at pp 4–5

²⁹⁰ Issues Paper Submission 62 at p 15

²⁹¹ Issues Paper Submission 54 at p 11

However, it is also clear, both from general principle and from the European experience, that formulating such *ex ante* rules entails high direct costs. Even more importantly, they can create significant error costs associated with the under or over-inclusiveness of the rules. These errors can have substantial consequences for efficiency and competition, since under-inclusiveness may erode the incentive for innovation (and as a result for the uniquely effective form of competition that innovation provides), while over-inclusiveness may grant exclusive privileges where they are not warranted.

Recommendation

Manner of manufacture

The Committee believes that Australia has on the whole benefited from the adaptiveness and flexibility that has characterised the ‘manner of manufacture’ test. As a result, we recommend that this test be retained.

Exclusions from manner of manufacture

Background and submissions

Although often technical/scientific in content, certain areas have been excluded from ‘manner of manufacture’ or its equivalent in most countries. The most important of these areas are abstract principle, laws of nature or mere discoveries. These have been invoked recently in controversies affecting two major growth areas of technology, namely computer software and gene sequences in biotechnology. In particular, it has been argued that computer software often consists of mathematical algorithms and therefore abstract principles, and that gene sequences *per se* already exist in nature and hence are mere discoveries unless tied to an application. The patentability of business schemes is also an area of some debate, though it raises issues somewhat different from those involved in the distinction between discoveries and inventions.

The ‘discovery/laws of nature/abstract principles’ exclusion from patenting was originally made explicit in the US Supreme Court.²⁹² In 1840, *Wyeth v Stone* involved a patent for an ice-cutting machine that claimed ‘an apparatus worked by any power other than human. The invention of this art, as well as a particular method of application of the principle, is claimed’. Justice Story, as trial judge, ruled that the patent was void ‘as it is for an abstract principle, and broader than the invention’. The Judge was concerned mainly about the uncertainty of the scope of the claim and its breadth relative to the invention Wyeth had made. However, the language about ‘abstract principles’ soon took on a life of its own. In 1853, a majority of the Supreme Court echoed Justice Story and declared that patents may not be issued for ‘phenomena of nature, laws of nature or abstract principles’. But three of the Justices dissented saying that if an inventor was permitted to patent a new application of a known principle then so too should the discoverer of a new principle be rewarded. They said that for the time of the patent, society would be no worse off than before the new patent and would clearly be better off when the patent expired.

²⁹² Schlichler J W ‘Patent Law: Legal and Economic Principles’ CBC (1992)

In Australia, the High Court in the *NRDC* case, citing with approval the view expressed by Lindley LJ in *Lane Fox v Kensington and Knightsbridge Electric Lighting Company* (1892) 3 Commonwealth 424 at 428, stated that ‘... a man who discovers that a known machine can produce effects which no one before him knew could be produced by it has made a discovery, but has not made a patentable invention unless he so uses his knowledge and ingenuity as to produce either a new and useful thing or result’. However, it went on to say that no general definition for what constitutes a discovery as opposed to an invention existed: ‘The truth is that the distinction is not precise enough to be other than misleading in this area of discussion. There may indeed be discovery without invention—either because the discovery is abstract information without suggestion of practical application to a useful end, or because its application lies outside the realm of “manufacture”.’²⁹³

Despite intense controversy in the late 1980s regarding the patentability of software because it involves or comprises algorithms and therefore mathematical principles, there now seems little disagreement that computer software should be patentable provided it meets the other tests for patenting. This follows the Federal Court’s decision in *IBM Corporation v Commissioner of Patents*.²⁹⁴ The Full Federal Court came to similar conclusions in *CCOM v Jiejing*.²⁹⁵ This is the position now adopted by the Patent Office in its *Patent Examiners Manual*.²⁹⁶

However, patenting of genes *per se* is still controversial. The Patent Examiners Manual (8.2.5.3), following the *NRDC* case, states that: ‘A chemical substance or microorganism which is discovered in nature without any practical application is a ‘mere chemical curiosity’ and not patentable subject matter. More commonly in examination, the specification provides some practical application for the isolated substance or microbe... Thus, the discovery of a microorganism, protein, enzyme or antibiotic in nature can be claimed in its isolated form or as a substantially free of (perhaps specified) impurities. Also, a gene can be claimed as the gene *per se* (as long as the gene does not include within its scope the native chromosome of which the gene forms a part) or as the recombinant or isolated or purified gene.’

Submissions to the Committee on patenting genes *per se* have varied widely. Some, such as Uniquet Pty Ltd.²⁹⁷ argued that genes were little different to other biologically active molecules, such as insecticides, which already enjoyed patent protection. Uniquet also argued strongly that not being able to patent genes *per se* would severely reduce the value of research outputs by research scientists and make it difficult to obtain funding for fundamental biochemical research. In contrast, Dr Charles Lawson of the Australian National University²⁹⁸ argued that: ‘isolating a gene or gene sequence should be viewed as a process of discovery of the information from ‘nature’ held in the sequence, which can then be applied for inventive purposes. The approach of characterising the invention as deriving the sequence information from ‘nature’, and then restricting the further exploitation of that information through broad patents is contrived and undermines the policy basis for patenting—the encouraging and rewarding of inventiveness.’

²⁹³ *Lane Fox v Kensington and Knightsbridge Electric Lighting Company* (1892) 3 Commonwealth 424 at 428

²⁹⁴ *IBM Corporation v Commissioner of Patents* (1991) 22 IPR 417

²⁹⁵ *CCOM v Jiejing*, 28 IPR 481

²⁹⁶ Vol. 2, s. 8.2.7, revised November 1999. See www.ipaustralia.gov.au/patents/Manual/P_vol2.htm.

²⁹⁷ Issues Paper Submission 29 at p. 5

²⁹⁸ Issues Paper Submission 3 at p. 29

Another submission went further: ‘This mosaic of rights to fragments of genes creates a potential litigation and licensing minefield for inventors who enter later in the process...If the distinction between intellectual property protection for biotechnology innovations and biotechnology *per se* is not maintained, there is the possibility of an adverse impact in the Australian biotechnology industry.’²⁹⁹

Although raised in the Issues Paper, the Committee received few submissions on patenting of business schemes and service industries generally, even though the latter represents a major and increasing part of the Australian economy. The *Patent Examiners Manual*, which guides current examination practice in IP Australia, quotes as the main precedent *Cooper’s Application* (1902) in which Sir Robert Filary, A.G. said: ‘You cannot have a Patent for a mere scheme or plan—a plan for becoming rich; a plan for better Government of a State; a plan for efficient conduct of business. The subject with reference to which you must apply for a patent must be one which results in a material product of some substantial character.’ However, as shown in the table above, there has been significant shift in Australian case law away from the need for an invention to be one that ‘results in a material product of some substantial character’ to one that ‘results in an artificially created state of affairs of utility in a field of economic endeavour’.³⁰⁰

The Committee is also aware of the recent substantial increase in applications for patents for business schemes in the United States. This follows the judgement in the *State Street Bank* (1998) case, which allowed patenting of business schemes (subject to other tests such as novelty and non-obviousness). This decision overturned a presumption of the United States Patent and Trade Mark Office (USPTO) that business schemes were not patentable subject matter. The United States Supreme Court has since decided not to review the judgement, making it effective United States patent law.

Committee consideration of ‘use’ and ‘manner of manufacture’

The Committee considers that the goals underpinning the National Competition Policy are well served by a patent policy that rigorously distinguishes between *discoveries* that advance our understanding of the nature, structure and properties of matter, and *inventions* that apply this understanding to useful products and processes. Within such a policy, only the latter should qualify for patent protection. In taking this approach, the Committee believes the following considerations are especially relevant.

The principle reason for distinguishing between discovery and invention is that the core purpose of the patent system is to encourage innovation and the transfer of technology in ways that make a contribution to economic welfare. This is reflected in the High Court’s suggested requirement that to meet the test of manner of manufacture there be *a mode or manner of achieving an end result which is an artificially created state of affairs of utility in the field of economic endeavour*. This would suggest that the patent must define a product and/or process which is of utility in the field of economic endeavour. Mere discovery without demonstration of utility in the field of economic endeavour cannot meet this requirement.

²⁹⁹ Issues Paper Submission 49

³⁰⁰ *Cooper’s Application* (1902) 19 RPC 53.

Other considerations reinforce the need to distinguish between discovery and invention. It is important that patent rights are clearly defined in a way that the difficulty and costs for the public or a competitor to determine the scope of a patent right are kept within reasonable limits. This result would not hold were the patent right extended to discovery. In particular, although ‘discovery’ is a heterogeneous category, it seems reasonable to suppose that it can be far more difficult to define and enforce the scope of a patent claim relating to, say, a law of nature than to a particular useful application of scientific and technological principles. Moreover, with the passage of time, it becomes ever more difficult to identify the uses in which a particular principle is embodied. Property rights in discoveries would therefore be costly to define and implement and could give rise to unreasonable barriers to potential competitors or to those who wished to use the ‘discovery’ in other fields of endeavour. It may also add very significant burdens on scientific communication.³⁰¹

The issue then is how this distinction between discovery and invention ought to be implemented in the Australian context.

The effect of the ‘manner of manufacture’ requirement has been to prevent the patenting of discoveries such as laws of nature while allowing patenting of their application to a particular purpose in the field of economic endeavour. For example, the discovery of the atomic structure of matter and within it the electron would not have been patentable. However its application to generation of electricity would have been. The criteria of ‘manner of manufacture’ and ‘utility’ have taken on a greater importance in some areas of new technology, particularly biotechnology, where the dividing line between mere discovery and invention has become more difficult to define. This is reflected in the debate about the patentability of the mere identification of genes of which the most significant examples are being generated by the Human Genome Project.

The Committee’s view is that the requirement to demonstrate a defined use for an invention is important and that it has not always been clear how this requirement has been imposed. We are aware that the ‘useful’ test under s. 18(1)(c) of the Patents Act has been interpreted by the Courts as meaning ‘simply that the result claimed is capable of being achieved following the instructions in the specifications’.³⁰² Section 40 requires that the application must also have sufficiency of disclosure but it is unclear to what extent this requires a clear statement of use or utility. As discussed above, the High Court’s *NRDC* test for manner of manufacture gives guidance on this. However, the Committee is concerned that the references to ‘use’ and ‘utility’ may conflict and that greater clarity is required.

The Committee is aware that the United States Patent and Trade Mark Office (USPTO)³⁰³ has recently issued revised interim utility guidelines that, if fully implemented, will bring about a more closely defined approach to the consideration of utility in the patent examination process in the United States.

³⁰¹ Merges R P ‘Property rights theory and the commons: the case of scientific research’ in *Scientific Innovation: Philosophy and public policy* eds Paul et al, Cambridge University Press (1996)

³⁰² McKeough J and Stewart A *Intellectual Property in Australia* 2nd Edition (1997) Butterworth p. 307

³⁰³ See www.uspto.gov.

These guidelines require that the utility be:

- *specific*—that is a utility that is specific to the subject matter claimed rather than a general utility that would be applicable to the broad class of the invention;
- *substantial*—that is a utility that defines a real world use rather than one that requires further research to identify such a use; and
- *credible*—that is the assertion of utility is believable to a person of ordinary skill in the art based on the totality of evidence and reasoning provided.

The implementation of these guidelines would preclude the patenting of discoveries for which a specific, substantial and credible use has not been defined. The Committee supports this approach. It is consistent with the objectives of the patent system; will limit the extent of market power obtainable through the system; and will meet the general principle of having a threshold test in Australia that is equivalent to the test that Australian innovators must meet for patentability in major overseas markets. The Committee also believes it is strongly preferable to define general criteria and avoid industry-specific criteria, which would likely need frequent updating as technical advances occur.

In summary, the Committee believes that mere discoveries—that is, the identification and specification of the nature, structure and properties of existing matter and its interaction—should continue to be excluded from the class of patentable subject matter. We consider that this principle should exclude from the scope of patent protection the mere identification of a gene sequence, much as it would preclude the granting of a patent over, say, Mendel’s law. We do not believe that this should be ensured through industry or technology specific statutory provisions; rather, the general principle underpinning the scope of patentability should be sufficiently clear to guide administrative practice and judicial decision in a way that ensures this outcome. The Committee is attracted by the approach suggested by the USPTO in its revised interim utility guidelines.

On business schemes, the Committee is not convinced that this area requires incentives for innovation. Indeed, we note that the Statute of Monopolies, still referred to in the definition of manner of manufacture in s. 18(1) (a) of the Act, was originally promulgated to stop abuses of exclusive franchises in business lines such as trading cards, alehouses and various staple products.³⁰⁴ However, we believe that no additional specific recommendations for business schemes are needed since most will not pass the general tests for patent grant, particularly if these tests are modified as recommended by the Committee and stringently applied.

The Committee recognises that modifying and subsequently implementing the threshold tests may create uncertainty. In general, we believe that areas of material uncertainty in the tests can introduce significant costs to applicants who will be unsure of the robustness and enforceability of the rights, to competitors who will be uncertain whether they are infringing a granted right, and to society through the costs of type 1 errors (granting patents which should not be granted) and type 2 errors (not granting patents which should be granted), as well as through possible loss of confidence in the system by those both inside and outside it. Type 1 errors lead to costs of exclusion without the corresponding benefits to society; while type 2 errors undermine the incentives to innovate.

³⁰⁴ Merges R P ‘Property Rights for business concepts, and patent system reform’ *Berkeley Technology Law Journal* No. 14:2 at www.law.berkeley.edu/journals/btlj/articles/vol14.html

Both types of costs may be borne over a number of years if it is left entirely to private litigation to correct areas of uncertainty. The Committee therefore considers that IP Australia should be active in resolving these areas of uncertainty by taking test cases to the courts.

Recommendations

Patent Office examination practice

The Committee recommends that the Patent Office ensure in its examination practice that the use described in the specification is specific, substantial and credible to a person skilled in the art.

The Committee recommends that where substantial areas of uncertainty exist in application of the patent law, particularly the threshold tests for granting a patent, IP Australia should initiate test cases to try to resolve the issues expeditiously.

Inventiveness or obviousness test

Background and submissions

The inventiveness/obviousness test has largely supplanted the new/novelty test as the main threshold height for the grant of a patent. The new/novelty test asks whether the alleged invention is different from the prior art in essential ways; the inventiveness/obviousness test asks whether it is sufficiently different to warrant a temporary exclusive right. The inventiveness test is therefore now the main test for deciding whether the dynamic benefits society might gain outweigh efficiency losses from the exclusive right.

At least partly because of the rapid advance in technology during the Industrial Revolution, the British Courts added a series of auxiliary tests to the novelty test to make obtaining a patent ‘monopoly’ more difficult. Some of these tests, which were precursors to the inventiveness test, included (under the umbrella of the ‘manner of new manufacture’ test):

- analogous use;
- new use of a known substance or process; and
- mechanical equivalence.

Simultaneously, and for similar reasons, the United States Courts developed the inventiveness/obviousness test to define whether ‘the invention would be obvious to a person reasonably skilled in that particular art (area of technology).’

The inventiveness test was formally introduced as a separate test during examination in Australia in s.18 of the *Patents Act 1990*. In the 1952 Patent Act, obviousness was only a grounds for revocation by the courts. As noted above, the High Court in *Philips v Mirabella* imported much of the earlier case on ‘manner of new manufacture’ law back into the invention test as a threshold test.

Several submissions to this Committee have argued that Australia's inventiveness/obviousness threshold may be too low.

Dr Charles Lawson³⁰⁵ stated that: 'This submission argues that the present patenting scheme for gene and gene sequences has been setting the hurdle of inventiveness (including non-obviousness and novelty) and the grant of a patent too low'.

The Department of Industry, Science and Resources³⁰⁶ said that 'in the case of the obviousness criterion, the test applied in Australia may be more lenient than in the United States. This is because in Australia, a new combination of known items may not be considered obvious, if the known items came from very different fields of technology.'

Biotech Australia³⁰⁷ said more generally: 'A strong Australian patenting system with standards closely aligned to the country's major trading partners is essential for the continued growth and development of any high technology (innovative) industry in Australia.'

Committee considerations

As with most other countries, the inventive step test in Australia entails whether a person skilled in the art would find the alleged invention obvious given the state of the prior art. Where Australia may differ is:

- in which documents, acts and knowledge are considered prior art; and
- how these might be expected to be combined by a person skilled in the art.

For Australia, the prior art for inventive step is defined by documents publicly available anywhere in the world and by acts and common general knowledge in the patent area (that is, in Australia). For the United States, prior art includes what is known and used in the United States, as well as in publications throughout the world. For the EPO, it includes everything available to the public.

One way of raising the height of the inventive step test in Australia would be to follow the IPAC Report's³⁰⁸ suggestion that the prior art base for obviousness should include information anywhere in the world which a person skilled in the art could have reasonably been expected to find, understand and regard as relevant. The Committee endorses this approach, as it would prevent patents from being granted in Australia on inventions that would not be considered inventive in the light of common general knowledge reasonably available elsewhere. One member of the Committee considers that 'reasonably available' should, as recommended by the IPAC,³⁰⁹ require common general knowledge outside Australia to be in recorded form publicly available otherwise, problems are created and uncertainty increased. However, a majority of Committee members felt that no such limitation ought to be imposed on the concept of 'reasonably available'. In the majority's view, this concept could and would be interpreted in a pragmatic manner, responsive to individual circumstances, by the Commissioner of Patents and the Courts.

³⁰⁵ Issues Paper Submission 3 Executive Summary

³⁰⁶ Issues Paper Submission 34 at p. 20

³⁰⁷ Issues Paper Submission 65 at p. 1

³⁰⁸ IPAC *Patents, Innovation and Competition in Australia* 1984, Recommendation 13

³⁰⁹ *Ibid* p. 45

Moreover, the majority noted that restricting common general knowledge to its recorded form amounted to equating it only to documents; such an equation defeats the distinction between these, which is contrary to the legislative intent.

In Australia, it is possible for more than one document to be combined for the purpose of demonstrating an inventive step, but only as long as the skilled person would treat the documents as a single source. In practice, this will require more than cross-referencing from one document to another; and no general ‘mosaicing’ or combining of documents is allowed. In the United States, the combined teachings of two or more prior art references can be used to find lack of inventive step. The rationale for modifying or combining the prior art does not have to be expressly stated in the prior art but may be impliedly contained in the prior art or reasoned from knowledge generally available to a skilled artisan, established scientific principles or legal precedent established by prior case law. In Europe, it is permissible to combine two or more documents or parts of documents, different parts of the same documents or other pieces of prior art, but only where such a combination would be obvious to the person skilled in the art. Adopting either the United States or European approach would effectively raise the height of the inventive step in Australia. The Committee believes that the European approach is less likely to lead to indiscriminate and somewhat arbitrary mosaicing.

Recommendations

Inventiveness or obviousness test

The prior art base for inventive step currently takes regard of documents available publicly anywhere in the world, but only of acts and common general knowledge in the patent area (i.e. Australia). The Committee recommends that the prior art base for obviousness should include all information, including acts and common general knowledge, anywhere in the world which a person skilled in the art could have been reasonably expected to find, understand and regard as relevant.

The Committee also recommends that, when considering inventive step, it should be permissible to combine two or more documents or parts of documents, different parts of the same documents or other pieces of prior art where such combination would have been obvious to the person skilled in the art.

Term of the patent

TRIPS sets the term of the standard patent at no less than 20 years. The committee does not believe that a case has been made for further extending the maximum patent term, and therefore takes it as given. There may be some scope for reducing the effective length of the patent term, so that less innovative patents are likely to extract lower economic rent, by using more steeply rising renewal fees.

Recommendation

Administration

The Committee recommends that the scope for, and impact of, implementing more steeply rising renewal fees for patents be considered by IP Australia.

Innovation patent

Many countries have a lesser patent (often called a ‘utility’ patent), which attempts to balance lower threshold tests with a lower level of protection (length and breadth) to encourage lower levels of innovation, particularly by small to medium enterprises.

Australia adopted a ‘petty’ patent in 1979. This has a lower threshold test (and so its grant is less demanding in terms of the standard of social gain), lower processing costs (by restricting the number of claims) and a shorter life (and so lower social cost in terms of exclusive use). The Petty Patent was supposed to particularly encourage SMEs to innovate and patent, but it is not widely used. The lower threshold relates mainly to the prior art being restricted to documents available in Australia. However, since most documents are available in Australia soon after they are available overseas, in practice the threshold tests for a Petty Patent are not very different from those that apply to the standard patent. The applicant nonetheless gets shorter protection and so less benefit. The Petty Patent has therefore not been seen as worthwhile for many applicants.

In 1995, an ACIP working party³¹⁰ recommended the introduction of an ‘innovation patent’ to replace the Petty Patent with a shorter life than the standard patent but with a lower height of inventive step. The Government has accepted this recommendation and has recently introduced legislation into Parliament.

Recommendation

Innovation patent

This Committee strongly supports the recommendations of the Advisory Council on Intellectual Property’s (ACIP’s) Review of Petty Patents on the innovation patent and urges the Government to expeditiously progress the relevant changes to the Patents Act. The Committee. We believe that the role of the innovation patent will be enhanced if the Committee’s proposals for higher thresholds for the standard patent are implemented.

Section 119 of the Patents Act 1990—prior user rights

The purpose of s. 119 of the Patents Act is to provide protection for an innovator from an infringement action where the product was made or the process used before the priority date of a claim in a third party’s patent. These situations can raise significant issues, especially where the technology is complex and involves substantial investment and long lead times.

³¹⁰ ACIP ‘Review of the Petty Patent System’ 1995

Australian Federation of Intellectual Property Attorneys (FICPI)³¹¹ and Ceramic Fuel Cells³¹² are concerned that this section does not give the protection intended, and that this can inhibit competition. ACIP³¹³ also noted that the rights could be of little value, and recommends that it be the subject of urgent consideration.

Section 119 reads as follows:

- (1) *Where, immediately before the priority date of a claim, a person:*
- a) was making a product or using a process claimed in that claim; or*
 - b) had taken definite steps (whether by way of contract or otherwise) to make that product or use that process;*
- the person may, despite the grant of a patent for the product or process so claimed, make the product, or use the process, (or continue to do so) in the patent area, without infringing the patent.*
- (2) *Subsection (1) does not apply if the person:*
- a) derived the subject-matter of the invention concerned from the patentee or the patentee's predecessor in title in the invention; or*
 - b) before the relevant priority date, had stopped making the product or using the process (other than temporarily), or had abandoned (other than temporarily) the steps mentioned in paragraph (1)(b).*

Some of the concerns raised, and the Committee's responses, are:

1. Whether the requirement to make or use is commercial or whether it can include experimental activities, and whether it needs to take place in Australia or could take place overseas. The Committee considered that the use could be experimental and that only prior use in Australia should be considered relevant.
2. Whether making or using the product or process 'immediately before' the priority date precludes from protection a tested development in one aspect of a technology which is put to one side, but not abandoned, while developments of other aspects are made and tested. The Committee considered that this was best left to the courts to decide in the context of the particular case, guided by the purpose and wording of the section.
3. Whether the prior user rights can be licensed or assigned. A majority of Committee members considered that only the actual prior user should be able to benefit from s. 119 rights. So limiting the exemption encapsulates the objective of the section, which is to allow innovators to bring together intermediate products and processes which need to be developed separately. The majority considered that extending the exemption might tilt the benefits too far towards a de facto patent right for the prior secret user. One member of the Committee, however, noted that the innovation process often required changing corporate arrangements and accordingly considered that the prior user should be able to license, assign or otherwise deal with those rights.

³¹¹ Issues Paper Submission 60, pp. 2–4

³¹² Issues Paper Submission 61

³¹³ Issues Paper Submission 27, p. 29

In general, the majority of the Committee considers that to obtain full patent rights, an innovator must abide by the strict rules of the patent system, including application with disclosure; otherwise the patent system itself may be undermined. However, we appreciate that there can be significant issues for research and manufacturing organisations, especially where the technology concerned is complex and involves substantial investment and long lead-times. We believe that the changes suggested above will help overcome some of these problems.

Recommendations

Prior use rights

The Committee recommends that s. 119 (1) (a) and (b) of the Patents Act be amended to make it clear that the prior use be only in the patent area and that this use includes experimental use. A majority of the Committee members recommend that only the actual prior user should be able to enjoy the benefit of s. 119.

Provisional patent applications

Provisional patent applications (often referred to as ‘provisionals’) are another means of interfacing the innovation period with the patent system. Provisionals are mainly used by Australian companies, particularly SMEs. Their original objective was to allow a ‘quick and cheap’ application to be lodged before the expense and rigour of a full application in the patent system, and to establish a priority date while giving time (up to one year) for inventors to reduce uncertainties including:

- developing the invention to make sure that it could be made to work industrially;
- undertaking market research on its commercial viability; and
- conducting a prior art search to ensure its novelty.

However, these advantages were perceived to have been lost when the *Rescare*³¹⁴ decision implied that provisionals needed to disclose as much as the complete applications if the claims were to be fairly based on the provisional application and the earlier priority date asserted.

ACIP³¹⁵ recommended in its recent review of enforcement that the test during examination be changed from ‘fairly based’ (all three ‘Mond Nickel’ rules) to ‘broadly described’ (first Mond Nickel rule only). It also recommended³¹⁶ that s. 40 of the Patent Act and relevant regulations be amended along the lines of the United Kingdom 1997 Patents Act, to read that ‘the claims be supported by the description’. ACIP felt that not only would these measures solve the problem caused by *Rescare* but would also ‘bring the Australian practice in line with European and US practice’.³¹⁷

³¹⁴ *Aneasthetic Supplies Pty Ltd v Rescare Limited* (1994) 122 ALR 141

³¹⁵ ACIP *Review of Enforcement of Industrial Property Rights* March 1999 Recommendation 4

³¹⁶ *Ibid*, Recommendation 5

³¹⁷ *Ibid*, p. 20

The Department of Industry, Science and Resources (DISR) in its submission to the review³¹⁸ considered the issue of provisional patents in its discussion of ‘grace periods’. The latter allow a patent application to be made within a specified period (in most countries, one year) after initial publication of the invention. DISR saw grace periods as addressing similar problems as are addressed by provisional patent applications. However, DISR agreed with an earlier IPAC³¹⁹ conclusion that grace periods would have to be approached globally as any unilateral approach could lead to a loss of priority dates for Australians applying for patents overseas.

The Committee is not convinced that ACIP’s recommendations would have their desired effect; and we are also concerned that they may harm competition. We are not clear on how ACIP’s recommendation (4) for examination (that the matter of the claims is broadly described in the provisional documents) is consistent with its recommendation (5) for legislation (that the claims be supported by the description). A similar requirement in United States legislation is interpreted that: ‘Invention disclosures presented in provisional applications must be just as thorough and clear as would be required in non-provisional applications.’³²⁰ Although provisional applications may be allowed in the patent systems of some individual European countries, they do not seem to be allowed as priority documents in the European Patent Office. It is also possible that individual patent systems in Europe will disappear with the advent of the Community Patent.³²¹

There are also dangers to competition if an applicant is allowed to make overly broad claims in a patent application, based on a provisional application that does not reasonably support the later claims. It may allow the provisional applicant an unfair advantage over competitors working in the same area of innovation, effectively reducing competitive innovation. Such an approach may also decrease, rather than increase, the certainty of granted patents, which is the objective of many of ACIP’s other recommendations.

The Committee is instead attracted to the idea of grace periods as a better way to interface the innovation period with the patent system. It is aware that the EU is looking again at grace periods and if it were to accept them then most countries would have grace periods, including all of Australia’s major trading partners. However, we are also aware of the strong arguments raised in the EU for and against grace periods. It is consequently not certain that the EU will introduce grace periods.³²²

Despite these uncertainties, the Committee on balance believes it would be desirable for Australia to introduce a grace period into its patent system. This is preferable to the approach proposed by ACIP in resolving the concerns surrounding the provisional patent application system. Ideally, Australia’s move to implement a grace period would coincide with a similar move in Europe. However, given the complexities involved, Australia may need to implement the reform proposed before, or even independently of, a similar change in Europe.

³¹⁸ Issues Paper Submission 34, pp. 21–2

³¹⁹ IPAC (Stonier Committee) 1984 *Patents, Innovation and Competition in Australia* AGPS p. 51

³²⁰ Don Kelly, Group Director, USPTO at www.inventorsdigest.com/clubhouse/question.html.

³²¹ *Intellectual Property News* Issue 11 (July 2000) p. 1

³²² See http://www.european-patent-office.org/news/headlns/2000_07_25_e.htm.

In summary, the Committee is not convinced that there is a need to amend current arrangements for provisional patent applications. However, we believe there is merit in introducing a grace period for public disclosure affecting the prior art base for novelty and inventive step. In the event that the European Patent Organisation moves expeditiously in the context of the European Patent Convention to introduce a grace period, then Australia's introduction of such a period should be coordinated with Europe. Currently, it appears that it will take Europe more than five years to introduce a grace period. It is therefore recommended that Australia proceed first. Upon the introduction of such a grace period, IP Australia should actively inform inventors in Australia of its implications and also of the risks that disclosure may incur to patentability in jurisdictions that lack a grace period.

Recommendations

Provisional patent applications

The Committee is not convinced of the need to amend the current arrangements regarding provisional patent applications. However, we believe there is merit in introducing a grace period for public disclosure affecting the prior art base for novelty and inventive step. In the event that moves to introduce such a grace period are made by the European Patent Organisation on an expeditious basis, in the context of the European Patent Convention, then the introduction of a grace period in Australia should be coordinated with an introduction in Europe. However, if it appears that such moves in Europe will take more than five years from October 2000, then Australia should seriously consider proceeding before its European counterparts. When introduced, IP Australia should actively inform inventors in Australia of the implications of the grace period and also of the risks that disclosure may incur to patentability in jurisdictions without a grace period.

Sections 144–146 contracts

Sections 144–146 of the Patent Act make void contracts that have 'tie-in' conditions that require the buyer, lessee or licensee to use a product from the patentee not covered by the patent, or which prohibit sourcing of a product or process from a third party.

Tie-in provisions were once considered to be anti-competitive on a *per se* basis. Prior to the introduction of the Trade Practices Act, these types of provisions may have been viewed as a way of limiting the ability of patentees to use patents to extend their market power.

For some years now, economists have recognised that tie-ins are not necessarily anti-competitive. Indeed, in most instances, they can enhance efficiency and more frequently reduce the social costs arising from a patent grant. They can also serve to enhance price discrimination, and as a result increase output by better aligning prices with the customer's willingness to pay (this would prevent low-value customers from being excluded from consumption). Tie-ins can also prevent inefficient substitution where relative prices of complements in production or consumption would, in the absence of a tie-in, be distorted.

Further, they can secure better risk-sharing, especially where consumption of the tied good can be used to measure demand *ex post*, and hence recoup the lower margin made on initial sale of the tying good by higher eventual income from the tied good. Last, but not least, tie-ins allow or can facilitate price competition in markets where competitive discounting would otherwise be limited.

As a result, the Committee feels there is no continuing policy justification for these provisions of the Patents Act. Rather, the amendments proposed to s. 51(3) of the TPA would provide a better framework for the control of the practices these provisions aim for. The Committee therefore considers that these sections in the Patents Act should be repealed.

Recommendation

Contracts

The Committee recommends that ss. 144–6 of the *Patents Act 1990* be repealed, as these provisions are not soundly based on efficiency considerations, and as the conduct they address is better dealt with through provisions of s. 51(3) of the Trade Practices Act, amended in line with the Committee’s recommendations.

Section 133 compulsory licences

The Committee is mindful that the grant of a patent is the grant of a right to exclude. It seems *prima facie* inconsistent with the policy purpose underpinning that grant to allow for a statutory right to seek access.

However, the Committee also recognises that compulsory access, even if limited, can affect the terms on which parties negotiate licences for the use of patents. The Committee was told that the current s. 133 Patents Act provisions, though they appear ineffectual, have a continuing impact on licence negotiations, notably between foreign rights owners and potential users of patents in Australia.

We accept that, at a conceptual level, there may be instances where a compulsory access right is warranted. These include situations in which bargaining between parties is not able to achieve an outcome or, more importantly, situations in which the access right acts as a pro-competitive remedy that tempers the exclusivity that the patent right primarily provides. Experience in other jurisdictions with compulsory licences, most notably the United States and Canada, demonstrates that these can, in carefully defined circumstances, lead to more efficient and immediate outcomes without harming long-term incentives to innovate. Indeed, the threat of compulsory licensing may lead to innovations being worked sooner and more widely than they would otherwise have been.

The current terms of the section seem poorly aligned to securing these goals. Rather, they hark back to a period where the primary concern was the promotion of domestic industry, rather than securing the best use of resources and achieving high levels of productivity. Moreover, they lack an explicit competition test, and do not seem to allow for the legitimate interests of the rights owner to be adequately protected.

As a result, the Committee recommends that s. 135 be repealed and that s. 133(2) be amended to include an order requiring a compulsory license to be made, if and only if all of the following conditions are met:

- a) access to the patented invention is required for competition in the (relevant) market;
- b) there is a public interest in enhanced competition in that market;
- c) reasonable requirements for such access have not been met;
- d) the order will have the effect of allowing these reasonable requirements to be better met; and
- e) the order will not compromise the legitimate interests of the patent owner, including that owner's right to share in the return society obtains from the owner's invention, and to benefit from any successive invention, made within the patent term, that relies on the patent.

Such orders should be obtained through application to the Australian Competition Tribunal (reflecting that Tribunal's expertise in competition matters, and its role in the application of Part IIIA of the Trade Practices Act), with rights of appeal to the full Federal Court. It is the Committee's view that the conditions for grant of a compulsory licence should be stringent. More specifically, though the Committee has not sought to draft the conditions that would need to be met for the grant of a compulsory licence, the Committee would expect that the expression 'required for competition in the (relevant) market' would amount to there being no other option for competition in that market; and that the enhancement of competition that would be secured by the grant would have to be material and substantial.

As a result, the test would, in these respects, be somewhat more stringent than those that have applied in the United States and in Canada. We believe that subject to safeguards such as these, a compulsory licensing scheme is likely to promote efficiency in the use of patents and to promote competition. We note that such a scheme is fully consistent with Australia's international obligations.

Recommendation

Compulsory licensing

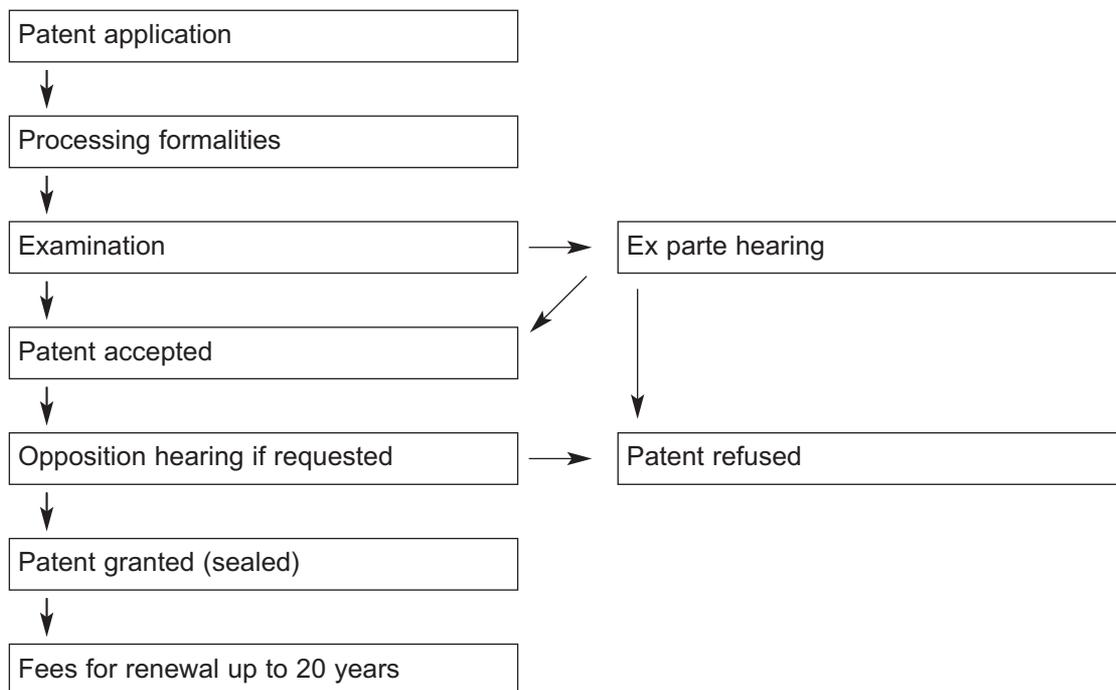
The Committee recommends that s. 135 of the Patents Act be repealed and that s. 133(2) be amended to include an order requiring a compulsory license to be made if and only if all of the following conditions are met:

- a) access to the patented invention is required for competition in the (relevant) market;
- b) there is a public interest in enhanced competition in that market;
- c) reasonable requirements for such access have not been met;
- d) the order will have the effect of allowing these reasonable requirements to be better met; and
- e) the order will not compromise the legitimate interests of the patent owner, including that owner's right to share in the return society obtains from the owner's invention, and to benefit from any successive invention, made within the patent term, that relies on the patent.

Such orders should be obtainable on application first to the Australian Competition Tribunal, with rights of appeal to the full Federal Court.

Improving administration of the patent system

The main steps of the administration system of the Patent Office for securing and maintaining a standard patent are as follows:



Further details can be found in s. 4 of the *Patents Act 1990*.

The administration of the patent system outside the Patent Office is more difficult to characterise as a simple flow diagram because of the overlap of jurisdiction of different courts, particularly the state Supreme Courts and the Federal Court, and also because the precise path depends on the nature of the challenge or appeal. The main bodies involved, together with their principle functions, can be set out as follows:

Administration body	Function
Administrative Appeals Tribunal	Review of Patent Office decisions on restoration (amongst others) of lapsed applications, extensions of time, co-ownership disputes and registration of patent attorneys.
State supreme courts	Application for infringement or relief against unjustified threats, compulsory licensing.
Single judge of the Federal Court	Appeal against Commissioner's decisions on validity of granted patent, extension of term of petty patents and pharmaceutical patents, revocation following re-examination, directed amendments.
Full bench of the Federal Court	Review on matters of law (only by leave).
High Court	Review on matters of law (only by leave).

An important objective of the patent system is to encourage and protect investment in innovation by granting exclusive property rights. These rights should, in the Committee's view, only be granted where it is clear that they are warranted. This points to the need for rigorous screening before granting a patent.

However, rigorous screening can imply relatively high costs for patent applicants. It may be questioned whether it is appropriate to impose these costs over all applicants at the initial grant stage rather than allowing them to be more selectively incurred in the course of specific litigation over patent validity. Since many patents have little and/or uncertain commercial value, it may seem preferable not to expend significant resources on initial screening but rather allow the validity of those which do prove valuable to be tested in the Courts.

In considering this issue it is important to note that a substantial share of patents in Australia are granted to foreign applicants. Many of these will only seek a patent in Australia because they believe the patent will have commercial value. In other words, the share of *de minimus* patents may be lower in Australia than it is in larger economies. Additionally, it is reasonable to believe that many *de minimus* applications will bear on the Innovation Patent, rather than on the standard patent, especially if the Committee's recommendations are accepted. As a result, the grant of a standard patent should not be seen to have little commercial consequence.

The Committee also notes that litigation cannot be counted on to dispose of patents that ought not to have been granted. The outcome of litigation is invariably uncertain. The complex technical nature of patent litigation makes the uncertainties all the greater. The party challenging the validity of a granted patent bears the risk that, should the action fail, the party challenging will have to bear the patent owner's costs and, if it has been infringing the patent, the party will be liable for damages. At the same time, should the action succeed, some benefit will likely flow to third parties (including consumers) once the floodgates are opened to competing entry. As a result, even the most improperly and severely restrictive patent may not be subject to challenge and overturned.

It follows that if initial screening is inefficient, patents that ought not to have been granted will be granted and may well persist. Moreover, competition will be inhibited, as uncertainty about the outcome of litigation discourages challenges from being mounted. The fact that in Australia's case a substantial portion of the financial benefit arising from these patents flows overseas aggravates the resulting economic costs.

The Committee therefore attaches great importance to ensuring that patents are granted when and only when they meet the statutory pre-conditions. We note that this will ensure that patents that are granted are known to be, strong, certain and enforceable. This approach will therefore reduce the uncertainty involved in patent enforcement and increase the value of those inventions that legitimately attract the benefit of patent protection. It will also further enhance the incentive for innovation associated with the patent system.

Quality of granted patents

During some of the Committee's preliminary oral consultations and in some submissions received,³²³ there was criticism that Australian patents are not as robust as those issued in

³²³ Issues Paper Submission 54 at p. 8

Europe or the United States. On the other hand, some³²⁴ argued that the standard of the search and examination conducted by the Australian Patent Office is comparable to that of the European Patent Office and the United States Patent and Trade Mark Office.

DISR³²⁵ in its submission to the review stated that: ‘Some interest groups have raised concerns about whether the drive for efficiency gains and lowering costs has adversely affected the quality of IP Australia’s examination and search work. IP Australia is conscious of this and has endeavoured to ensure that any efficiency improvements have not been at the expense of quality. However, the issue of quality of examination is a complex one and is one that many intellectual property offices around the world are trying to deal with’.

The Australian National Audit Office commented that ‘IP Australia’s standards focussed largely on its internal processes and did not appear to address fully the quality concerns from the customers’ perspective. IP Australia has agreed with this and will undertake, as part of its work on refining and developing its quality systems, to address this issue’.³²⁶

ACIP³²⁷ in its submission said that: ‘ACIP is particularly interested to ensure that the quality of intellectual property rights granted is not compromised by an over-concentration on fee reductions. In the end there must be a balance between the fees charged and the provision of adequate services leading to clear enforceable rights. Granting quick, cheap but weak or unenforceable rights will not enhance innovation or competition...A weak intellectual property right may also disadvantage the consumer, as increased uncertainty can lead to increased costs.’ IPTA³²⁸ agreed with this approach, saying that ‘certainty in relation to intellectual property rights is an important factor in relation to competition in the marketplace.’

The Committee notes that the effective quality of the granted patent and the costs and benefits of the patent system depend on the threshold tests as actually applied to the application during examination. In addition to the height of the thresholds being defined through the legal requirements (as discussed earlier in this section), the height of the threshold for a granted patent depends on two administrative factors:

- a) the stringency of the test; and
- b) the quality of examination.

Stringency of tests

There are at least three levels of stringency that could be applied to the threshold tests during examination:

- giving the ‘benefit of the doubt’ to the applicant (as at present);
- using a standard based on a ‘balance of probabilities’ (as in most civil law cases); and
- using the standard of ‘beyond all reasonable doubt’ (as in criminal law cases).

³²⁴ Issues Paper Submission 15 at p. 5

³²⁵ Issues Paper Submission 34 at p. 24

³²⁶ *Ibid* at p. 25

³²⁷ Issues Paper Submission 27 at p. 11 and p. 22

³²⁸ Issues Paper Submission 24 at p. 8

Section 49 of the Patent Act sets out the conditions for acceptance of a patent. The pattern of court decisions relevant to the benefit of the doubt in examination and subsequent acceptance is that the Commissioner can only refuse to grant a patent when it is clear that a valid patent cannot be granted.³²⁹

The ACIP report on Enforcement³³⁰ states: ‘As a result of this decision, IP Australia’s practice is to not take or maintain an objection where there is a doubt about the validity of the objection. This effectively creates a standard of proof for examination objections of “beyond reasonable doubt” before an objection can be taken. The consequence of this is that the standard applied in the Patent office is different from that applied in the courts. Furthermore, the practice is out of step with overseas practice. For example, the UK practice places the onus upon the applicant to demonstrate compliance when faced with a reasonable challenge. This means that objections are taken or maintained according to whether, on the balance of probabilities, they are appropriate.’

ACIP continued: ‘A tightening of the benefit of the doubt approach would increase the threshold used by IP Australia and change the standard of proof for acceptance so that granted patents would be more likely to be valid. This could be achieved by amending section 49(1) to the effect that the current rules giving the benefit of the doubt to applicants on the issue of novelty and obviousness be set aside.’

The Committee agrees with ACIP’s analysis. While there may be some increase in costs due to more protracted arguments between applicants and examiners, these are likely to be small and to be reduced as each side becomes more familiar with the new stringency of testing. The benefits in terms of improved certainty and validity are likely to be considerable.

Recommendation

Stringency test for patentability

The Committee recommends changing the Patents Act to require a ‘balance of probabilities’ approach to be used during examination, rather than conferring the ‘benefit of the doubt’ to the applicant as at present.

Quality of examination by the patent examiner

There are at least two areas where lapses in the quality of the examiner’s work in applying threshold tests, particularly on inventive step, may affect the validity of the granted patent:

- not all the prior art being found; and
- incorrect judgement of inventiveness even if all prior art has been found.

Generally, the Australian Patent Office conducts its own searches of the prior art only for the minority of applications for which no overseas search results are available. This particularly occurs with Australian applicants who enter the examination process directly or through the Patent Cooperation Treaty (PCT) route.

³²⁹ *Commissioner of Patents v Microcell Ltd* (1959) 102 CLR 232

³³⁰ Advisory Council on Industrial Property *Review of Enforcement of Intellectual Property Rights* 1999, p. 15

Searching prior art can be a time-consuming and costly and can require considerable expertise, judgement and skill on the part of patent examiners. In a small office such as IP Australia, with less than 200 patent examiners, resources can be stretched in some areas of technology.

By comparison, in the United States, European and Japanese patent offices, patent examiners specialise to a much greater degree and so accumulate more detailed knowledge of the prior art. Greater specialisation with more cases examined in a given technology can also lead to greater appreciation of what constitutes an inventive step. It becomes easier for the examiner to adopt the position of a person skilled in the art of that technology.

Recent advances in information technology create opportunities for improvements in coverage and reductions in the cost of searches for prior art. For example, more patent databases and scientific/technology journals are being put online, both in Australia and overseas. These advances can reduce the disadvantages small offices like IP Australia have relative to larger offices. The Committee also believes that future productivity gains in IP Australia should in general go into further improved searching processes (such as improved information technology), rather than toward further fee reductions, as has been the case in the recent past.

Another possibility for improving the quality of examination would be to specialise in certain technologies in which the Australian economy has particular expertise, as part of a larger South-East Asian regional office. At present, IP Australia conducts examinations for a number of South-East Asian countries—in future reciprocal arrangements might develop.

Recommendations

Quality of examination

The Committee recommends that IP Australia devote additional resources to improving the quality of examination, particularly to prior art search processes including through enhanced use of information technology. We also recommend that IP Australia should to explore cooperation with other intellectual property offices in the region, including the possibility of forming a Patent Office covering East Asia, Australia and New Zealand.

Disclosure of prior art requirements

The process of finding prior art can be more reliable if applicants are required to disclose all prior art known to them. The case for disclosure is strengthened by the fact that in new areas of technology, such as information technology and biotechnology, the prior art is often not in the patent literature and so difficult to find. This is even more likely with applications about business systems.

Under s. 45(3) of the *Patents Act 1990*, applicants may be directed by the Commissioner to provide results of searches from specified overseas patent offices, which the applicants have received by the time of that direction from the Commissioner. At present, such directions are only made prior to examination, and the results available depend on the relative speed of examination in Australia compared to overseas. A direction by the Commissioner could be

made again at any other time but the Patent Office has been reluctant to do so because of the administrative costs of sending out later directions.

ACIP, in its review of enforcement of intellectual property rights³³¹, stated that an ‘applicant often becomes aware of additional prior art during the prosecution of an application in the overseas patent offices. One approach would be to move to a US model. This requires applicants to disclose relevant prior art up to the grant of the patent, or to risk losing the patent. However, there might be problems with this as the US requires disclosure of any information available to the organisation...For example, any large company has enormous amounts of information flowing into it from a large number of sources. We therefore consider that the obligation of disclosure be restricted to knowledge possessed by the applicant or, where the applicant is a corporation, by the person employed by the applicant who is at the relevant time concerned with the preparation or prosecution of the application. The council also concluded that it would also be important to set realistic time limits on the requirement for disclosure. The date of the advertisement of notice of acceptance would be a suitable cut off point, since the applicants do not know the actual date of acceptance of the application until they receive the notice.’

The Committee examined the United States system of disclosure of prior art. In discussing this system, Merges³³² states that: ‘Although the examiner is charged with the duty of making a search of the prior art, he or she cannot be expected in one search to duplicate the knowledge of the applicant regarding the particular field relating to the invention. For these reasons, and because applicants have an obvious incentive not to disclose prior art that would be damaging to their chances for a patent, applicants come before the Patent Office with a stiff duty of disclosure. Because the patent system relies so much on conscientious disclosure, it necessarily metes out harsh punishment when this duty is breached. Thus a patent whose prosecution was marked by significant non-disclosure receives the system’s ultimate sanction—total unenforceability. Any lesser penalty, it is thought, would invite non-disclosure.’ Merges later points out (p. 596) that the penalty for such ‘inequitable conduct’ regarding *any* claim is the unenforceability of the *entire patent*.

Although the Committee agrees that some penalty is needed to force disclosure, it is not convinced that complete unenforceability is an appropriate balance between the penalty and the net social cost of the breach. Rather, it believes a sufficient incentive for disclosure would be to not allow the patent to be amended after acceptance where intentional non-disclosure has occurred. Thus, if the undisclosed prior art is relevant to one or more claims, these claims would be rendered invalid and could not be amended to make them valid in the light of this undisclosed prior art.

The Committee does not agree with ACIP’s view that, where the applicant is a corporation, the obligation for disclosure should be restricted to the person who is at the relevant time concerned with the preparation or prosecution of the application. The Committee believes that this could induce facile evasion of the substance of the obligation, with artificial divisions, either informal or formal, within the company being used to avoid communication of relevant knowledge. However, we agree with ACIP that a company-wide obligation could be onerous for large companies. Given this, we believe that, where the applicant is a

³³¹ Advisory Council on Industrial Property *Review of Enforcement of Intellectual Property Rights* 1999, p. 21

³³² Merges R P *Patent Law and Policy* The Michie Company 1992, p. 587

corporation, it should be required to make ‘reasonable enquiry’ within its own organisation as to what prior art is known to it.

Recommendation

Disclosure of prior art

The Committee recommends that the Patents Act should be amended to require applicants to continuously disclose to IP Australia any prior art material that comes to their attention up until the date of advertisement of notice of acceptance. A company applicant must make ‘reasonable enquiry’ within its own organisation about what prior art is known to the company. Intentional non-disclosure of prior art would lead to a patent being unamendable, to reflect that prior art, after acceptance.

Dissemination of patent information

Section 40(2)(a) of the *Patents Act 1990* states that: ‘A complete specification must describe the invention fully, including the best method known to the applicant of performing the invention.’ It is an important part of the *quid pro quo* for granting an exclusive patent right that the applicant is required to make public the invention. Publication enables competitors to:

- avoid trespassing on the exclusive property right;
- invent around the right, so promoting competition;³³³ and
- use the invention on expiry of the patent.

The Institute of Patent and Trademark Attorneys in its submission³³⁴ said that: ‘Modern communication techniques have made patent information available to the public almost instantaneously following publication, and with modern searching techniques is more widely accessible. Furthermore, it is a fact that the patent documentation is being more widely accessed by third parties, both as a means of providing the basis for further innovation and development and as a means of ascertaining what patent rights exist in particular technology fields.’ Other submissions^{335 336} strongly agreed.

In its recent report, the House of Representatives Standing Committee on Primary Industries and Regional³³⁷ services stressed the need for innovation, particularly in biotechnology, if Australian rural industries are to flourish and remain internationally competitive. However, it emphasised (at 6.72 of its report) that ‘the first step in a project’s design is to make sure that the results of any planned research are not already other people’s property and therefore unavailable for commercialisation.’

³³³ This promotion of competition is not costless, as it may involve duplicative R&D.

³³⁴ Issues Paper Submission 24 at p. 5

³³⁵ Issues Paper Submission 21 at p. 5

³³⁶ Issues Paper Submission 13 at p. 1

³³⁷ House Standing Committee Report *Primary Producer Access to Gene Technology* June 2000 Canberra

Dam³³⁸ considers that dissemination of new knowledge is as important to the patent system as it is on the incentive to create new knowledge: ‘There are many kinds of access issues, particularly in patent law, but the essence of the access principle is that we want not only to encourage the original innovator but we also want to encourage those who come later to build on and add value to the original innovation, and for that they must have access to that innovation...Thus, in intellectual property, innovation is not seen as a one-time thing; what counts is continued innovation over time.’

The Committee therefore encourages IP Australia to make as much of its prior art information as possible available in a readily accessible and searchable form, particularly on its web site. However, because Australian patent applications represent only a relatively small part of prior art, which includes both patent and non-patent literature world-wide, potential applicants should be made aware of this and, where possible, pointed to other sources of prior art.

Review and enforcement of granted patents

After acceptance, the validity of a patent may be challenged by competitors, either in opposition hearings in IP Australia before the patent is sealed (granted) or in the Courts after the patent is granted. The latter cases are often associated with infringement actions to enforce the patent. Some important questions relating to the efficiency of administration of the patent system after the patent is accepted are:

- what is the best structure for any review/hearings mechanisms below the courts?;
- can the granted patent be presumed valid so as to reduce enforcement costs?; and
- can the court system be made more effective, particularly for SME patentees?

Hearing mechanism

Under s. 59 of the Patents Act, patents accepted by patent examiners may be opposed before the patent is finally granted by the Commissioner, on the grounds of a failure to meet the conditions required for the grant of a valid patent in terms of manner of manufacture, novelty, inventive step, description of the invention or a claim being clear or fairly based on the description. Section 60 states that the Commissioner of Patents is responsible for these ‘opposition hearings’. The hearings are carried out by senior examination staff, usually supervising examiners, who also have other responsibilities within the Patent Office, including supervision of examination.

Submissions to the Committee on opposition hearings concentrated mainly on two issues, namely:

1. whether the hearings should be pre- or post-grant; and
2. who should be responsible for the hearings process.

³³⁸ Dam K W ‘*IP and the academic exercise*’ University of Chicago Economics Working Paper no.68 (1999) www.law.uchicago.edu/Publications/working/index.html

FICPI Australia³³⁹ proposed that there should be an appeals board or an appropriate tribunal to which decisions of IP Australia (either opposition matters or decisions for refusal to grant intellectual property protection) can be taken prior to appealing to the Federal Court or to another Tribunal. FICPI likened their proposal to the appeals tribunal in the USPTO or the Board of Appeals in the European Patent Office. The rationale for this approach would be to provide a further and less expensive appeals process than is currently available before the Federal Court or other tribunals.

In its recent report on enforcement, ACIP concluded³⁴⁰ ‘...that there is a need to strengthen the appeal mechanism to give the applicants and third parties greater confidence in the system. ACIP is concerned that the current hearings process operates too closely with the day-to-day examination functions of the office, and is not seen as a sufficiently independent avenue for appeal. Furthermore, while the council is satisfied that the staff who are currently involved in the appeal process are highly skilled and competent in the patent examination field, it is concerned that these staff do not always have a high level of expertise in appeals matters...ACIP considers that while the appeals function should remain the responsibility of IP Australia, it would be better served by using staff who specialise in the function, and are part of an independent unit operating separately from the patent examination function’.

ACIP continued: ‘The Council also considered the issues of pre-grant versus post-grant opposition. It generally supported the concept of replacing pre-grant oppositions with post-grant oppositions...The consultation process, however, indicated that industry groups did not support replacing pre-grant opposition with post-grant opposition. In the weight of this opinion, the Council decided not to proceed with this recommendation.’³⁴¹

IP Australia, in its oral submission to the Committee, did not favour setting up a separate section within the IP Australia to hear appeals, saying it would remove the best examiners from the examination system and reduce feedback of case law to examiners, thereby leading to a decrease in the quality of examination. The Committee was provided with evidence of the extensive and ongoing training provided to hearings officers in IP Australia.

The Committee also sought advice from the Australian Government Solicitor’s office on the legality of IP Australia conducting reviews of patents post-grant. The advice given was that it was a ‘grey’ area because the High Court’s views on such tribunals had varied over time. However, the overall advice was that there are risks in recommending a review process post-grant. This is because the High Court may view such a review process as the exercise of a judicial power by a non-judicial body, which would offend the separation of powers doctrine in the Constitution. This would be the case whether a non-judicial review body was based in IP Australia or independent of it.

In the light of this advice from the Australian Government Solicitor’s office and the recommendation by ACIP, the Committee decided not to proceed with further consideration of post-grant hearings and concentrated its deliberations on who should be responsible for the pre-grant hearings.

³³⁹ Issues Paper Submission 60, p. 5

³⁴⁰ Advisory Council on Industrial Property *Review of Enforcement of Intellectual Property Rights* 1999, p. 22

³⁴¹ *Ibid*, pp 28–29

In its hearings and consultations with interested parties, it was generally agreed by all that the skills base in Australia is too small for the hearings process to be totally independent of IP Australia, and that the Tribunal models used by larger overseas patent offices such as the United States Patent and Trade Mark Office and European Patent Office are not appropriate for Australian conditions.

Three models were therefore considered in more detail by the Committee. These are:

- a) leaving the present system as is, with the hearings officers from senior examination staff in the Patent Office as delegated by the Commissioner of Patents;
- b) establishing a hearings section in IP Australia responsible to the Director-General of IP Australia and separate from the Patent Office but with hearings officers delegated from senior examination staff in the Patent Office;
- c) establishing a Hearings Board whose Chair would be independent of IP Australia but with hearings officers seconded from senior examination staff in the Patent Office.

The advantages and disadvantages of the three proposals put to the Committee are summarised in the table that follows.³⁴²

³⁴² As background, it is worth noting that in 1995, the Australian Industrial Property Organisation (now IP Australia) was created from the Patents, Design and Trade Mark Offices with a Director-General as the chief executive officer to whom the Commissioner of Patents and Designs, and the Registrar of Trade Marks are administratively responsible, though they retain statutory independence to grant patent, trade mark and design rights.

Responsibility for hearings	Advantages	Disadvantages
<p>IP Australia officer responsible to Commissioner of Patents (as is)</p>	<p>Administratively less complex:</p> <ul style="list-style-type: none"> • Director-General responsible for overall IP Australia administration (budgets, policy etc.); and • Commissioner of Patents responsible for patent process (examination up to grant, staff allocation etc.) <p>Current delegation instrument gives hearings officers de facto independence.</p> <p>Decisions currently respected as being professional and unbiased.</p>	<p>Perceptions by some of lack of independence of hearings from examination process.</p> <p>However, it is not clear:</p> <ul style="list-style-type: none"> • how widespread this view is; and • how it relates to decisions currently being respected as professional and unbiased.
<p>IP Australia officer responsible to Director-General of IP Australia</p>	<p>May give improved perception of independence of review.</p>	<p>Perception of change may be illusory:</p> <ul style="list-style-type: none"> • with Director-General in practice relying on Commissioner's advice; and • examiners still delegated as hearings officers. <p>Thus may appear <i>less</i> transparent to those outside the system</p> <p>Administratively more complex with separation of Director-General and Commissioner of Patents roles less clear.</p>
<p>Board chair independent of IP Australia</p>	<p>Yet greater perception of independence.</p>	<p>Administratively yet more complex:</p> <ul style="list-style-type: none"> • who appoints chair? • to whom is the chair responsible? • who pays the chair? <p>Problems of finding a chair with suitable expertise but appearance and reality of independence from all stakeholders.</p>

The Committee believes that for a pre-grant review of the patent to be effective, the hearings process must be carried out by a person not involved in the examination before acceptance. It accepts Patent Office assurance on this point and also accepts that the delegation instrument gives hearings officers independence to make their own judgements on the facts of the case. The Committee also notes that all submissions praised the decisions of the hearings officers as professional and unbiased.

We therefore believe that the proposal by ACIP to make the person managing the hearings process directly responsible to the Director-General, rather than the Commissioner of Patents as at present, will have little effect on the independence of the process or on the quality of decisions made.

Nevertheless, we appreciate that the hearings process must be seen by all parties to be independent and more generally fair and equitable if the hearings system is to retain community confidence. One of the most important guarantors of fairness and equity already exists, namely the public reporting of the decisions—the Committee was consistently told that these are highly professional and unbiased. However, we believe that IP Australia should take additional measures to improve the perception of independence. Possible measures include:

- the manager of hearings, though responsible to the Commissioner of Patents, should have no responsibility for managing the examination process;
- the Director-General, as part of her/his responsibility for the overall management of IP Australia, should have explicit responsibility for hearings being conducted in a fair and equitable manner;
- the biannual ANOA audit of IP Australia should be required explicitly to report on whether hearings are being conducted in a fair and equitable manner; and
- IP Australia should make the details of its hearings process publicly available, preferably prominently on its web site, including the means by which any complaints about the operation of the process can be made.

Recommendations

Patent hearing mechanism

The Committee recommends that patent hearings should continue to be pre-grant and the responsibility of IP Australia. On this basis, a specialist hearings section would not be established, but there would be a senior officer directly responsible to the Commissioner of Patents for hearings, with hearings officers continuing to be drawn from senior examination staff of the Patent Office. We also recommend that IP Australia take further measures to improve the perceptions of the hearings process being independent of, and more generally fair and equitable to, all parties.

Presumption of validity of granted patents

Section 20(1) of the *Patents Act 1990* states that: ‘Nothing done under this Act or the Patent Cooperation Treaty guarantees the granting of a patent, or that a patent is valid, in Australia or anywhere else’. This appears to ensure that neither the Commonwealth nor employees of the Patent Office are liable, as confirmed in s. 20(2). In addition, it has been the practice of the Courts, particularly when the validity of a patent is questioned (eg. as a counterclaim in an infringement action), to effectively re-examine the patent de-novo.³⁴³

³⁴³ See, for example, *Acusneth v Spalding* (1990) 17 IPR 36.

ACIP in its enforcement review³⁴⁴ states: ‘If the threshold for validity of patents is increased, other parties should have less grounds for challenging it on the basis that it is not valid. The council therefore believes that where validity is challenged, the onus of proof should be on the challenger to prove why the patent is not valid. To assist in this it should be made clear in the Act that a granted patent is presumed valid unless a challenger can prove otherwise’.

The Committee’s own research into case law suggests that the onus of proof is already on the applicant in a case. The Committee’s understanding is that:

1. the person bringing the action normally has the ‘onus of proof’ unless specifically stated otherwise in the legislation; and
2. that a ‘reverse onus of proof’ would have to be written into the legislation and would only be approved by the Senate Standing Committee if there was gross asymmetry of information, i.e. the person defending the action inherently had much more information than the person bringing the action. Section 121A of the Patent Act is a rare instance of this kind.

The Committee thus believes that a granted patent right will be presumed valid until proven otherwise. However, this validity can never be completely guaranteed and the patent must always be open to challenge if an error has been made during examination or if new evidence becomes available. It also understands that, under the separation of powers provided for in the Constitution, the courts have the right to renew all aspects of an administrative decision, including the right to re-examine all evidence and to consider additional evidence (effectively re-examining the original grant). The Committee therefore does not agree with ACIP’s view that legislative change is needed in this respect.

Appeals, challenges and enforcement in the courts

A variety of prescribed courts may hear appeals against decisions of the Commissioner, challenges to the validity of patents by competitors and infringement proceedings by the patentee. The courts are prescribed in the relevant sections of the Patents Act and associated regulations. Chapter 16 of the Act also defines more generally the jurisdiction and powers of the courts.

ACIP has recently considered these matters in more detail.³⁴⁵ A major concern of submissions to the Committee was the cost and complexity of the court system, particularly for SMEs. For example, in its submission, the Institution of Engineers Australia³⁴⁶ stated: ‘Of more concern is the cost and complexity of enforcing industrial property rights, which continue to be a problem for many users. Dispute resolution mechanisms are time consuming and expensive, and discourage firms from taking enforcement action. For example, one engineering firm has stated that it costs on average \$250 000 to prosecute a claim for patent infringement. If intellectual property owners cannot enforce them because of cost and complexity, the intellectual property system serves no useful purpose. This is an inhibiting factor on commercial activity, which reduces competition’.

³⁴⁴ Advisory Council on Industrial Property *Review of Enforcement of Intellectual Property Rights* 1999 p. 15

³⁴⁵ Advisory Council on Industrial Property *Review of Enforcement of Intellectual Property Rights* 1999

³⁴⁶ Issues Paper Submission 40 p. 3

The importance of simpler, less expensive court procedures was also recognised by ACIP in its earlier *Review of the Petty Patent System* (1995): ‘We recognise there is a strong perception among users that the present enforcement procedures are lengthy, complex and expensive. As the petty patent system is designed particularly for smaller innovators an important element if it is to be effective, will be a less complex and less expensive enforcement process’. After canvassing options, including the Patent Office acting as a low-cost umpire in the first stage of infringement proceedings, ACIP concluded: ‘We have therefore reluctantly reached the conclusion that in the light of the constitutional constraints as we understand them, and as our national court structure currently exists, the option of determining issues of infringement in a non-judicial tribunal, or in the original jurisdiction of the inferior courts, does not appear open or viable. We nevertheless are firmly of the view that a substantial need exists for the provision of a lower level of determination of the issue of infringement, at least in the case of innovation patents...There may be alternative procedures worth examining and there may be changes made to the Federal judicial structure’.

ACIP, in its later *Review of Enforcement*,³⁴⁷ stated that: ‘From time to time there have been proposals for the establishment of a federal inferior court system such as a federal magistracy. If this were to happen, there may be opportunity to appoint federal magistrates with intellectual property qualifications to hear minor infringement matters and possibly other matters under the Act’.

The Federal Government in February 2000 announced the establishment of a Federal Magistracy Court to deal with less complex matters that mainly involve the Family Court. The Attorney-Generals’ Department advised the Committee that the Federal Magistracy service should lead to quicker, less costly resolution of disputes because of factors such as more streamlined procedures, reduced administration fees and a lower level of legal representation. No extra level would be added to the system because the Magistracy would replace hearings by a single judge of the Federal Courts. However, the Federal Court has not recommended intellectual property as a priority matter for the Magistracy and magistrates are being appointed with mainly family law and general business law backgrounds. Because patent law is a specialised area with limited workload, it is doubtful that magistrates with relevant expertise will be appointed in the near future.

The Committee believes that cases involving intellectual property, including patents, will increase in future, reflecting the growing importance of knowledge and intangible assets in economic and social activity. It agrees with ACIP on the need for a simpler, less expensive system of adjudication if the Innovation Patent is to be successful in encouraging innovation, particularly among the small and medium scale enterprises that account for the majority of Australian businesses. It therefore believes that opportunities should continue to be explored for reducing the costs of resolving the disputes that inevitably arise with respect to patents. If the new Federal Magistracy Court can play a role here, then Government should actively encourage it to do so.

³⁴⁷ Advisory Council on Industrial Property *Review of Enforcement of Intellectual Property Rights* 1999, p. 18

Recommendation

Patent appeals, challenges and enforcement

The Committee recommends that the Federal Magistracy be used as a lower court for the patent system, particularly for matters relating to the Innovation Patent.

DESIGNS ACT

Description of the rights granted by the Designs Act

An industrial design is the shape, configuration, pattern or ornamentation applicable to an industrial article. In essence, design protection is for the look or appearance of an industrial product. It is not intended to protect single artistic works or to protect how products work.

Applications to obtain design registration must be made to the Designs Office, which forms part of IP Australia and is responsible for assessing whether an application meets legislative requirements. To be eligible for registration, a design must be new or original—with ‘new’ meaning not known or previously used in Australia, and ‘original’ meaning the design has never been applied to the applicant’s product (although it may have been applied to another type of product).

The design right presently accords the owner an exclusive right to manufacture, sell, hold for sale, or hire articles that are of an appearance that has been registered as a design. The design right is initially registered for 12 months, but can be extended for a total of 16 years.

Objectives of the Designs Act

The traditional rationale for design rights is to encourage, by preventing design piracy, the manufacture and sale of new, visually-appealing articles. To achieve this it protects designs which have appearance that might, through their aesthetic appeal, influence market choice.³⁴⁸

The design right impedes slavish copying and cheap imitations but can be relatively easily passed over by design improvements that serve as a base for further innovation. Design concepts may also capture forms of innovative and inspirational spill over to the extent that the inspiration and insight comes from observation of other designers’ work, rather than from nature.

The Australian Law Reform Commission (ALRC) has stated that the primary objective of designs law is to encourage innovation in Australian industry for the country’s net economic benefit. Innovation, it notes, is one of the most important factors influencing Australia’s future competitiveness and welfare.

Design is a crucial element in innovation and is pivotal to commercialisation and marketing processes.³⁴⁹ However, the Bureau of Industry Economics³⁵⁰ view varies, noting that although it has been economically demonstrated that intellectual property rights such as patents are vital to innovation and growth, there is no empirical evidence to support such a claim with respect to any form of design right.

³⁴⁸ *The Economic Rights of Intellectual Property Rights for Design*, Bureau of Industry Economics Occasional Paper 27 May 1995

³⁴⁹ Extract from ALRC *Designs Report 74* 1995 p. 31

³⁵⁰ *The Economic Rights of Intellectual Property Rights for Design*, Bureau of Industry Economics Occasional Paper 27 May 1995 p. 3

The Second Reading speech for the *Designs Amendment Bill 1981* sums up the aims of the Bill as follows: ‘...[The Bill’s] aim is to encourage innovation and industrial design within the community...It seeks to make industrial property more responsive to our needs in developing and exploiting Australia’s innovative technology... It is, however, only in comparatively recent times that industrial designing has intensified. It has been encouraged by the need to exploit wider markets; by domestic and overseas competition; by increased media advertising and display; by the discovery of many new processes and materials; and by the higher level of community education...If good design is to flourish, those responsible for producing it must be protected’.³⁵¹

Problems the design right attempts to address

Like patent rights, design rights help address market failure, by minimising the opportunities for free riders to use the outcomes of investment in creative effort without adequately contributing to the costs that investment entails.

Nature of restrictions on competition

Two issues of potential restriction on competition have been identified during the review process. These two issues, which will be discussed in more detail later in this section, are:

- protection of functionality; and
- spare parts.

The Committee notes that the Designs Act does not prohibit parallel imports, although it does prohibit pirate imports.³⁵² As such, the Designs Act only prevents the importation of articles to which a registered design has been applied outside Australia without the owner’s consent.³⁵³ The Committee is therefore of the view that the Designs Act deals appropriately with the question of parallel imports.

Background to the proposed design system

Following its 1995 report on design law, the ALRC was required to develop proposals to modernise and simplify existing design legislation and to remove difficulties that had arisen in the operation of the *Designs Act 1906*. The Government has responded to the ALRC Report and agreed with many of its recommendations, but no legislation has been drafted to date. When drafted, the new Designs (Visual Features) Bill will be released for comment as an exposure draft prior to its introduction into Parliament.

The proposed changes to the design system are expected to improve it by providing clearer definitions, stricter eligibility and infringement tests, a more streamlined registration system and better enforcement and dispute resolution procedures. The maximum term of design protection is proposed to be reduced from 16 to 10 years.

³⁵¹ Excerpt from second reading speech, *Designs Amendment Bill 1981* by Hon David Thompson, Minister for Science and Technology

³⁵² *Designs Act* s. 30

³⁵³ ALRC *Designs*, p. 289–290

Protection of functionality

During its considerations, the ALRC looked at the innovation threshold for design and considered extending the boundaries on design protection beyond aesthetic designs to certain types of functional design. It concluded that functionality equates to a low-level innovation, which would be better covered by a lower form of patent protection. The ALRC recommended that designs continue to focus on visual appearance and that gaps in the protection of function be considered by the Advisory Council on Industry Property (ACIP) in its review of the petty patent system. This view was accepted by Government.

ACIP reviewed the petty patent system in 1995 and recommended the adoption of a second tier patent protection to provide fast, limited monopoly protection for lower level or incremental inventions. ACIP believes this would overcome the ‘gap’ in protection for functional innovations that are not sufficiently inventive under the present standard or petty patent system to warrant protection, and are not protectable under the design system which protects the appearance of articles, but not the ‘way they work’.

The Committee notes that amendments have been proposed to the *Patents Act 1990* to introduce a new Innovation Patent and that the Innovation Patent Bill was introduced into Parliament on 29 June 2000. The Bill, as introduced, excludes plants and animals and biological processes for the generation of plants and animals from the innovation patent system. This exclusion does not extend to microbiological processes or products from such processes.

Views for and against

Some submissions submitted during the review argue that the proposed Innovation Patent should provide appropriate protection for functional designs which would not meet the requirements of a standard patent.³⁵⁴ ACIP does not believe that the design system should be extended to cover functional elements. However, ACIP notes that mere functionality of an article should not be a bar to protection if that article includes a unique shape.

It was claimed that the design legislation should protect function because the current primary concern with appearance is too narrow for most engineering purposes.³⁵⁵ IEAust believes there is a gap between the Designs Act and other intellectual property laws, which prevents certain innovative products from being protected. IEAust does not see that the introduction of the innovation patent will solve this issue, although they expect it will go some way to lessen the gap. They propose that anti-copying laws should be considered and possibly introduced as a means of overcoming the residual gap problem. IEAust also believes the Designs Act should be amended to include protection of function.

A number of parties commented during the review process that the current design legislation is ineffectual. Under the present system, the scope of protection is construed extremely narrowly, with the result that only a minor variation in appearance is needed to avoid infringement of design rights. Consequently, the registration system requires revitalisation to ensure it provides certainty of the scope and validity of the protection.

³⁵⁴ Issues Paper Submission 15, p. 7 and Issues Paper Submission 27

³⁵⁵ Issues Paper Submission 40, p. 5

Committee considerations

The Committee agrees with the claims that the design system does not current adequately address the problems it was intended to address. The balance the current system strikes between the scope and validity of the design right does not properly address market failure by minimising the opportunities for free riding.

The Committee considers that proposed changes to the design legislation to introduce a new two-step threshold test requiring design to be both new and distinctive, together with other proposed changes, will adequately address deficiencies in current arrangements. It also appears to the Committee that the introduction of the new innovation patent will likely overcome the main problems associated with the gap in protection for functional innovations.

The Committee believes the Innovation Patent and new design legislation will foster innovation and therefore believes that their early passage should be encouraged. Continued delay in progressing the legislation may have a detrimental effect on the efficient functioning of markets.

The Committee notes the claims made that a gap in protection respecting functionality will continue after the new legislation for designs and of the innovation patent are introduced. We acknowledge that some intellectual property users experience difficulties protecting aspects of functionality and incremental innovations under the current intellectual property regimes. However, mere assertion is not a compelling reason to consider an additional form of intellectual property protection, or modifications to the legislation, over and above what is currently proposed. The Committee believes it is first necessary to question and demonstrate whether there is evidence that this perceived gap leads to significant social costs in terms of reduced or lost innovation. We invited submissions demonstrating whether this perceived ‘gap’ leads to significant social costs in reduced or lost innovation or competition. No such evidence was forthcoming, however. As a result, and after considering information available on this issue, we have formed the view that further changes to address the alleged gap in IP protection are not currently warranted.

Spare parts

The complex issue of how applications for design registration of spare parts (including motor vehicle spare parts) should be treated has been the subject of additional consideration by Government. Results will be incorporated into the new legislation.

Under the current Designs Act, protection is given to designs for spare parts provided they meet the criteria of Section 4(1) of the Act, which defines a design to be a ‘...feature of shape, configuration, pattern or ornamentation applicable to an article being features that, in the finished article can be judged by the eye, but do not include a method or principle of construction’.

Views for and against

The protection of spare parts under the design laws has been the subject of much policy debate over recent years because spare parts have economic features that can be distinctive from other products protected by intellectual property law. When spare parts are protected under design legislation, producers who may not have market power in a primary market for the complete goods may be able to charge a monopoly price for spare parts in the aftermarket in which spare parts are sold. Apart from consumers being charged higher prices for parts, competition may be restricted for the repair and servicing of original equipment. This was illustrated in a submission in relation to design registration for specially shaped toner and inkjet cartridges for printers.³⁵⁶

In some instances the market for spare parts may be considered separately from the original market for the equipment. The ACCC³⁵⁷ submits that: ‘If consumers consider the relative price of spare parts (as well as the frequency of breakdown etc.) when buying the original equipment, then the two should properly be considered part of the same market; the price of spare parts would not reflect the exercise of any more market power than the manufacturer possessed as a supplier of original equipment, since to do so would adversely affect sales of the latter. However, to the extent that consumers do not make fully informed purchasing decisions (reflecting the high cost of acquiring the information), the price of spare parts may reflect the exercise of a much higher degree of market power in the ‘derivative market’ for spare parts for that particular brand of original equipment. To the extent that the spare parts are not interchangeable with those used for other brands and if independent suppliers are not able to enter the market, the manufacturer may have an effective monopoly over the supply of those spare parts’.

The ACCC further states that: ‘The policy question arises as to the extent of the problem which arise when rights are granted, versus the extent of any dampening of the incentive for innovation which the removal of rights may induce. However, in the case of spare parts, where protection is already provided to the original equipment, the incentive for design of most spare parts already exists. Furthermore, as the Industry Commission pointed out, original equipment manufacturers enjoy a number of competitive advantages, relating to reputation effects, over suppliers of *non-genuine* parts. There is considerable anecdotal evidence in relation to motor vehicle spare parts that suggests design registration can significantly inhibit competition and increase prices. As with access to other intellectual property, it is far from clear that the Trade Practices Act would be able to secure competitive access to spare part designs where problems arise. The Commission therefore recommends that design protection be removed from spare parts’.

IEAust³⁵⁸ opposes the prospect of differentiation of spare parts, arguing that it would be illogical to introduce different intellectual property protection regimes for the three classes which encompass spare parts, component parts used for the initial assembly of complete equipment, and the complete assembled finished product.

³⁵⁶ Issues Paper Submission 12, p. 2

³⁵⁷ Issues Paper Submission 53, p. 15

³⁵⁸ Issues Paper Submission 40, p. 1

The Committee suggested in our Interim Report that the new design legislation should be given a reasonable time to take effect and then be reviewed and its impact monitored. This was endorsed in subsequent submissions from the Australian Consumers Association,³⁵⁹ ACIP³⁶⁰ and IPTA.³⁶¹

Committee considerations

In considering the issues raised by the ACCC, the Committee came to the view that if the original or pre-market is competitive, it is not obvious whether the control of sale of spare parts will give rise to power in other markets. In the specific case of motor vehicles, which seems central to the policy debates in this area, we recognise that some consumers do not take prices for spare parts into consideration when purchasing a vehicle; however, many others do.

Unless producers can effectively price discriminate between consumers who take spare parts prices into account and those who do not, the conduct of even a relatively small number of consumers in the former category will price protect those in the latter category. Even putting this aside, market power arising from consumer myopia is at best limited as prices for spare parts are clearly reflected in prices for used vehicles, which in turn constrains prices for which new vehicles can be sold. Finally, if evidence of market power arises in respect of an aftermarket and producers relied on the design protection to prohibit a potential competitor from selling spares, this action could be subject to s. 46 of the Trade Practices Act. The Committee notes that the changes proposed to s. 51(3) of the Trade Practices Act should help remedy conduct that seeks to extend market power from one market to another.

The Committee considered the ACCC's recommendations that design protection be removed from spare parts, but found these to be problematic. We recognise that spare parts have been an issue but believe there is limited evidence to suggest that the problem will persist. We refer to a joint submission by the NRMA and the Australian Consumer Association, which in essence states that these organisations do not support the Designs Act in its current form. They believe that changes are required to ensure a reasonable level of competition in spare parts after-markets. However, these organisations support the amendments by Government, and they do not seek special treatment for component parts of designs. Additionally, the Committee is concerned that it would be extremely difficult and administratively complex to define what constitutes a spare part. Even if this could be accomplished, it is likely to lead to complex and arcane legislation, which in itself may inhibit innovation and competitive entry.

The Committee recognises that new design legislation is in progress and supports both its aim and early release. We do not, however, believe there is a need for further modifications respecting spare parts at this stage.

³⁵⁹ Interim Report Submission 2, p. 5

³⁶⁰ Interim Report Submission 16, p. 8

³⁶¹ Interim Report Submission 37, p. 8

TRADE MARKS ACT

Description of the rights granted by the Trade Marks Act 1995

A trade mark is a sign which is used to distinguish the goods and services of one trader from those of another. The sign can be a letter, number, word, phrase, sound, smell, shape, logo, picture, aspect of packaging or any combination of these elements.

A trade mark must be distinctive or capable of becoming distinctive of the trader's goods or services before it can be registered. By registering a trade mark the owner gains the exclusive right to prevent the use of the mark in Australia for the goods or services covered by the registration, and the right to obtain relief for infringement of the trade mark.

Applications for registration are made to the Trade Marks Office within IP Australia. Trade mark registration is initially for a period of 10 years, but may be extended indefinitely if renewal fees are paid and the mark continues to be used as originally intended.

Objectives of the trade mark right

In the Second Reading Speech of *Trade Marks Bill 1995*, Senator Schacht said:

Australia's trade marks law serves two complementary objectives—first, identification and protection of a business's products and, second, protection of the consumer.

In relation to the first objective, the value of a trade mark to its owner can be enormous in terms of the reputation and goodwill associated with the trade mark...a registered trade mark, properly managed, can become a valuable asset of a business, an asset that can be sold, franchised out, licensed or used as security. As such, adequate protection of trade marks and other valuable intellectual property is vital for all innovative Australian enterprises.

In terms of the second objective, trade marks also provide certainty to consumers by indicating the trade source of goods or services. Through use, consumers can also come to associate a trade mark with the quality of a particular good or service...Because consumers make purchasing decisions based on the trade marks associated with goods or services, trade marks legislation, as well as trade practices and related legislation, provide appropriate checks and balances to ensure that use of trade marks do not deceive or confuse consumers. Quite obviously, trade marks are a vital link between the owner of the trade mark, the owner's products, and consumers.³⁶²

Over time, consumers have become increasingly removed from the source of the products they purchase. As a result, trade marks have taken on the function of product identification and differentiation, as well as source identification. Therefore, the economic function of trade marks differs from other intellectual property regimes in that they indirectly protect the consumer by ensuring that purchasing decisions are based on marks that properly identify the

³⁶² Excerpts from Second Reading Speech Trade Marks Bill 1995—Senator the Hon Chris Schacht, Minister for Small Business, Customs and Construction.

product and its source. Because they differentiate similar goods and services, trade marks also convey the message that the products bearing the mark are from a specific producer and can be expected to possess a certain quality. It allows producers to invest in business reputation, which over time ensures that their marks represent an important economic asset. To protect this asset, they have incentives to maintain product and service quality. This helps ensure that consumers are protected from exploitation in instances where the quality of a product or a service is difficult or costly to assess in advance of purchase.

Problems that trade marks attempt to address

Despite the distinct character of trade marks, the economic rationale for their protection is the same as for other intellectual property rights—the prevention of free riding, particularly in relation to quality.

The trade mark system promotes orderly marketing and helps to increase market efficiency. As trade marks provide product identity the system can help reduce consumer search costs. In order to convince consumers to reduce search costs by relying on trade marks, the producer of the marked goods has to maintain a consistent quality over time for all consumers.

Recognised branding can be copied by competitors and if this occurs it can erode the value of the brand to the original producer and to consumers. Furthermore, consumers may be deceived or confused by simultaneous brand use. Copying tends to decrease the information available to buyers when they make their purchase choice. This erodes the efficacy of markets, reducing consumer welfare and economic efficiency overall. Legal regulation, in the form of trade marks, helps overcome the problems of simultaneous use and brand erosion. It also avoids the costs copying would otherwise impose in terms of market disruption and the potential for consumer confusion and deception.

Alternatives to trade marks, including non-legislative approaches

The common law provides limited protection for trade secrets and business reputation through the equitable doctrine of breach of confidence and the common law tort of passing off.

Any information is capable of generating equitable obligations of confidence. There are three elements which must be present for an action for breach of confidence to succeed:

- the information must have the necessary quality of confidence;
- the information must have been imparted in circumstances imposing an obligation of confidence; and
- there must be unauthorised use of the information to the detriment of the party communicating it.³⁶³

³⁶³ *Coco v AN Clark (Engineers) Ltd* [1969] RPC 41 p. 47

The common law tort of passing off protects the ‘benefit and advantage of the good name, reputation and connection of a business’.³⁶⁴ Passing off protects a trader’s goodwill and reputation by making it unlawful for other traders to deceptively misappropriate a trader’s reputation. Traders are not permitted to market their own products by using the distinctive attributes of another person’s business where this is likely to cause damage to that person’s business.³⁶⁵ The tort of passing off is similar to trade mark law—as both provide incentives for investment in quality and reputation.

These common law remedies relate to the general Paris Convention (Article 10b) obligation to suppress unfair competition, which breaks down into protection of business reputation and, particularly under TRIPS, protection of undisclosed information. Article 39 of TRIPS requires the protection of undisclosed information. Australia does not have specific legislation to protect the misappropriation of confidential information, although it does have specific statutory provisions requiring the preservation of secrecy. Specific legislation protects confidential data submitted for regulatory approval of new pharmaceuticals and agricultural and veterinary chemicals. The law of breach of confidence, however, is sufficiently broad to satisfy the general requirements of TRIPS, and in some respects may go beyond the minimum requirements imposed by the Agreement.

Consumer protection legislation also plays a role in the protection of business reputation. Division 1, Part V, of the Trade Practices Act proscribes a number of practices which are detrimental to the interests of consumers. The most significant of these is s. 52, which makes it illegal for corporations to engage in conduct that is misleading or deceptive, or likely to mislead or deceive. Although the purpose of s. 52 is to protect consumers, a trader whose reputation has been misappropriated may bring an action under the section, and benefit from the protection granted to the public. The Trade Practices Act is a federal law subject to constitutional limitations. Given that this review is carried out under the Competition Principles Agreement between the Federal Government and State Governments, State fair trading legislation may also be relevant.

The Committee notes that the reputation of traders and consumer rights are protected under common law remedies and alternate legislative instruments such as the Trade Practices Act. However, the Committee views these as important but supplementary forms of protection. They cannot replace the protection afforded by the trade mark system.

Nature of restrictions on competition

Limits on what can be registered as a trade mark are a competition issue. To minimise the social costs of granting trade mark rights, restrictions are placed on what can be registered. These limitations include not allowing the registration of: descriptive or generic terms that other traders may need to describe products in a manner that is comprehensible to consumers; geographic names to designate location; or signs which when attached to a product would likely confuse or deceive consumers. Further limitations exist in terms of the requirements that a trade mark must be in use or intended to be used, and it must be distinctive or capable of becoming so. Without such limitation on what can be registered, trade mark protection could limit the ability of potential competitors to enter the market.

³⁶⁴ *Inland Revenue Commissioners v Muller & Co's Margarine Ltd* [1901] AC 217, p. 223–4

³⁶⁵ *Conagra Inc v McCain Foods (Aust) Pty Ltd* (1992) 23 IPR 193, p. 231

Three trade mark issues were identified as having a potential negative impact on competition. These are:

- uncertainty regarding assignment provisions and their effect on parallel import restrictions;
- mandatory disclaimer provisions; and
- the interaction between trade marks and domain names.

Parallel importation and the Trade Marks Act

Background

Use of a trade mark in relation to goods or services will not infringe the Trade Marks Act provided that the registered mark has been applied to the goods or services by, or with the consent of, the Australian owner of the mark.³⁶⁶ The Trade Marks Act therefore adopts the principle of ‘international exhaustion’, whereby placing the goods onto the market exhausts the owner’s ability to control subsequent dealings with the goods or services.

In March 1999, the Federal Court consolidated the consistent approach of Australian courts in rejecting the rights of an international trade mark owner to control the distribution channels of its goods through trade mark rights, affirming the exhaustion of rights doctrine.³⁶⁷

However, there still appears to be uncertainty where goods are imported from overseas after an Australian trade mark is assigned to the Australian distributor.³⁶⁸

Views for and against

The Committee received submissions on parallel importation and the *Trade Marks Act 1995* which pointed to the uncertainty created when an overseas owner of a trade mark conditionally assigns the trade mark to an Australian distributor.³⁶⁹ The assignment is made on the condition that the Australian trade mark must be reassigned to the overseas owner if the distributorship arrangement between the overseas owner of the trade mark and the Australian trade mark comes to an end. The purpose of such an arrangement is to permit the Australian distributor to prevent the parallel importation of trade marked goods from overseas that would compete with the Australian distributor.

In addition to questions about the legality of these arrangements, there may be substantial anti-competitive effects created by these assignments that are plainly aimed at giving the distributor the right to control the flow of the trade marked goods. If the overseas trade mark owner retained the Australian ownership of the trade mark and retained the Australian distributor merely as an authorised user, neither the Australian distributor nor the overseas trade mark owner could prevent parallel importing. This is due to the impact of s. 123 of the

³⁶⁶ *Trade Marks Act 1995* s.123

³⁶⁷ *Transport Tyres v Montana Tyres, Rims & Tubes Ltd* (1999) AIPC 91– 467 (Full Court of the Federal Court of Australia)

³⁶⁷ See Mr Mark Davison, Issues Paper Submission 6 at p. 2; also further discussion below.

³⁶⁸ Issues Paper Submission 6

Trade Marks Act and the various case law concerning parallel importation that was decided pursuant to the *Trademarks Act 1955* (Commonwealth).

Section 123(1) of the *Trade Marks Act 1995* provides that a mark applied to the same or similar goods ‘with the consent of’ the registered owner does not infringe. There are doubts as to what ‘consent’ means in this context, although it is presumed that the section is meant to introduce into trade mark legislation the concept of exhaustion of rights. However, before the introduction of s. 123, arrangements preventing parallel importation of trade marked goods were effected through the mechanism of foreign companies assigning their Australian trade marks to local distributors in order to assist the local distributor to prevent parallel importation.

In the Fender Guitar case, *Fender Australia v Bevik*,³⁷⁰ Justice Burchett held that a local distributor, to whom the foreign owner had assigned its trade mark in Australia, was entitled to prevent the parallel importation of goods bearing the trade mark. On the facts before him, the Judge found that the local company had developed an independent reputation in the trade mark through the selection of the goods it imported and the after sales service it provided to the public. There was no challenge to the validity of the assignment of the trade mark from the foreign company to the local company. Following this case it became common for foreign companies to assign their Australian trade marks to local distributors in order to assist the local distributor to prevent parallel importation.

The recent Montana case (*Transport Tyre Sales Pty Ltd v Montana Tyres Rims and Tubes Pty Ltd*, (1999) 43 IPR 481) has cast doubts on the Fender Guitar arrangements. An international manufacturer assigned its Australian trade marks to a local distributor, in order to use trade mark rights to challenge parallel importation. This case consolidates the consistent approach in Australian courts in rejecting the rights of an international trade mark owner to control the distribution channels of its goods through trade mark rights, affirming the ‘exhaustion of rights doctrine’. However, the appeal judgment leaves unanswered some of the most important issues arising out of the facts in the Montana case. The Court did not consider the issue of ‘sham’ transactions in relation to the recording of assignments. There remains a question whether in some circumstances involving ‘Fender’ assignments, where the assignment document does not on its face reflect the real agreement between the parties, the lodgement of the document could amount to a false suggestion thereby invalidating the assignment.

A submission by Mr Mark Davison³⁷¹ states that there are difficulties and inefficiencies associated with the present position, including:

- the situation is uncertain. Neither authorised Australian distributors nor the parallel importer are certain of the legality of the parallel importer’s activity;
- trade mark owners and their Australian distributors will be entering into assignments and related agreements purely for the purpose of preventing parallel importing. There are transactional costs incurred in these activities such as liability for capital gains tax and legal fees every time the trade mark is assigned and re-assigned; and

³⁷⁰ (1989) 15 IPR 257

³⁷¹ Issues Paper Submission 6

- parallel importers can have their trading activities ended by the stroke of a pen although there is no real change in the trade activities of the overseas owner, the Australian distributor or the parallel importer. The appropriateness of parallel importing from the policy perspective is not altered in any way by the mere conditional assignment of Australian ownership to an Australian distributor but the legality of parallel importing may hinge on it.

Davison therefore concludes: ‘What is clear is that the type of artificial arrangements that have lead to the Montana case and *Fender v Bev* should not impact on the legality of parallel importing of trade marked goods. Whatever policy position is taken on the issue of parallel importing, that position should not be capable of being altered by the formation of artificial arrangements in which an Australian distributor which was previously acting as an authorised user becomes the owner of the Australian trade mark in circumstances which demonstrate that it will simply continue to perform its role as an authorised user. Section 123 of the Act needs to be amended or a new sub-section introduced to clarify that issue of what is included within the concept of “consent” by the trade mark owner to the application of the trade mark to goods. Such an amendment should make it clear that a registered owner who is, in effect, the authorised user of the overseas owner of the same trade mark is consenting to the application of the trade mark to goods made by or under the control of that overseas owner’.

Submissions also pointing out the restrictions on competition of this issue were received from the ACCC³⁷² and Mr Leslie Aldor³⁷³ acting on behalf of Holstar Cycles Pty Ltd.

Committee considerations

The Committee accepts that the current situation imposes costs, including creating uncertainties that inevitably affect the competitive process.

Generally, the Committee believes that suppliers should be able to enter into exclusive dealing arrangements except when these will substantially lessen competition in a market. We accept that the contractual assignment of trade marks is one way exclusive dealing arrangements may be established.

However, in line with its broader approach to parallel importation,³⁷⁴ the Committee does not believe that trade mark assignment contracts should serve as a means of triggering statutory provisions that protect a supplier from import competition. We are mindful of the costs to consumers that can arise from such dealings, particularly from restrictions on competition.

The Committee therefore believes that legislative changes should be enacted to ensure that artificial arrangements are not used to defeat the policy of international exhaustion with respect to trade marks.

³⁷² Issues Paper Submission 82

³⁷³ Issues Paper Submission 83

³⁷⁴ See page 41 on *Parallel Importation*.

Recommendation

Parallel importation

The Committee recommends that the Trade Marks Act be amended to ensure that the assignment provisions are not used to circumvent the intent to allow the parallel importation of legitimately trade marked goods.

Trade mark disclaimers

Background

Under the *Trade Mark Act 1955*, the Registrar of Trade Marks could insist that the registration of a trade mark be subject to the condition that the ‘non-distinctive’ elements of the mark be disclaimed. Examples of non-distinctive matter included elements that were descriptive of a characteristic of the goods and/or services; were common to the trade (such as bunches of grapes on a trade mark for wine); or were common or geographic names.

The purpose of the disclaimer was to define and clarify the distinctive element of the mark. By defining the rights of the proprietor, disclaimers assisted trade mark owners in resolving conflicts with other parties where the exclusive right of the owner to use part of a trade mark is in dispute. Moreover, they assisted potential competitors in designing marks of their own.

Under the 1995 Trade Mark Act, the Registrar no longer has the power to require applicants to disclaim rights to parts of a trade mark. Disclaimers may still be recorded on the Register, however, they are now only recorded at the request of the applicant.

Mandatory disclaimer provisions were not included in the 1995 Act because overall the costs involved in retaining them were considered to outweigh the perceived benefits. There were several reasons for this. Considering disclaimer requirements during examination was difficult and as such involved lengthy time delays and additional costs to all parties. Further, there were problems with interpretation and consistency in the application of disclaimers that reduced certainty. Finally, because disclaimers are not evident when a trade mark is used, they did not directly benefit consumers or other traders in the market place.

Views for and against

The Committee received submissions which concluded that the removal of mandatory disclaimers has contributed to uncertainty and increased costs. These submissions, made by ACIP³⁷⁵, Telstra,³⁷⁶ IPTA³⁷⁷ and FICPI³⁷⁸ urge the re-introduction of mandatory disclaimers.

³⁷⁵ Issues Paper 27 and Interim Report Submission 16

³⁷⁶ Issues Paper 62 and Interim Report Submission 26

³⁷⁷ Issues Paper Submission 24, Interim Report Submission 37

³⁷⁸ Interim Report Submission 35

The general thrust of the arguments in favour of re-introducing mandatory disclaimers are that trade marks are registered which combine both distinctive elements and descriptive elements. If disclaimers are not required, it is argued that the descriptive element is a prominent, and therefore essential, feature of the mark; thus use of that descriptive element without the other distinctive element infringes the trade mark. As a consequence of these risks, business and the public may stop using such descriptive material. Submissions supporting the reintroduction of mandatory disclaimers claim that these difficulties arising from the removal of mandatory disclaimers are widespread and are not in the public interest as they give rise to uncertainty, considerable expense and potentially over-broad trade mark protection.

However, DISR³⁷⁹ in its submission reiterated the considerable processing cost that mandatory disclaimers involve for all parties and the interpretation problems and the lack of consistency of application of mandatory disclaimers. In DISR's view, the problems noted contribute to reduce certainty, with DISR's overall conclusion being that the administrative costs involved in a mandatory system outweigh the perceived benefits.

A submission by Mr Darryl Mischlewski³⁸⁰ suggests that the effective scope of trade marks is not altered by the absence of disclaimers, and that disclaimers are rare in the systems of most other countries. Mischlewski also suggests that the absence of disclaimers in these countries does not seem to negatively affect competition. In a later submission³⁸¹ he points out that the requirement for disclaimers under the 1955 Australian Trade Mark Act increased prosecution costs and led to many trade marks that were in use not being registered. The European alternative is to register most marks so it is easy to determine which are in use. In Mischlewski's view, arguments about what components of a registered mark can be copied should be postponed until they need to be argued between two parties who are able to assess the commercial importance of the argument before committing themselves to legal expense.

Committee considerations

The Committee notes that Telstra and some IP practitioner organisations strongly urge the re-introduction of mandatory disclaimers based on the belief that their absence increases costs for users, increases uncertainty over the scope of the monopoly (which can be seen as harming competition,) and can cause market inefficiencies.

On costs, it appears to the Committee that in a system that requires mandatory disclaimers the direct costs are borne by many trade mark applicants during the examination process. In a non-mandatory system it appears the cost is primarily carried by the parties that become involved in trade mark disputes. We are not convinced that a mandatory disclaimer process is necessarily the most cost-effective approach.

Costs arise from the difficulties inherent in considering disclaimer requirements. These difficulties delay and lengthen the examination process—for example, difficulties relating to protracted arguments or negotiations between the examiner and the applicant on the wording of a disclaimer or relating to the need for a search for precedent and past practice with regard to pertinent words.

³⁷⁹ Issues Paper Submission 34, pp. 15 and 23

³⁸⁰ Issues Paper Submission 15, p. 7

³⁸¹ Interim Report Submission 6, p. 3

In instances where the trade mark is prima facie registrable, it would appear that this additional time and cost has a negative effect, especially so if it stops the trade mark from being registered.

The Committee accepts that additional social costs can arise if a system, or absence of a system, causes uncertainty in the market place. However, the Committee believes that the claims made by some parties, that mandatory disclaimers create certainty, is not clear cut. The explanatory memorandum to the *Trade Marks Bill 1995* shows that disclaimers were intended to allow an applicant for registration to disclaim the exclusive rights to the use of a part of a trade mark to assist in resolving conflicts regarding the use of that part. However, this does not provide certainty since the use of the ‘descriptive’ elements of a trade mark by another party may still constitute infringement despite the existence of disclaimers. Further, even where a word or part of a trade mark is disclaimed, the disclaimer relates only to the circumstances at a particular time and does not prevent the proprietor from acquiring rights in disclaimed matter as a result of its becoming distinctive through use.³⁸²

The absence of a disclaimer does not mean an owner has rights to any of the elements of the trade mark considered separately. The Act makes it clear that registration is for the trade mark as a whole. The *Philip Morris Inc’s Trade Mark Application [1980] RPC 527 at 532* states that:

Theoretically no disclaimer is ever necessary, since registration of a trade mark cannot give rise to any rights except those arising from the mark as a whole. Where a proprietor claims to be entitled to the exclusive use of any element in a composite mark he may apply to have that element registered as a separate mark. It can be registered only if it satisfies all the conditions of an independent mark.

The Committee consequently notes that the suggestion that disclaimers create certainty is open to question. The *Discussion Paper of the Working Party on Streamlining the Trade Mark Legislation* states:

Uncertainties can extend to a concern that erroneous inferences will be given that rights are in the undisclaimed portion of the mark not in the word or mark as a whole (‘CAL-U-Test’ Trade Mark [1967] FSR 39 at 61). But difficulties in understanding can extend even further. This is discussed in the High Court in the Eclipse Sleep Products case (supra). The Court refers to the decision in the Tudor case (Cadbury Bros Ltd’s Application (1915) 32 RPC 456) wherein Sargant J. refused to impose a disclaimer saying “the result would be to give rise to a crop of passing off actions” and supports the view of that decision expressed by Irving CJ in re Innes’s Trade Mark (1923) VLR 359. The High Court stated (at 321): “Irvine CJ must surely have been right when he said ‘It seems to me...that the discretion given by section 24 ought not be exercised on the assumption that commercial men engaged in the trade affected, and their advisers, are ignorant of the effect which the Legislature has, in the most explicit and definite terms, attached to the insertion of a disclaimer’. Where it can be seen so clearly that members of the judiciary have had divergent views on the matter of imposition of disclaimers, it seems quite understandable that the matter of exercising that discretionary power has become a time consuming aspect of examination.”³⁸³

³⁸² Discussion Paper, Working Party on Streamlining Trade Marks Legislation Trade Marks Office Oct 1990

³⁸³ *Ibid*

Further, the Committee is not convinced that the level of certainty would be improved for the general public and consumers as some proponents of mandatory disclaimers suggest. Disclaimed trade mark material, whether mandatory or otherwise, is not evident to the general public as it does not appear on the mark when it is in use. Disclaimed material only appears on the Trade Mark Register and although the general public may view the Register, the Committee considers this to be extremely unlikely as a matter of course.

Lloyd-Jacob J, in *Forde-Werke's Application (1955) 72 RPC 191 at 195*, commented on this notion: '...a disclaimer does not affect the significance which a mark conveys to others when used in the course of trade. Disclaimers do not go into the marketplace, and the public generally has no notice of them. In my opinion matter which is disclaimed is not necessarily disregarded when questions of possible confusion or deception of the public, as distinct from the extent of a proprietor's rights, are to be determined'.

The Committee also considered the view that disclaimers may promote and encourage anti-competitive behaviour if trade mark owners with greater resources than competitors use the disclaimer as a subject of argument. We do not put great weight on this view, however.

The Committee understands that trade mark disclaimers are not a feature of the trade mark systems in many other countries. The United Kingdom, United States, New Zealand and Singapore have voluntary disclaimer systems similar to that in Australia. The United States and Singapore trade mark offices differ slightly in that they charge a fee to provide this service. The absence of mandatory disclaimers in these countries perhaps suggests that disclaimers have a limited impact on competition, cost and certainty. We could not find an obvious reference to the use of trade mark disclaimers in jurisdictions such as the European Union, China or Japan, which suggests, that if they exist, they are not a significant issue.

The Committee notes that the issue of mandatory disclaimers does have some impact on competition. However, differing views on the issue of mandatory disclaimers were submitted to the Committee in response to the Issues Paper. There are obviously costs involved in maintaining a mandatory disclaimer system, just as there are costs involved for parties in the absence of such a system.

In our Interim Report, we invited interested parties to present empirical evidence to support claims that mandatory disclaimers should be re-introduced. This is consistent with our position that the evidentiary onus should lie with those who present claims. These parties should support their claims by illustrating what the benefits are and how they outweigh costs. However, despite additional submissions asserting negative impacts, the actual extent of this impact is still not clear. In the absence of convincing evidence, we not inclined to support the re-introduction of disclaimers on a mandatory basis.

Having said that, we place considerable importance on ensuring that the rights granted by a trade mark should not be over-broad. We believe that disclaimers can help in this respect, although the extent to which they do so will vary greatly from case to case. We accept that effective disclaimers are a useful indication in beginning an analysis of the scope a competing party has to use aspects of a mark. As a result, we believe that a system of voluntary disclosure that has vitality, in the sense that use is made of the opportunity to disclaim, is in the public interest.

The Committee also accepts that a system without an incentive to disclaim is not likely to meet this legitimate goal. However, we do not believe this incentive can or should be provided at the examination stage: rather, the examination needs to focus solely on the issue of the distinctiveness of the mark considered as a whole. In our view, the incentive must be linked back to the purpose of the disclaimer system, which is to reduce the risk of breach and the costs involved in determining breach.

As a result, we believe that the appropriate course is for legislation to direct the courts when determining relief in actions for infringement, to take account of the completeness of the disclaimers made of any non-distinctive elements of the mark. The Committee does not believe that, as a practical matter, this would materially complicate the task being faced by the courts, since relevant information would normally be carefully and fully addressed in the proceedings. The costs involved in pursuing an action for infringement should not, therefore, be materially affected. However, knowledge of the consideration that would be given to disclaimers in the determination of relief would, in the Committee's view, promote their more widespread use.

Recommendations

Disclaimers

The Committee recommends that:

- mandatory trade mark disclaimers not be re-introduced;
- voluntary trade mark disclaimers be encouraged and that:
 - it should be made clear in the legislation that the use of a voluntary disclaimer should not adversely affect the registrability of the mark, which must be determined by considering the distinctiveness of the mark as a whole; however,
 - courts, when awarding relief in disputes, should be directed through the legislation to take account of whether the trade mark owner has appropriately defined the scope of the right by the use of voluntary disclaimers over any non-distinctive elements in the mark.

Trade marks/domain names

Background

As the Internet explodes in popularity and e-commerce becomes increasingly important to business, governments around the world are struggling to find a regulatory framework which provides the certainty of rights needed for the efficient operation of a market economy while minimising administration and transaction costs. The main issue brought to the Committee's attention under its Terms of Reference is the conflict between domain names and trade marks.

Trade marks can be registered with IP Australia under the Trade Marks Act in one or more of 42 independent categories of goods and services. The same trade mark can be used by different owners in different categories or locations, provided it does not cause confusion in the market place. Global coordination of trade marks is handled by WIPO through various treaties. Recent treaties aim to ban the use of ‘famous’ trade marks between countries.

Domain names are electronic addresses used on the Internet, most commonly on the World Wide Web. They are the addressing arrangements for an integrated global network and so must be unique worldwide. To enable multiple use of common words for easier address remembrance, various levels of domain names with different suffixes are allowed (for example, ‘.com’ for commercial use and ‘.au’ for Australia). Until recently, registration of domain names has been handled by an informal network of delegates within the Internet system. It is becoming better organised through a mixture of not-for-profit and for-profit companies, however. Internationally, the domain name registration system is coordinated by the Internet Corporation for Assigned Names and Number (ICANN), a not-for-profit organisation that now includes international representatives.

After referral by ICANN A recent WIPO report, on the interaction of trademarks and domain names, included recommendations on:

- best practices for registration authorities;
- administrative procedures concerning abusive domain name registrations;
- exclusions for famous and well-known marks; and
- new generic top level domain names (gTLDs).

The Uniform Domain Name Dispute Resolution Procedure³⁸⁴ (UDRP) was adopted by ICANN in Autumn 1999, and made applicable as of 1 January 2000 to those generic Top Level Domains ending in the .com, .org and .net suffixes. As of 15 June 2000, all ICANN-accredited domain name registrars had adopted the UDRP and required that domain name registrants agree to abide by the terms of that policy. The policy replaces various other *ad hoc* policies of individual registrars, and has been praised for assisting with speedy and efficient resolution of disputes.³⁸⁵

The Committee notes that in July 2000, WIPO launched the next phase of its work to stamp out bad faith registration of domain names on the Internet and to study other intellectual property issues relating to the domain names system.³⁸⁶

A group of countries spearheaded by Australia (including Argentina, Canada, Denmark, the European Union, France, and the United States) wrote to WIPO’s Director General requesting that WIPO, in line with its mandate to promote the protection of intellectual property rights, initiate international consultations to address outstanding issues relating to intellectual property and domain names.³⁸⁷

³⁸⁴ <http://www.icann.org/udrp/udrp.htm>

³⁸⁵ ‘Although it is true that the robustness of these decisions has yet to be tested, this regime has proved successful in meeting its objective of delivering a fast resolution to commercial disputes where timing is key.’ M. Buckley, *A fast-track way to tackle cybersquatters*
<http://www.the-times.co.uk/news/pages/tim/2000/07/11/timlwtlwt01011.html>

³⁸⁶ <http://arbiter.wipo.int/press/update106.html>

³⁸⁷ *Ibid*

These include abusive registrations of trade names, geographical indications and other rights not based on trade marks. The request also calls upon WIPO to compile a list of best practices to help administrators of gTLD registries prevent and resolve domain name disputes. The results of these are expected to be submitted to WIPO's member states and the Internet community in the first half of 2001.³⁸⁸

Views for and against

Submissions received in response to the issues paper and the interim report strongly supported the WIPO and ICANN dispute resolution initiatives.³⁸⁹ It was also suggested that Australia should consider passing domain name 'cybersquatting' legislation similar to that passed by the United States.³⁹⁰

A number of submissions expressed concern at the overlap between trade marks and domain names and business and company names, and argued that this created confusion in the market.³⁹¹

A view was put to the Committee that a generic top level domain name—.tm for trade marks—be implemented to allow legitimate trade mark owners to apply for and own the domain name address in respect of their trade mark.

This view was challenged by a submission which argued that the domain name system has potential to bring into conflict businesses which had previously co-existed in different product or geographic markets without dispute. It was argued that it is not feasible to divide domain names into classes of goods or services like the trade mark register. Proposals to implement new domains such as .shop, .store, .product or .tm will only exacerbate the problem.³⁹²

Committee considerations

Although the domain name system was conceived as an addressing system, the Committee notes that with the expansion of the Internet, domain names now also function as powerful marketing tools. As a result there are circumstances where rights and obligations between trade marks, domain names and business and company names overlap.

We believe that effectively and efficiently resolving cross-border and domain name registrar standards disputes need more than an ad hoc approach. They are best dealt with in the international processes available through ICANN and WIPO. The Committee applauds the progress made by ICANN on the speedy and efficient resolution of disputes under the UDRP for generic Top Level Domains and the work being undertaken under the auspices of WIPO.

³⁸⁸ Further information about the consultations and how to participate, are available on WIPO's electronic commerce web site: <http://ecommerce.wipo.int>.

³⁸⁹ Interim Report Submission 35

³⁹⁰ Interim Report Submissions 25

³⁹¹ Issues Paper Submission 24, p. 18 and Issues Paper Submission 27, pp. 23 –24

³⁹² Issues Paper Submission 62, pp. 16 –18

In keeping with this approach and in relation to a suggestion to the Committee that a generic top-level domain name *.tm* be developed for trade marks, we note the WIPO final report which states:

In view of past experience, intellectual property owners are very apprehensive about the introduction of new gTLDs and the possible repetition in the new gTLDs of that experience.

As a result, the Committee does not believe that further change is needed at this time, and does not make recommendations specifically addressing this issue.

CIRCUIT LAYOUTS ACT

Description of the rights granted by the Circuit Layouts Act 1989

The Circuit Layouts Act provides a *sui generis*—copyright-style protection for eligible layouts for integrated circuits and computer chips. A layout is the plan which shows the three-dimensional location of the electronic components in the computer chip. The Circuit Layouts Act provides certain exclusive rights to the creator of an original circuit layout. These are: the right to copy the layout; the right to make an integrated circuit in accordance with the layout; and, for commercial purposes, the right to first import, sell or otherwise distribute a layout or an integrated circuit incorporating the layout. An owner of rights (initially the layout maker or their employer) may enforce rights against an infringer by civil action—claiming damages, account of profits and injunction.

Rights under the Circuit Layouts Act arise automatically and last for 10 years after the creation of the eligible layout and, if the layout is commercially exploited during that time, for 10 years from the commercial exploitation.

Objective of the Circuit Layouts right

Enactment of the *Circuit Layouts Act 1989* meant Australia satisfied the requirements for joining the 1989 WIPO Treaty on the Protection of Intellectual Property in respect of Integrated Circuits. The Act was designed to overcome the possibility that copying electronic circuitry would not be caught by the Copyright Act, where the layout is in an integrated circuit (silicon chip) rather than stored on a floppy disk.

Excerpts from the second reading speech for the Copyright Amendment Bill 1988³⁹³ state: ‘The Circuit Layouts Bill 1988 protects computer chip layouts from unfair copying...The Australian computer chip industry is small but important and growing. Australian chips, for example, make bionic ears and heart pacemakers work, detect messages from space and from the ocean and convert sunlight to power. Importantly, our specialised products have found valuable markets overseas...Chips are essential products in modern society. Innovators need to be able to stop unauthorised copying in order to protect their investment. However, that protection should not be at the expense of proper availability of the product for use in machinery and consumer appliances...The Australian computer chip industry is recognised by this Government as an important, innovative and growing one. The Government is committed to fostering its development. The Circuits Layout Bill is a significant and timely demonstration of this commitment and [to] Australian companies. Both innovative producers and users of computer chip technology will benefit from legal certainty provided by this special legislation. However, the Government also recognises that in this fast moving area, its commitment must be responsive to the needs of the industry’.

³⁹³ Second reading speech, *Copyright Amendment Bill 1988*, The Hon Nigel Bowen MP, Attorney-General November 1988

In the second reading speech for the Circuit Layouts Bill 1988³⁹⁴ it was noted: ‘This Bill is necessary because of the amendments to copyright protection of artistic works industrially applied included in the Copyright Amendment Bill 1988 which I have just introduced...The impact on the integrated circuit industry, however, should be positive, encouraging investors and creators in this field.’

Problems the right attempts to address

Like other intellectual property rights, the Circuit Layouts Act is designed primarily to correct market failure by preventing unfair copying and free riding by those who have not contributed to the original investment in the creation of the circuit layout.

Nature of restriction on competition

The Committee was not presented with any evidence to suggest that the Circuit Layouts Act restricts competition, above and beyond those restrictions inherent in providing an intellectual property right.

The Committee notes that the owner of an eligible layout under the Circuit Layouts Act cannot prohibit parallel imports from being sold in Australia. Commercial exploitation of an eligible layout is permitted where the copy or circuit has been acquired as a result of an authorised commercial exploitation in Australia or another country.³⁹⁵ The parallel importation provisions in relation to copyright material are expressly excluded from applying to any copyright work in a circuit layout, as long as the eligible layout rights themselves are not being infringed.³⁹⁶

Views for and against

The Committee did not receive any submissions in relation to the Circuit Layouts Act.

Committee considerations/evaluation

The Committee notes that under TRIPS, Australia is required to protect integrated circuit layout designs for at least 10 years. However, how this protection is provided is at the discretion of each participating country.

The Washington Treaty on Intellectual Property in Respect of Integrated Circuits (1989) covers the reproduction of the layout-design of integrated circuits and their importation, sale and distribution. However, certain acts may be freely performed for private purposes, research and teaching or for commercial evaluation and analysis (reverse engineering). Although this treaty has not yet come in force, and has not been signed by Australia, its provisions have been incorporated into TRIPS with some modifications—notably in relation to the term of protection. The Australian *Circuit Layouts Act 1989* is consistent with the TRIPS version.

³⁹⁴ Second reading speech, *Circuit Layouts Bill 1988*, The Hon Nigel Bowen MP Attorney-General, November 1988

³⁹⁵ Circuit Layouts Act, s. 24(1)

³⁹⁶ *Ibid*, s. 24(2)

The Committee notes that the circuit layouts legislation does not appear to have an adverse effect on competition. As a result, we make no recommendations for change in this respect.

However, the Committee questions the value of, and the need for, *sui generis* laws such as the Circuit Layouts Act. By their nature, such laws are highly specialised, technology-specific and narrowly defined. Their ability to keep pace with technological changes is limited.

The Committee believes that great caution should be exercised if Australia considers adopting narrowly defined, technology specific, *sui generis* intellectual property legislation in the future.

SECTION 51(3) TRADE PRACTICES ACT

Introduction

The Terms of Reference for the review require the Committee to have regard to the conclusions and recommendations in the report of the National Competition Council (NCC), entitled *Review of Sections 51(2) and 51(3) of the Trade Practices Act*.³⁹⁷ Section 51(3) exempts certain intellectual property rights from some provisions of Part IV of the Trade Practices Act.

Current law

Section 51 of the Trade Practices Act provides a number of limited exemptions from competition law. It begins by stating:

51 Exceptions

(1) In deciding whether a person has contravened this Part, the following must be disregarded:

(a) anything specified in, and specifically authorised by:

(i) an Act (not including an Act relating to patents, trade marks, designs or copyrights); or

(ii) regulations made under such an Act.

Intellectual property laws excluded by s. 51(1) are instead specifically provided for in s. 51(3), which exempts the imposing of, or giving effect to, conditions of licences and assignments from certain sections of the Trade Practices Act concerning restrictive trade practices, to the extent that those conditions *relate to* the subject matter of the relevant intellectual property right.

In the case of trade marks, the exception applies only to the extent that the conditions relate to the kinds, qualities and standards of goods bearing the trade mark.

Section 51(3) exempts intellectual property licences and assignments only from certain sections of the Act. These are set out in the following table.

³⁹⁷ Paragraph 2 (d) (i)

Section	Subject matter
45	<i>Collusive conduct</i> : contracts, arrangements or understandings are prohibited which contain an exclusionary provision or have the purpose and effect of substantially lessening competition.
45A	<i>Contracts, arrangements or understandings in relation to price</i> : contracts, arrangements or understandings are deemed to have the purpose or effect of substantially lessening competition if a provision has the purpose or effect of fixing, controlling or maintaining prices for, or providing discounts, allowances, rebates and credits in relation to, goods or services.
47	<i>Exclusive dealing</i> : supply by a corporation of goods or services to a third party is prohibited on terms constraining dealings with competitors of the corporation.
50	Acquisitions which would result in a substantial lessening of competition in a market are prohibited.
50A	The acquisition outside Australia of a controlling interest in a corporation which would lead to substantially lessening competition in a market is prohibited.

However, s. 46 (abuse of market power) and s. 48 (retail price maintenance) are not exempted.

What did the National Competition Council recommend?

The National Competition Council (NCC) recommended that the exemption in s. 51(3) be amended to remove protection for price and quantity restrictions and for horizontal agreements.³⁹⁸ The NCC also recommended that the ACCC formulate guidelines for the assistance of industry on when intellectual property licensing and assignment conditions might be exempted under s. 51(3) and when conduct not within the exemption and likely to breach Part IV might be authorised.

In its submission to the Committee, the NCC³⁹⁹ stated that an exemption for certain intellectual property activities could be justified, but that a balancing of costs was required to ensure that conduct was only exempted if it was less likely to be anti-competitive and more likely to be socially desirable. The NCC identified two types of conduct exempted by s. 51(3) that might in some circumstances be anti-competitive:

- horizontal arrangements such as cross-licences or other arrangements or understandings between competitors; and
- horizontal and vertical arrangements that substantially lessen competition, but where it cannot be established that the conduct has one of the prescribed purposes in s. 46 (3) (i.e. to drive competitors out of the market, prevent entry, or deter persons from engaging in competitive conduct). In some cases it will be difficult to establish that the purpose, as distinct from the effect, of the conduct is anti-competitive.

At the same time, the NCC recognised that horizontal arrangements, such as patent pool arrangements, could be efficiency-enhancing in certain circumstances (for example, by facilitating the adoption of a common industry standard).

³⁹⁸ The NCC also recommends the extension of the operation of s. 51(3)(a) to cover intellectual property rights granted under the *Plant Breeder's Rights Act 1994* (Commonwealth) and to refer to services as well as goods for the purposes of the *Trade Marks Act 1995* (Commonwealth).

³⁹⁹ Issues Submission 57, pp. 3–4

Implicitly, it was considered that these sorts of arrangements should be dealt with on a case-by-case basis, using the Trade Practices Act's authorisation procedures, rather than through a blanket exemption provision.

Comparative international approaches

*Competition policy and IP (intellectual property) rights are key instruments in government policy, providing incentives for innovation and the rapid diffusion of new technology...Over the past few years, both the United States and the European Union have issued new policy guidelines pertaining to the application of competition policy vis-a-vis [intellectual property rights]...Moreover, policies relating to the interface between competition policy and intellectual property rights have been the subject of international deliberations both at the multilateral and regional levels in recent years.*⁴⁰⁰

However, different approaches have been implemented internationally.

The United States

In 1995, the United States Department of Justice and the Federal Trade Commission (FTC) issued *Antitrust Guidelines for the Licensing of Intellectual Property*,⁴⁰¹ including copyright, patent, trade secret and know-how. The guidelines are designed to help parties predict whether the Department of Justice or the FTC will challenge a particular practice as anti-competitive.

The guidelines embody three general principles:

- for the purposes of antitrust analysis, intellectual property is comparable to other forms of property;
- there is no presumption that intellectual property creates market power in the antitrust context; and
- intellectual property licensing allows firms to combine complementary factors of production and is generally pro-competitive.⁴⁰²

An antitrust 'safety zone'⁴⁰³ is also created under the guidelines. In general, the Department of Justice or the FTC will not challenge a condition in an intellectual property licensing arrangement if:

- the restraint is not facially anti-competitive;⁴⁰⁴ and
- the licensor and licensee collectively account for no more than 20 per cent of each relevant market significantly affected by the restraint.

⁴⁰⁰ Robert D Anderson and Nancy T Gallini (eds) 'Competition Policy and Intellectual Property Rights in the Knowledge-Based Economy' University of Calgary Press (1998), p. 1

⁴⁰¹ <http://www.usdoj.gov/atr/public/guidelines/intellectualpropertyguide.htm>

⁴⁰² *Ibid* at 2.0

⁴⁰³ See *ibid* at 4.3 for a detailed discussion of the 'safety zone'.

⁴⁰⁴ 'Facially anti-competitive' refers to restraints that normally warrant per se treatment, as well as other restraints of a kind that would always or, almost always tend to reduce output or increase prices: *Ibid* at 4.3

In addition, a restraint will not be challenged if:

- the restraint is not facially anti-competitive; and
- four or more independently controlled entities in addition to the parties to the licensing arrangement possess assets, characteristics and incentive to engage in research and development that is a close substitute for that in the intellectual property arrangement.⁴⁰⁵

The Agencies will consider arrangements outside the ‘safety zone’ based on the considerations set out in detail in the guidelines.

The European Union

The European Union (EU) has taken a different approach to when intellectual property licensing activities may result in anti-competitive conduct. The EU has provided Group Exemptions which exempt categories of conduct deemed to be in the public interest. Arrangements that meet all conditions for application under the regulations are automatically exempted from the prohibitions on anti-competitive practices set out in the Treaty of Rome.

There are eight group exemptions, including a regulation on technology transfer agreements, and on research, development and exploitation of the results.⁴⁰⁶ For example, under the Technology Transfer Regulation, certain types of intellectual property licences are deemed to be acceptable, and certain types of conduct are made unlawful. Article 3 makes unlawful specific covenants in an intellectual property licence such as export, customer and price restrictions, obligations to assign improvements to the licensor, and quantity limitations.

In general, for an agreement to qualify for a group exemption, it must meet each condition set out in the relevant group regulation. The regulations are, in other words, interpreted narrowly. As a result, contracting parties have few opportunities to depart from the approved template.

Canada

In September 1999, the Canadian Bureau of Competition released draft guidelines for the treatment of intellectual property rights under its *Competition Act*.⁴⁰⁷

- (4) *The purpose of these Guidelines is to alleviate uncertainty that the business community may face concerning this interface and to promote transparency in the enforcement of the Competition Act. These Guidelines explain how the Bureau will assess business arrangements involving intellectual property.*

⁴⁰⁵ This second aspect of the ‘safety zone’ is consistent with congressional intent in enacting the National Co-operative Research Act.

⁴⁰⁶ See Regulation (EC) No. 240/96 on technology transfer agreements, and Regulation (EU) No. 418/85 on research, development and exploitation of the results.

⁴⁰⁷ <http://strategis.ic.gc.ca>

- (6) *The Bureau's approach to the application of the Competition Act to intellectual property is based upon the following broad framework:*
- (a) *in general, the majority of circumstances pertaining to intellectual property will be dealt with under the general provisions of the Competition Act. In such cases, the Bureau will only take enforcement action if the owner of an intellectual property right engages in conduct that is beyond the statutory and common law intellectual property rights and the conduct is anti-competitive;*
 - (b) *underlying this approach is the presumption that the exercise of an intellectual property right is not considered anti-competitive in and of itself;*
 - (c) *while intellectual property has important characteristics that distinguish it from other forms of property, the same competition analysis can be applied to conduct involving intellectual property, as to conduct involving other forms of property, to determine any anti-competitive effects. The guidelines demonstrate how the special characteristics of intellectual property can be taken into consideration in the context of this competition analysis.*
- (12) *Intellectual property has unique characteristics which make it difficult for owners to exclude others and profit from their intellectual property. First, intellectual property is typically non-excludable; it is impossible or at least very costly for owners of intellectual property to exclude others from its use without legal recourse...The problem of non-excludability is exacerbated because, while intellectual property is often expensive to develop, it is often easy and inexpensive to copy. Second, intellectual property is typically non-rivalrous: two or more persons can simultaneously make use of an intellectual property right...As a result, the task of establishing and enforcing private property rights in intellectual property is more difficult than for other kinds of property and the common and civil laws alone have not been considered as sufficient to protect most intellectual property rights.*

Policy objective

The original objectives of s. 51(3) are unclear. The NCC considers the most likely reason that s. 51(3) was enacted was to prevent a perceived clash between the interests of intellectual property owners and competition law.

In 1974, when the Trade Practices Act was enacted, intellectual property laws were widely believed to confer on the owners of intellectual property a limited economic monopoly. This led to a concern that the unrestrained application of competition law to intellectual property could undermine intellectual property rights.⁴⁰⁸

⁴⁰⁸ Review of ss. 51(2) and 51(3) of the Trade Practices Act 1974, *National Competition Council Report* March 1999

Advice from the Australian Government Solicitor

The Committee obtained advice on the meaning and operation of s. 51(3) from the Australian Government Solicitor (AGS). In its advice, the AGS highlighted the lack of clarity as to exactly which conduct is exempted.⁴⁰⁹ The ambiguity of s. 51(3), together with a lack of case law, has meant that the scope of the exemption has been subject to a range of interpretations.⁴¹⁰

One view is that almost any condition would relate to the copyright work or other subject matter and hence would be exempt. Accordingly, exclusive licensing, territorial restraints and price and quantity restrictions of intellectual property rights would not contravene the Trade Practices Act.

Another view is that a condition must relate directly to the work itself in order to be covered by s. 51(3). Therefore, conditions which, for example, specify the form of performance of a musical work would be covered, but exclusivity conditions would constitute collateral arrangements between the parties and would not be covered by the exemption. This view of s. 51(3) renders the exemption ineffectual as it would only exempt conduct which would likely not breach the Trade Practices Act in any case.

An intermediate, more purposive view, suggests that even in the absence of s. 51(3) an exercise of intellectual property rights is unlikely to constitute a breach of the Trade Practices Act unless the conduct increases market power *beyond* that granted by the relevant intellectual property right. However, the advice provided by the AGS states that if s. 51(3) were repealed, some conduct in relation to intellectual property, which at present does not constitute a contravention of Part IV, might constitute a contravention.⁴¹¹

Views for and against

Submissions received by the Committee focussed largely on the following:

- the importance which Australian industry and research institutes attach to the operation of s. 51(3);
- the need to protect exclusive licensing arrangements, such as those underpinning the operation of CRCs;⁴¹²
- the need for certainty in intellectual property licensing; and
- the appropriateness of the recommendations of the NCC to remove horizontal agreements and price and quantity restrictions from the scope of the exemption.

⁴⁰⁹ Australian Government Solicitor 'Memorandum of Advice' January 2000

⁴¹⁰ There has only been one judicial decision, *Transfield v Arlo* (1980) 30 ALR 201, that has touched on s. 51(3) and that has been used to support both views.

⁴¹¹ Australian Government Solicitor p. 21

⁴¹² Issues Paper Submission 20

Submissions were largely opposed to amending s. 51(3) as recommended by the NCC. These submissions argued that the proposed amendment would remove an essential incentive for innovation⁴¹³ and would be likely to result in increases in cost and uncertainty without leading to a more efficient operation of markets or the fuller achievement of the objectives of intellectual property laws⁴¹⁴. Some submissions noted that, despite criticism of it, the current section does not appear to have created any hardship or undesirable economic effect.⁴¹⁵

A number of submissions emphasised the importance of the s. 51(3) exemptions to the research community in Australia and stated that the exemptions provide certainty, which encourages innovation and the further development of new technology. Statements from industry seemed to be based on perceptions of both what s. 51(3) was *felt* to do, and statements about what s. 51(3) *should* do, without these always being distinguished. A strong theme from both public consultations and written submissions was that, given the substantial risks inevitably involved in investment in innovation, an uncertain regulatory framework could be damaging. The universities feared that Australian industry might look to other, more certain jurisdictions for collaborative research partnerships.⁴¹⁶ Somewhat paradoxically, submitters typically admitted that the precise meaning of s. 51(3) was highly uncertain, and yet they asserted that it had provided a firm basis for major investment decisions.

Concerns were also expressed about the cost, delay and difficulties in using the ACCC authorisation and notification procedures as recommended by the NCC and the potentially detrimental effect these processes had on investment and innovation.^{417 418} Section 51(3) was perceived, not always with clear justification, as obviating the need for expensive investigations into the acceptability, or not, of particular negotiated positions reflected in licensing agreements. Additional concerns were raised regarding the status and effectiveness of the guidelines recommended by the NCC^{419 420} although the ACCC endorsed the view that such guidelines should be established.⁴²¹

Differing opinions were expressed on whether the European Union approach served as a better model for adoption in Australia. Some saw it as a highly prescriptive, overly complex and costly approach to licensing,⁴²² whilst others saw it as creating certainty, avoiding the cost of ‘market’ enquiries and authorisation, and providing exemptions for know-how licences.⁴²³

⁴¹³ Issues Paper Submission 40, p. 1

⁴¹⁴ Issues Paper Submission 62, p. 21

⁴¹⁵ Interim Report Submission 10A, p. 4

⁴¹⁶ Issues Paper Submission 48, p. 9

⁴¹⁷ *Ibid.*, p. 25

⁴¹⁸ Issues Paper Submission 40, p. 8

⁴¹⁹ *Ibid.*, p. 21

⁴²⁰ Interim Report Submission 6, p. 3

⁴²¹ Issues Paper Submission 53, p. 17

⁴²² Issues Paper Submission 27, p. 17

⁴²³ Issues Paper Submission 30, p. 12

On the other hand, some submissions believed that intellectual property should be viewed no differently from any other form of property and that the authorisation process in the Trade Practices Act was an effective option, which permits an explicit assessment of whether the public benefits of specific conduct outweigh the competitive detriment: ‘The advantages of these approaches over an exemption is that they are transparent (involving as they do public processes) and apply on a case by case basis.’⁴²⁴

The ACCC considered that IP rights should be accorded the same treatment as any other property rights and that the uncertainty over the meaning and extent of s. 51(3) exceptions limits any benefit for business certainty, which might otherwise be afforded by it.⁴²⁵ In summary, the ACCC concluded that ss. 51(3), 44B and 152AL(6) should be removed from the Trade Practices Act.

Committee considerations

The fundamental question relates to the applicability of the full provisions of Part IV of the Trade Practices Act to conduct involving the exercise of intellectual property rights.

In considering this issue, the Committee takes those provisions as they stand. However, some comment on Part IV is warranted, as it may assist in evaluating the Committee’s recommendations.

Overall, although the broad design of Part IV dates back to the early 1970s, the approach it sets out has performed remarkably well in the test of time. Relying on prohibitions for conduct that is likely to lessen competition, with scope in most, though not all, instances for authorisation on grounds of public benefit, Part IV has provided a flexible framework in which to accommodate change both in the operation of the economy and in the intellectual understanding of the competitive process. Great confidence can consequently be placed in this framework and in its ability to handle the diverse and complex types of rights the system of Intellectual Property laws involves.

Having said that, it is important to note that the content of the Part IV prohibitions is to some degree shaped by the period in which it was enacted. More specifically, at the time of the passing of the Act, the Australian economy was heavily regulated; many markets were protected from international competition by a combination of explicit protective measures and by the high costs of transport and communications; and there was a well-established tradition of cartelisation, as well as of other arrangements that dampened competition. As a result, it was reasonable to presume that many forms of conduct were harmful, leaving scope for those that had an efficiency justification to demonstrate that justification through a public inquisitorial process.

The intellectual climate also played a part. In the early 1970s, most participants in the policy debate would have reasonably assumed that many practices that involved tying, bundling, price discrimination or resale price maintenance, were primarily means of lessening competition and exploiting consumers. Today it would be recognised that while these practices can lessen competition in some circumstances, there are many instances in which

⁴²⁴ Issues Paper Submission 37, p. 4

⁴²⁵ *Ibid.*, pp. 19–20

they enhance efficiency and make for more vigorous rivalry. The presumption of harm would therefore require far more nuance than appears in the prohibitions as they stand.

This is not to deny that significant change has occurred in respect of the relevant provisions. For instance, the repeal in 1995 of s. 49 of the Act highlights the adjustments that have been made in the face of changed circumstances and understanding. Nonetheless, it remains the case that the Act establishes a presumption that seems adverse to a range of conduct that may be more uncertain in its effects.

It is not the Committee's remit to comment on, or seek amendment to, the overall provisions of the Act. We do not claim to be in a position to do so, since the matters at issue are complex and deserve close and detailed examination. However, we do note that our views have been reached on the basis of analysing the Act as it stands, and of considering the effects that (given the Act as it stands) would flow from different approaches to the coverage by the Act of conduct relating to the exercise of IP rights.

As a general matter, the Committee recognises that intellectual property has important features that differentiate it, to a greater or lesser extent, from other property or assets. It is well known that intellectual property is typically non-excludable: that is, preventing others from using IP in the absence of an effective system of IP rights is difficult and at times impossible. Intellectual property is also typically non-rivalrous, in the sense that greater consumption by one party does not reduce the scope for consumption by others.

Partly reflecting these factors, and of great importance to the issue at hand, contracts and licenses and assignments have a pivotal role in securing efficient use of intellectual property. This is for three reasons:

1. The initial owners of IP rights are often not the parties best placed to exploit the output of their creative efforts. This is most plainly the case with specialised inventors, who remain responsible for some of the most important innovations in industrial use;⁴²⁶ it also applies to small, research-intensive firms.⁴²⁷ In these circumstances, licenses and assignments are needed to ensure that control over the rights is allocated to the parties that can exploit them most effectively.
2. In many, if not most, areas of technology, rights do not map simply into products. Commercial products often embody technology covered by claims in tens or even hundreds of patents.⁴²⁸ And the inter-dependence between rights is even greater in the innovation process itself, which frequently involves combining technological inputs owned by multiple rights owners.⁴²⁹ Complex webs of cross-licenses are required if these accumulated technical capabilities are to be put to productive use.

⁴²⁶ See Jewkes, Sawers and Stillerman (3rd ed, 1993) *The Sources of Invention*.

⁴²⁷ On the importance of which see for example, Mowery and Rosenberg (1998) *Paths of Innovation: Technological Change in 20th Century America* 41 and follows. Interestingly, Mowery and Rosenberg argue that small firms in the US innovation system have generally benefited from weaker rather than stronger IP rights, as weaker rights have reduced the risk they bear of litigation and facilitate their access to technology.

⁴²⁸ See Kitch (1997) 'The nature and function of the patent system' 20 *Journal of Law and Economics* 265.

⁴²⁹ See Merges and Nelson (1990) 'On the complex economics of patent scope' 90 *Columbia Law Review* 839.

3. Even independent of the factors set out above, the costs of impeding efficient licensing of IP can be especially high. As noted above, knowledge is non-rivalrous: increased access to it by one party does not reduce the stock available to others. As a result, when parties are forced to ‘invent around’ existing knowledge, there is a risk that the resources consumed in the process will, in social terms, be largely wasted. Even when the result of inventing around is greater immediate competition, and hence a lower allocative efficiency loss, the benefits can readily be swamped by the productive inefficiency the duplication of outlays entails.⁴³⁰

All of this means that it is essential that firms have the scope to enter into efficient contracts that involve intellectual property rights, free of onerous and ultimately counter-productive regulatory burdens. Great caution is therefore needed in imposing on transactions in IP rights constraints that may be less costly when applied in other areas of property.

However, this should not involve an open slather for owners of IP rights to act as they please, without regard to the community’s interest in competitive markets.

The Committee recognises that the IP legislation confers upon the intellectual property right holder a series of exclusive privileges designed to promote innovation. Given that these rights are conferred by legislation, they should be able to be effectively exercised even when this involves (as it generally must) the exclusion of others. However, these rights should not be capable of being used to *go beyond* the market power those rights directly confer. That is, the right holder should not be allowed to extend the statutory right into a wider right of exclusion with the effect of substantially lessening competition (SLC).

Put in slightly different terms, the system of IP rights acts to provide to those who invest in creative effort a claim on the differential efficiency associated with the results of their investment—that is, of the social gain consequent on that investment’s outcomes. Those rights should not be used to secure a gain that goes beyond that differential efficiency through the exercise of market power. Thus, it is an inherent element in the IP right that the owner of a patent on an invention can secure an income dependent on the unique efficiency that invention allows; but it ought not to be acceptable for the owner of that patent to, say through the formation of a patent pool with owners of competing patents, effect a horizontal cartel, raise prices and secure monopoly rents. The grant of IP rights seeks to provide for creators a return on their investment in creation—the rights should not be used to secure returns that do not come from the social contribution that creation makes.

The importance of ensuring that IP rights are not used in ways that go beyond the scope of the grant is especially great in a system in which IP rights are relatively strong—as is, and should remain, the case in Australia. (Indeed, several of the Committee’s recommendations make these rights clearer and more certain, and hence ultimately add to their strength). Such strong rights are necessarily more likely to confer a degree of market power; and they can more readily be used in ways that go beyond their policy purpose. For example, where rights are well-defined and readily tradeable, it may be easier for firms to rely on licence

⁴³⁰ This is not to deny that duplication can bring benefits also in the form of a wider diffusion of innovative skills, increased product differentiation and the occasional serendipitous discovery. However, the fact remains that, with a non-rivalrous good, the productive inefficiency (a rectangle) associated with duplication will generally outweigh the reduction in deadweight loss associated with increased competition (merely a triangle).

arrangements involving these rights to effect horizontal price agreements, than they could in a regime where the rights were uncertain. Or, it may be easier for an incumbent firm to enter into licence arrangements with potential competitors who own technology that could be used to challenge the incumbent's market position, therefore making it advantageous for those potential competitors not themselves to compete in the incumbent's market. In other words, the strength of IP rights, precisely because it facilitates agreements involving those rights, can make the anti-competitive use of the rights more likely.

The central question then is whether the current s. 51(3) strikes an appropriate balance in allowing the exercise of the rights but not their use in ways that go beyond the purposes underlying the rights.

As is evident from the advice provided by the AGS, there are flaws in the drafting of s. 51(3) that under any scenario would require amendment. Leaving aside drafting considerations, the Committee believes that the uncertainty surrounding the scope of the section, and the possibility that it may exempt virtually all agreements which touch on IP from relevant sections of the Trade Practices Act, make the current section inappropriate. At the same time, the Committee does not see a clear policy rationale for the uneven coverage of the section; for instance, the exclusion of the provisions dealing with resale price maintenance.

As a result, we do not believe that the section properly defines the interaction between IP laws and Part IV prohibitions. The issue is what reforms would best meet the public interest.

The Committee does not believe that simple repeal of the section would be desirable. Any assessment of repealing the section must take account of the effect repeal would have on licensing and assignment decisions. More specifically, it seems reasonable to suppose that the *per se* prohibitions embodied in the Act, and the potentially burdensome requirements for administrative review, would catch many license conditions that are usually socially beneficial—for example, tying and exclusive dealing arrangements in patent licenses.⁴³¹ Over the longer term, this could both reduce innovation and distort competition between those (typically smaller and more specialised) firms that depended on licenses and assignments and those that did not.⁴³²

⁴³¹ On the economic impacts of which see Bowman Jr (note 34 *supra*), Bowman Jr. (1973) *Patent and Antitrust Law: A Legal and Economic Appraisal* 64–139 and Rey and Winter (1999) *Exclusivity Restrictions and Intellectual Property*. These contract provisions can serve four major efficiency-enhancing purposes: they can prevent inefficient substitution when the good protected by the IP right is used in variable proportions; they can control double marginalisation; they can enhance the efficiency of metering and hence of price discrimination, which itself can lead to higher output; and in the face of transactions costs that impede complete contracts, they can reduce the risks of post-contract opportunism and better align the incentives of the contracting parties. However, this does not mean that they will invariably enhance efficiency. Moreover, other practices, such as pooling and joint pricing among potentially competing rights—owners of similar patents, clearly have the potential to act as conduits for horizontal price fixing.

⁴³² The efficiency costs of obstacles to the licensing and assignment of IP rights are well illustrated by reference to the technological histories of the UK, France and the US in Macleod (1991) 'The paradoxes of patenting: invention and its diffusion in 18th and 19th century Britain, France and North America' *Technology and Culture*, 885.

Having ruled out simple repeal, the Committee does not believe that the proposals adopted by the NCC fully address its concerns. We are not clear what content would be left in the section if (in line with the NCC's recommendations) all horizontal arrangements and all price and quantity restrictions were removed from its scope.

As the vast majority of intellectual property licences could be said to fall within these categories, we believe that adoption of the NCC's proposals would amount to a repeal of the section. By eliminating the protection the Committee believes is desirable, such a move would impose unnecessary costs on the innovation process.

Rather, it is our view that achieving an appropriate balance between the needs of the IP system and the wider goals of competition policy requires a careful re-framing of the section. More specifically, we believe this balance can best be addressed through the following changes:

- repealing s. 51(3) and related provisions from the TPA;
- amending s. 51(1)(a)(i) of TPA to list all the relevant IP statutes; and
- including amendments in the TPA to ensure that a contravention of Part IV of the TPA, or of s. 4D of that Act, shall not be taken to have been committed by reason of the imposing of conditions in a licence, or the inclusion of conditions in a contract, arrangement or understanding, that relate to the subject matter of that intellectual property statute, so long as those conditions do not result, or are not likely to result, in a substantial lessening of competition.

The term 'substantial lessening of competition' is to be interpreted in a manner consistent with the case law under the TPA more generally.

The Committee also notes that the imposing of conditions in a licence, or the inclusion of conditions in a contract, arrangement or understanding, should also clearly mean the refusal by the owner of an IP right to enter into a licence, contract, arrangement or understanding. This means that the intellectual property owner still has the benefit of the relevant provisions even in the absence of a contract. However, this will not over-ride separate provisions made in the IP legislation that bear on compulsory licensing.

To assist users of the IP system to better understand the proposed changes, the Committee considers it appropriate that the ACCC be required to issue guidelines on how it will implement enforcement activities related to the provisions. These should provide sufficient guidance to owners of intellectual property rights as to the types of behaviour likely to result in a substantial lessening of competition. The guidelines should also make provisions for potential contractors to seek written clearance from the ACCC on whether the proposed behaviour is likely to result in a substantial lessening of competition. This written clarification should be quick and simple and operate in a similar fashion to the 'letters of comfort' provision included in the ACCC Merger Guidelines. Furthermore, the Committee believes the guidelines should be drafted in close consultation with the public and, in particular, with intellectual property owners, users, licensees and facilitators. The Committee also believes that the ACCC should be required to undertake a public education and or awareness program, in conjunction with other relevant bodies, on the effects of the changes to the TPA.

These changes would ensure that conduct relating to the subject matter of IP rights, which does not result in a substantial lessening of competition, would be exempt from the relevant provisions of the TPA. It would accept that conduct from the Act's *per se* prohibitions, thus minimising the range of instances in which administrative procedures such as authorisation or notification were required.

The Committee notes that in the normal course of trade there are almost always alternative or suitably equivalent products or processes in the market place; as a result, instances in which contractual arrangements relating to intellectual property could or would potentially result in a substantial lessening of competition are likely to be rare. In most instances, it will be apparent to practitioners whether serious competition issue arises—much as it is in the other contexts in which Part IV applies. The Committee therefore believes that the proposed system will ensure the efficient development and use of intellectual property rights and ensure that these rights are not exploited to extend market power beyond the scope of the right initially granted.

Committee considerations of Part IIIA and Part XIC of the Trade Practices Act 1974

In its Issues Paper, the Committee queried to what extent the need for the compulsory licence provisions in the Patents Act would be reduced if the exception in favour of intellectual property were removed from s. 44B of the Trade Practices Act.

The Committee has therefore considered the IP exceptions provided for under Part IIIA and Part XIC of the Trade Practices Act, and believes it is convenient to consider these in parallel to the exemptions effected under s. 51(3).

The *Competition Policy Reform Act 1995* inserted a new Part IIIA into the Trade Practices Act, which established a new regime providing for third party access to a range of facilities of national importance. There are three mechanisms under Part IIIA for the provision of third party access:

- a potentially compulsory process, whereby the service is 'declared', and then is the subject of arbitration if the parties cannot agree as to access;
- a voluntary process, whereby a service provider can offer the ACCC an undertaking which sets out the terms and conditions on which it will offer third party access, and which the ACCC may accept; and
- State and Territory Government laws that regulate access, and are deemed 'effective' in terms of their compliance with national policy criteria for access laws.

Access to intellectual property is excluded from Part IIIA, except to the extent that it is an integral but subsidiary part of a broader (non-exempt) service to which access is sought. The material surrounding this exception gives little guidance as to its precise purpose.

Nonetheless, the Committee believes that there is a case for such an exception to be provided. This case has two central elements:

1. The Committee notes that the intellectual property statutes provide for third party access, albeit in differing ways and to differing extents. The compulsory licensing provisions of the Patent Act are a case in point.
2. The Committee recognises that the design of Part IIIA and Part XIC seem poorly suited to handle intellectual property rights, as these rights do not fit easily into the 'facility' and 'service' concepts which underpin those sections of the Trade Practices Act.

Overall, the Committee considers that there is merit in having provisions for third party access to IP rights along the lines provided in respect of other services by Part IIIA and Part XIC. However, the Committee is not convinced that this objective is well met by simply repealing the exception that IP rights currently have from these sections of the Trade Practices Act. Rather, it is the Committee's view that this goal is best served by reviewing, and where appropriate amending, the relevant provisions in the intellectual property statutes. In this light, the Committee has proposed reforms to the compulsory licensing provisions of the Patents Act, with the view to ensuring that these provisions can be triggered by a well structured and articulated competitive effects test.

Recommendations

Trade Practices Act

The Committee recommends that intellectual property rights continue to be accorded distinctive treatment under the Trade Practices Act (TPA). This should be achieved by:

- amending section 51(1)(a)(i) of the TPA to *list* all the relevant Intellectual Property statutes, that is 'an Act relating to patents, trade marks, designs, copyright, circuit layouts and plant breeder's rights'; *
- repealing the current section 51(3) and related provisions of the TPA; and
- inserting an amended section 51(3) and related provisions into the TPA to give effect to ensuring that a contravention of Part IV of the TPA, or of section 4D of that Act, shall not be taken to have been committed by reason of the imposing of conditions in a licence, or the inclusion of conditions in a contract, arrangement or understanding, that relate to the subject matter of that intellectual property statute, so long as those conditions do not result, or are not likely to result in a substantial lessening of competition. The term 'substantial lessening of competition' is to be interpreted in a manner consistent with the case law under the TPA more generally.

The ACCC should be required by the legislation to issue guidelines as to the manner in which it will implement any enforcement activities related to these provisions. Those guidelines should provide sufficient direction to owners of intellectual property rights to clarify the types of behaviour likely to result in a substantial lessening of competition. Provisions should exist within the guidelines for parties to seek a written clearance from the ACCC. This written clarification process should operate in a similar fashion to the 'letters of comfort' provision included in the ACCC's Merger Guidelines.

The ACCC should be required to consult widely with intellectual property owners, users, licensees, facilitators and the public generally in preparing these guidelines.

* It should be noted that this recommendation has strayed beyond the Terms of Reference of the Review in respect of the reference to plant breeder's rights. The Committee has taken the liberty of including this reference since we believe it is important to capture all intellectual property rights within the relevant provisions, including those intellectual property rights which are not a specific subject of this Review.

APPENDIX 1: TERMS OF REFERENCE

- 1) The Committee shall inquire into and report to the Attorney-General and Minister for Industry, Science and Resources by 30 June 2000 on:
 - a) the objectives of, including the nature and magnitude of the problems sought to be addressed by:
 - (i) the *Copyright Act 1968*;
 - (ii) the *Designs Act 1906*;
 - (iii) the *Patents Act 1990*;
 - (iv) the *Trade Marks Act 1995*;
 - (v) the *Circuit Layouts Act 1989*; and
 - (vi) any regulations made under the Acts referred to in (i) to (v);
 - b) the nature of the restrictions in the legislation on competition;
 - c) the likely effects of those restrictions on competition, businesses (including small businesses) and the economy generally;
 - d) whether there are alternative means, including non-legislative, for achieving the objectives referred to in (a);
 - e) the costs and benefits to businesses, including small businesses, and the economy generally of:
 - (i) the restrictions referred to in (b); and
 - (ii) the legislation overall referred to in (a); and
 - (iii) any identified relevant alternatives to the legislation, including non-legislative approaches;
 - f) the appropriateness, effectiveness and efficiency of:
 - (i) the legislation referred to in (a) and regulations made thereunder;
 - (ii) the administration established under that legislation; and
 - (iii) any identified relevant alternatives to the legislation, including non-legislative approaches—in achieving the objectives of the legislation.

- 2) In undertaking the inquiry and preparing the report referred to in (1), the Committee shall have regard to:
 - a) the determination, in the Competition Principles Agreement, that legislation which restricts competition should be retained only if the benefits to the community as a whole outweigh the costs, and if the objectives of the legislation can only be achieved by restricting competition;
 - b) the intentions and policies of the Government as expressed in statements made or authorised by responsible Ministers in relation to the legislation referred to in (1)(a), including amendments approved and announced but not yet enacted;
 - c) the obligations under international treaties that relate to the subject matter of the legislation referred to in (1)(a) and of which Australia is a member country or may become a member country;
 - d) the conclusions and recommendations in recent reviews affecting the legislation referred to in (1)(a) that have not yet been responded to by the Government, including, but not limited to:
 - (i) the report of the National Competition Council entitled *Review of sections 51(2) and 51(3) of the Trade Practices Act 1974*;
 - (ii) the report of the Copyright Law Review Committee entitled *Simplification of the Copyright Act 1968*; and
 - e) the views conveyed to it by any current review affecting the legislation referred to in (1)(a).
- 3) In undertaking the inquiry and preparing the report referred to in (1), the Committee shall:
 - a) advertise these Terms of Reference nationally;
 - b) consult with stakeholders and invite submissions from all interested parties;
 - c) hold hearings to afford interested parties the opportunity to make oral submissions;
 - d) invite the views of any review referred to in (2)(e); and
 - e) note the possibility that its report may be published.

APPENDIX 2: OVERVIEW OF AUSTRALIA'S WIPO OBLIGATIONS

Paris Convention for the Protection of Industrial Property (1891)

This convention applies to 'industrial property' in the widest sense, including inventions, trade marks, industrial designs, utility models, trade names, geographic indications and the repression of fair competition. It essentially covers national treatment (preventing discrimination against non-residents), right of priority provisions (for subsequent applications in contracting states) and some common rules. The most significant of the common rules cover independent assessment of patent eligibility by contracting states; limitations on compulsory licensing provisions for patents; protection measures for trade names, marks and geographic indications; and maintaining National Administrations, including a special industrial property service with a central office for the communication with the public of patents, marks and industrial designs.

Patent Cooperation Treaty (PCT) (1970)

This treaty enables patent protection for an invention to be sought simultaneously in a number of member states designated by the applicant. An international search is conducted by one of the eight major patent offices, of which Australia is one, and the report lists citations of prior art, which are relevant to the novelty and inventiveness of the application. The applicant can optionally ask for an 'international preliminary examination report' which gives a preliminary but non-binding opinion about the patentability of the claimed invention. However, after time periods specified by the PCT, the application must be filed with national offices where they are processed against the same national standards as any other application, though taking into account the results of the PCT search and examination.

Budapest Treaty on the International Recognition of the Deposit of Micro-organisms for the Purposes of Patent Procedure (1977)

This treaty is only open to parties to the Paris Convention and covers micro-organisms for which written disclosure is not possible. It allows for disclosure by deposit of a sample of the micro-organism at a specialised 'international depository authority' which suffices for all States contacting to this treaty. Australia has such a depository.

Strasbourg Agreement Concerning the International Patent Classification (1971)

Prior to this agreement, each patent office had their own method of classifying patent applications for subsequent searching. The agreement produced an international patent classification, which allows for easy searching of other countries' prior art. It is upgraded approximately every seven years to adapt to changes in technology.

Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Trade Marks (1957)

Like the Strasbourg Agreement for patents, this agreement provides an international system of classification for trade marks for use by contracting States. There are 34 classes for goods and eight for services with an alphabetical list of some 11 000 subclasses. Both lists are periodically updated.

Trademark Law Treaty (TLT) (1994)

The aim of this treaty is to simplify trademark registration. The permitted maximum formal requirements for registration are exhaustively listed and all other requirements are prohibited. The TLT also standardises the initial period of registration and the duration of each renewal to 10 years each. It extends to all Paris Convention trademark obligations to service marks.

Berne Convention for the Protection of Literary and Artistic Works (1886)

The fundamental principles of the convention include national treatment with the same protection in all member states as its own nationals; automatic protection with no formality requirements; coverage of 'every production in the literary, scientific and artistic domain whatever may be the mode or form of its expression'; the minimum duration of protection; and defines explicitly a minimum list of nine exclusive rights such as the right to broadcast and the 'moral rights' of authors.

Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organisations (1961)

This convention elaborates on the Berne Convention. Performers are protected against unauthorised recording or broadcasting of their live performances; producers of 'phonograms' (sound recordings) are protected against direct or indirect reproduction; while broadcasters can prohibit unauthorised recording or rebroadcasting. The convention allows exceptions to these rights such as for private use, research or reporting of current events.

Geneva Convention for the Protection of Producers of Phonograms Against Unauthorised Duplications of their Phonograms (1971)

This convention protects producers of phonograms (sound recordings in any form) against unauthorised duplication and importing for commercial distribution of unauthorised copies. Protection may be provided through copyright law, sui generis law, unfair competition law or penal law.

Brussels Convention Relating to the Distribution of Program Carrying Signals Transmitted by Satellite (1974)

The convention provides obligations for contracting states to take measures to prevent unauthorised distribution on or from its territory of any program-carrying signal transmitted by satellite.

Washington Treaty on Intellectual Property in Respect of Integrated Circuits (1989)

This treaty covers the reproduction of the layout-design of integrated circuits and their importation, sale and distribution. However, certain acts may be freely performed for private purposes, research and teaching or for commercial evaluation and analysis (reverse engineering). Although this treaty has not yet come in force and has not been signed by Australia, its provisions have been incorporated into the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) with some modifications, notably the term of protection. The Australian *Circuit Layouts Act 1989* is consistent with the TRIPS version.

WIPO Copyright Treaty (WCT) (1996)

This treaty has yet to receive ratification by the at least 30 countries, needed before it can come into force. Although Australia has not yet signed this treaty, government statements have broadly supported its aims. The treaty mentions two subject matters—computer programs (in whatever form) and compilations of data or other material (databases), which by reason of the selection or arrangement of their contents constitute intellectual creations. The treaty deals with three rights of authors—distribution, rental and communication to the public (including the Internet). Along with the WIP Performances and Phonograms Treaty (WPPT) the WCT introduces new obligations to prohibit circumvention of technological measures (such as encryption) used to protect copyright and related rights, and to prohibit tampering with rights management information (such as watermarks). In addition, the treaty requires contracting States to comply with the substantive provisions of the 1971 (Paris) Act of the Berne Convention.

Further details of these conventions and treaties can be found at <http://www.wipo.org/eng/general/index3.htm>

APPENDIX 3: SUMMARY OF INTELLECTUAL PROPERTY RIGHTS

Types of IP rights	Types of protection	Subject matter and Features protected	Maximum life of IPR	Specific economic justification of the IPR	Australian Acts (bold are in IPCR Terms of Reference)	Major international agreements (*not ratified by Australia)
Industrial property	Patents	New, non-obvious inventions capable of industrial application.	20 years	Promotes technological progress and economic growth: more efficient processes, improved functionality of products and greater consumer choice.	Patents Act 1990 The petty patent (and the proposal before Government for an Innovation Patent) is peculiar to Australia and are, or will be, covered under the Patents Act.	Paris Convention Patent Cooperation Treaty (PCT) Budapest Treaty Strasbourg Agreement Trade-Related Aspects of Intellectual Property Rights (TRIPS)
	Utility models Petty patents Innovation patents	As above, but covers inventions with a short commercial lifespan.	6 to 8 years			
	Industrial designs	Ornamental designs: Shape; configuration; pattern; and ornamentation.	16 years	Incentive to produce aesthetic utilitarian products; differentiation through appearance and minor functions; consumer choice.	Designs Act 1906 (major revisions currently before Government)	Paris Convention Hague Agreement* Locarno Agreement* TRIPS
	Trade marks	Signs or symbols to identify the origin of goods and services.	Initial 10 years plus further renewals indefinitely	Protects business reputations for quality. Meets consumer needs for information and lowers their transaction costs.	Trade Marks Act 1995 (currently subject to post-implementation review)	Madrid Agreement* Paris Convention Nice Agreement Trademark Law Treaty TRIPS
	Geographical indications	The geographic origin of goods.	Indefinite	Similar to trade marks	Trade Marks Act 1995 <i>Wine and Brandy Act 1993</i>	Paris Convention Lisbon Agreement* TRIPS
Literary and artistic property	Copyrights and neighbouring rights	Original works of authorship: literary, musical, artistic and dramatic works; films, recording, broadcasting, performances. Ideas/concepts not protected, only the expression.	Works generally 50 years from death of author. Other generally 50 years.	Provides incentives for artistic creativity by rewarding original (creative) effort. Promotes investment in industries such as book, film and software. Meets consumer needs for aesthetics, news, entertainment and education	Copyright Act 1968 (major revisions currently before Government)	Berne Convention Rome Convention Geneva Convention Brussels Convention WIPO Copyright Treaty* WIPO Performances and Phonograms Treaty* TRIPS
Sui generis protection	Plant Breeder's Rights	New, stable, homogenous, distinct varieties.	20 to 25 years	Similar to patent protection, but with lower threshold of inventiveness.	<i>Plant Varieties Act 1987</i> <i>Plant Varieties Act 1994</i>	UPOV TRIPS
	Database protection Integrated circuits	New databases. Layout of circuit designs.	As copyright 10 years	Prevent free riding on others' work. Prevent free riding on Others' work.	Copyright Act 1968 Circuit Layouts Act 1989	Washington Treaty* TRIPS
Trade secrets	Confidential information.	Secret business information.	Indefinite	Fairness in trade. Alternative to registered protection of IP.	<i>Trade Practices Act 1974</i>	TRIPS
		Test data submitted for regulatory approval.	5 to 10 years	Promotes introduction of new pharmaceuticals and agricultural chemicals.	<i>Therapeutic Goods Act, 1989</i>	

APPENDIX 4: WRITTEN SUBMISSIONS

(a) In response to Issues Paper

1	Dr Ross M. Woods
2	John and Fiona Carroll
3	Dr Charles Lawson
4	Screenrights
5 (confidential)	Peter van Bruchem
6	Mark Davison
7	Simon Walmsley
8	Humberto Urriola
9 (confidential)	Leslie R. Marchant, Chevalier
10A (confidential)	Philip Marshall
10B (confidential)	Philip Marshall
11	Geoff Wharton
12	PBTI Pty Ltd
13	Professor Ian Frazer
14	Dr Ian Ferguson
15	Darryl Mischlewski
16	Stephen Dawson
17A	Advertising Federation of Australia Limited (AFA)
17B	Advertising Federation of Australia Limited (AFA)
17C	Advertising Federation of Australia Limited (AFA)
18	NRMA Insurance Limited and the Australian Consumers' Association
19	Humberto Urriola
20	Cooperative Research Centres Association Inc.
21	Mr Keith Handscombe
22	The Royal Australian Institute of Architects (RAIA)
23	University Copyright Officer, Queensland University of Technology
24	The Institute of Patent and Trade Mark Attorneys of Australia (IPTA)

25	The Text Publishing Company Pty Ltd
26	Mr Leif Gamertsfelder
27	Advisory Council on Industrial Property (ACIP)
28	ACROD and the Australian Blindness Forum (ABF)
29	UniQuest Pty Ltd
30	Philip Mendes
31	I P Gorman
32	Australian Digital Alliance (ADA)
33	Australian Libraries Copyright Committee (ALCC)
34	Department of Industry, Science and Resources
35	Australian Toy Association (ATA)
36	Australian Film and Video Security Office
37	Ray Steinwall
38	Motion Picture Association (MPA)
39	RVIB Library and Information Services
40	The Institution of Engineers, Australia
41A (confidential)	Software Engineering Australia
41B	Software Engineering Australia
42	AVCARE (National Association for Crop Production and Animal Health)
43	Federation of Commercial Television Stations (FACTS)
44	Department of Defence
45	Australian Visual Software Distributors Association Ltd (AVSDA) (with confidential attachment)
46	Professor William J Caelli
47	Productivity Commission
48	Australian Vice-Chancellors' Committee (AVCC)
49 (confidential)	Biotechnology Australia
50	IBM Australia Limited
51	Attorney-General's Department
52	Microsoft Corporation
53	Australian Competition and Consumer Commission (ACCC)
54	ORBITAL

55	Australian Sports Commission
56	Australian Publishers Association (APA)
57	National Competition Council (NCC)
58	Copyright Agency Limited (CAL)
59	Australasian Performing Right Association (APRA)
60	The Australian Federation of Intellectual Property Attorneys FICPI Australia
61	Ceramic Fuel Cells Limited
62A	Telstra
62B	Telstra
63	Supporters of Interoperable Systems in Australia (SISA)
64	Australian Copyright Council
65	Biotech Australia
66	Steven O'Grady
67	Australian Pharmaceutical Manufacturers Association (APMA)
68	Australian Screen Directors Association (ASDA) and Australian Screen Directors Association Collecting Society (ASDACS)
69	Combined Newspapers and Magazines Copyright Committee (CNMCC)
70	Phonographic Performance Company of Australia Ltd (PPCA)
71	Tom Cochrane Pro-Vice-Chancellor, Queensland University of Technology
72	The Institution of Engineers, Australia
73	Marianne Dunham, Finlaysons
74	Jim Elder, MLA, Acting Premier of Queensland
75	Arts Law Centre of Australia
76	Department of Communications, Information Technology and the Arts (DOCITA)
77	Australian Recording Industry Association (ARIA)
78	National Copyright Industry Alliance (NCIA)
79	The International Association for the Protection of Industrial Property (Australian Group) Inc (AIPPI)
80	The International Association for the Protection of Industrial Property (AIPPI)

- 81 Department of Communications, Information Technology and the Arts
- 82 Australian Competition and Consumer Commission
- 83 Leslie R Aldor for Holstar Cycles Pty Ltd

(b) In response to the Interim Report

1	Leif Gamertsfelder
2	Australian Consumers' Association (ACA)
3	Charles Lawson
4	Elizabeth Melih
5	AVCARE (National Association for Crop Production and Animal Health)
6	Darryl Mischlewski
7	Australian Competition and Consumer Commission
8	Keith Handscombe
9	Penelope Nichol
10 A	Rodney De Boos
10 B	Rodney De Boos
11	INTERPAT
12	Philip Mendes
13	The Text Publishing Company Pty Ltd
14	Cooperative Research Centres Association, Inc
15	National Library of Australia
16	Advisory Council on Industrial Property (ACIP)
17	Australian Digital Alliance (ADA)
18	Vince Bagusauskas
19	Plant Breeder's Rights Office (PBRO), Department of Agriculture, Fisheries and Forestry
20	Australian Library and Information Association (ALIA)
21	Australian Biotechnology Association (ABA)
22	AstraZeneca Australia
23	Licensing Executives Society of Australia and New Zealand
24	Federation of Australian Radio Broadcasters (FARB)
25 (confidential)	IBM
26	Telstra
27	Attorney-General's Department
28	OKal Sentry Bollards (Aust) Pty Ltd

29	Australian Publishers Association (APA)
30	Humberto Urriola
31	Ceramic Fuel Cells Ltd
32	Australian Visual Software Distributors Association Ltd (AVSDA)
33	Gerald Dworkin
34	Sustainable Energy Foundation
35	The Australian Federation of Intellectual Property Attorneys FICPA Australia
36	Australian Toy Association Ltd (ATA)
37	The Institute of Patent and Trade Mark Attorneys of Australia (IPTA)
38	John MacPhail
39	Department of Defence
40 (with confidential attachment)	Copyright Agency Limited (CAL)
41	Phonographic Performance Company of Australia Ltd (PPCA)
42	Geoffrey M Brash
43	Law Council of Australia
44A	Microsoft Corporation
44B	Microsoft Corporation
45	MCEETYA Taskforce on Copyright Law
46	Motion Picture Association (MPA)
47	Screenrights
48	Australian Copyright Council
49	Australian Council of Building Design Professionals Ltd
50	Simon Walmsley
51	Waltzing Matilda Centre, Winton
52	Screen Producers Association of Australia (SPAA)
53	Australian Film Commission (AFC)
54	Aircar Industry
55	Associate Professor Brian Fitzgerald, School of Law and Justice, Southern Cross University
56	Music Industry Piracy Investigations (MIPA)

APPENDIX 5: PARALLEL IMPORTING AND CD PIRACY (AIC)

Consultant's report prepared for the Intellectual Property and Competition Review Committee

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Canberra

26 January 2000

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Executive summary

Prior to the liberalisation of parallel importing of compact discs (CDs) in mid-1998, Australia had a comparatively low level of CD piracy—estimated by industry groups at around seven per cent of total sales in 1998 (a rise from around four per cent in preceding years). This compares with levels of around four per cent for film piracy and over 30 per cent for business software piracy.

Since mid-1998, there is little evidence of the increase in CD piracy predicted by opponents of liberalisation. Figures supplied by Customs, the Australian Federal Police and the Director of Public Prosecutions indicate that levels of criminal infringement of copyright during 1998-99 remain roughly in line with previous years.

It may be that not enough time has elapsed to make a realistic assessment on the basis of these statistics, particularly given the approximate two-year time lag for prosecutions. This also applies to the effect of increased penalties and the ‘reversal of onus of proof’ provisions in civil infringement actions, also introduced as part of the mid-1998 amendments.

However, anecdotal evidence and media reports indicate that in Australia, factors other than legislative amendment may be responsible for increases in CD piracy. These factors include:

- changes in economic conditions (such as the recent downturn in Asian economies) and the global enforcement environment within which music piracy operates; and
- technological advances which enable low-cost, domestic CD piracy and electronic music piracy (Internet downloading).

These factors suggest that increased enforcement by Customs and other public authorities of existing copyright and trade mark protection would have limited effect in reducing CD piracy.

INTRODUCTION

In mid-1998 the Australian Parliament passed the *Copyright Amendment Act (No 2) 1998*, amending the *Copyright Act 1968* to allow for ‘parallel importing’ of sound recordings. The major thrust of this reform was to provide greater competition through market liberalisation leading to increased choice and reduced prices for Australian consumers of CDs.

Opponents of this legislative change predicted negative consequences of liberalisation, including an increase in levels of CD piracy. Piracy is not legally connected to parallel importing. It remains prohibited under the Copyright Act and other intellectual property legislation—indeed, penalties for copyright piracy were increased as part of the 1998 amendments. Nonetheless, opponents argue that allowing the importing and sale of CDs produced overseas alongside the sale of locally produced recordings makes the task of detecting and prosecuting CD piracy considerably more difficult and will lead to piracy increases.

This paper assesses this argument in light of Australia’s recent – piracy and counterfeiting experience. While the focus is mainly on CD piracy, the issues raised are relevant to other forms of product covered by intellectual property rights, particularly given the likelihood of further legislative reform in the area of parallel importing.

The main sources of information relied upon for this report are recent publicly available reports and submissions of industry groups, academic researchers, and law enforcement agencies. The author also conducted personal interviews with representatives of the Australian Customs Service (ACS), the Australian Federal Police (AFP) and the Commonwealth Director of Public Prosecutions (DPP) and wishes to acknowledge the assistance these organisations provided.

1. LEGISLATIVE BACKGROUND

The protection of intellectual property in Australia is governed primarily by the following Commonwealth statutes:

Copyright Act 1968;

Designs Act 1906;

Patents Act 1990;

Trade Marks Act 1995; and

Circuit Layouts Act 1989.

While the primary focus is on copyright, reference will also be made to the enforcement provisions of other legislation in order to present a more complete picture of the operations of enforcement agencies.

In addition, Australia is party to a number of international agreements on the protection of intellectual property, the most significant of which is the 1994 *Agreement on Trade-Related Aspects of Intellectual Property Rights* (TRIPs), a product of the Uruguay Round of the World Trade Organisation (WTO).

Copyright Act 1968

(i) Civil infringement provisions prior to mid-1998

Under the pre-1998 provisions of the *Copyright Act 1968*, copyright in a literary, dramatic or musical work could be infringed without the consent of the copyright owner by:

- reproducing, publishing, performing, broadcasting, transmitting or adapting the work (ss.31, 36);
- importing for sale or hire (s.37);
- selling or other commercial dealings (s.38); and/or
- permitting a place of public entertainment to be used for performance of the work (s.39).

Similarly, before the 1998 amendments copyright in sound recordings (with analogous provisions for categories of ‘subject matter other than works’) could be infringed without the consent of the copyright owner by:

- copying, broadcasting or causing to be heard in public the sound recording (ss.85, 101);
- importing for sale or hire (s.102); and/or
- selling or other commercial dealings (s.103).

Provisions for infringement by importing for sale or hire (ss.37, 102) impose an additional (actual or constructive knowledge) requirement:

‘... that the importer knew, or ought reasonably to have known, that the making of the article would, if the article had been made in Australia by the importer, have constituted an infringement of the copyright.’

Similarly, provisions for infringement by sale and other dealings (ss38, 103) impose the requirement that:

‘... the person knew, or ought reasonably have known, that the making of the article constituted an infringement of the copyright or, in the case of an imported article, would, if the article had been made in Australia by the importer, have constituted such an infringement.’

(ii) Civil Infringement Provisions after mid-1998

The mid-1998 amendments made s.37 subject to a new s.44D which provides that importing, selling and other commercial dealings with a ‘non-infringing copy’ of a sound recording does not constitute infringement of copyright (Similar provisions have applied in a restricted form to the parallel importation of books since the introduction of s44A in 1991).

Sections 102 and 103 are now subject to a new s112D, which provides that importation, sale and other commercial dealing with a ‘non-infringing copy’ of a sound recording do not constitute infringement of copyright.

Non-infringing copy

Section 10AA of the *Copyright Act 1968* now in effect provides that an overseas-produced copy of a sound recording in which copyright subsists in Australia is ‘non-infringing’ if it is produced with the consent of the copyright owner. This is subject to the provision that the overseas country satisfy certain minimum requirements in regard to copyright protection in a manner consistent with WTO standards as set out in treaties such as TRIPs (more than 120 countries are members of the WTO). Where an overseas record company, for example, legitimately produces its domestic market and for international supply through a series of distribution agreements (whether ‘exclusive’ or not), the article is non-infringing even if an Australian copyright owner or licensed distributor does not consent to its importation. It is through this that the mid-1998 amendments liberalise the copyright regime to allow parallel importation of sound recordings.

It must be stressed that an imported copy of a sound recording is non-infringing *only* if its production does not infringe copyright in the country in which it was produced. Therefore, a pirated CD cannot be legitimately imported or sold in Australia under the liberalised parallel importing provisions.

Reversal of Onus of Proof

A further modification of the civil infringement provisions of the *Copyright Act 1968*, as part of the mid-1998 amendments, is a new s.130A which stipulates that:

‘In an action for infringement of copyright described in section 37, 38, 102 or 103 by an act involving an article that is a copy of a sound recording, it must be presumed that the copy is not a non-infringing copy unless the defendant proves that the copy is a non-infringing copy.’

Section 130A ostensibly reverses the onus of proof in a civil infringement action relating to unauthorised copies of a sound recording, but only on the question of whether the impugned copy is ‘not a non-infringing copy’. The onus still rests on the plaintiff to show that copyright subsists in the article, that the plaintiff is the owner (or licensee) of the copyright, and that the defendant committed acts which constitute infringement. In all cases, this means that the plaintiff must show that the defendant was not licensed to perform the acts alleged to infringe copyright. In the case of importation or sale, knowledge requirements must also be satisfied. Proving these elements can be difficult, particularly in light of the offence provisions (s.132) which require the higher criminal standard of proof ‘beyond reasonable doubt’.

Given that the plaintiff in a civil case has to prove all elements of copyright infringement—at least in the sense of establishing a prima facie case—before s130A can apply to raise a rebuttable presumption that a copy is not ‘non-infringing’, it is somewhat misleading to claim that the 1998 amendments ‘change the onus of proof’⁴³³. Rather than achieving its aim as a ‘strong anti-piracy measure’, s130A has been predicted to make ‘little or no difference from the [pre-1998] regime from the importer’s point of view’ while at the same time, because substantially defending the presumption against rebuttal involves adducing evidence as to the legal position in the country of manufacture, leading from the copyright owner’s point of view to a ‘substantially increased cost and difficulty in proving copyright infringement’². To date, there are no reported cases involving judicial interpretation of the section against which such a prediction can be assessed.

In addition, s130A has no application beyond civil infringement actions to the offence provisions (s132) of the *Copyright Act 1968*. This makes government claims about reversing the onus of proof for copyright piracy somewhat unclear.

Affidavit evidence

A further practical concession (introduced in 1986) is that evidence of matters such as subsistence, ownership and licensing of copyright can be introduced by affidavit, according to s134A(1). However, according to s134A(2), a party wishing ‘in good faith’ to cross-examine the maker of the affidavit may require that person to give oral evidence in court.

⁴³³ *Australian Copyright Council (ACC) Discussion Paper 1998*, at 25, challenging the Australian Government’s Press Release of 8 October 1997 entitled *Inquiry Into Enforcement of Copyright in Australia*, ACC Submission, at 8-9.

² S Peach, “Proposed Repeal of Parallel Importation Provisions – The Effect on Record Piracy in Australia” (January 1998), Gilbert & Tobin, www.gtlaw.com.au.

The Effect of Parallel Importing Liberalisation on Civil Enforcement

Given that only 18 months have elapsed since the introduction of legislative amendments allowing parallel importing of CDs, it is not yet clear to what extent the civil enforcement provisions of the *Copyright Act 1968* have in practical terms been affected. Certainly, the range of infringements potentially giving rise to litigation is reduced by the introduction of the 'parallel importing exception'. Whether this is effectively counter-balanced in civil actions for infringement by unauthorised copying (CD piracy) through the 'reversal of onus' provision in s.130A will be assessed as cases are concluded in the courts. At present, a test case on the mid-1998 amendments has commenced in the Federal Court and is awaiting determination (*BMG Music Pty Ltd & ors v Much More Music Pty Ltd*, before Hill J, noted in the Commonwealth Parliament's Bills Digest No.12 1999/2000 on the *Copyright Amendment (Importation of Sound Recordings) Bill 1999*, at 2 and note 6; preliminary action against the same defendant is discussed in the submission by APRA and AMCOS to the Inquiry Into Enforcement of Copyright in Australia).

However, the major complaint of civil litigants relates to the cost of litigation to protect their intellectual property rights. This is not likely to be allayed by recent legislative amendments (*Inquiry into Enforcement of Copyright*, MIPI Submission, at par (B)(i)). Affected parties and industry groups will likely continue to demand that action against CD pirates be taken by public authorities under the offence provisions of the *Copyright Act 1968* and the *Trade Marks Act 1995*.

(iii) Copyright offences prior to mid-1998

Since the earliest enactment of Commonwealth copyright legislation in Australia, remedies have included prosecution under a range of offence provisions. The *Copyright Act 1905*, for example, explicitly prohibited the sale, distribution and importation of 'pirated books' and 'pirated artistic works' (s.50), which were defined as reproductions made without the authority of the owner (s.4). Amendments in 1912 replaced the 'pirated' with 'infringing', which in effect prohibited unauthorised (parallel) importation alongside piracy (Kelcey 1995, at pp. 232–3). The 1998 amendments have in part reversed this.

The offence provisions of the *Copyright Act 1968* are mostly contained in s.132, which provides in subsection (1) that a person shall not, when copyright subsists in a work:

- a) make an article for sale or hire;
- b) sell or let for hire, or by way of trade expose for sale or hire, an article;
- c) by way of trade exhibit an article in public; or
- d) import an article into Australia for the purpose of sale, hire etc.;

if the person knows, or ought reasonably to know, the article to be an infringing copy of the work.

Section 132(2) prohibits distribution of an infringing copy for the purpose of trade, s.132(2A) prohibits possession of an infringing copy for commercial purposes, and s.132(3) concerns manufacture or possession of devices for producing infringing copies.

Maximum penalties under the pre-1998 legislation depended on the category of copyright material involved (with higher maximum fines for cinematographic films) and whether the offence was a first or subsequent offence (s.133). An overall maximum fine of \$50 000 for a natural person, or \$250 000 for a body corporate, could be imposed for offences involving more than one infringing article, with a maximum sentence of five years for an offence other than a person's first offence under s.132.

(iv) Copyright Offences after mid-1998

Section 132(6A) now provides that a person who contravenes provisions of s.132 is guilty of an offence punishable on summary conviction of a fine of not more than 550 penalty points (currently \$60 500) and/or imprisonment for not more than five years. Under s.4B(3) of the *Crimes Act 1914* (Cth), a corporation may be fined up to five times the maximum for a person (that is, \$302 500).

Apart from increasing the levels of fines for contravention of s.132 by 10 per cent, the mid-1998 amendments did not significantly change the range of offences under the *Copyright Act 1968*. However, the definition of 'non-infringing copy of a sound recording' in s.10AA (and the corresponding re-definition of 'infringing copy' in s.10) ensures that commercial (parallel) importation of CDs legitimately produced overseas no longer constitutes an offence under the legislation. The reversal of onus provision in s.130A does *not* apply to prosecutions under s.132, which means that elements of a copyright offence must still be proved beyond reasonable doubt.

The only concession is the provision in s.134A(1) for admitting evidence on matters such as subsistence, ownership and licensing of copyright in affidavit form. However, the Director of Public Prosecutions has commented that this provision 'does not reduce the evidentiary requirements but simply allows the evidence to be provided by way of affidavit' (Inquiry into the Enforcement of Copyright in Australia, DPP Submission, at 5) subject of course to the defendant's right to cross-examine (s.134A(2)).

The effect of parallel importing liberalisation on criminal enforcement

The direct effect of legislative changes allowing parallel importing of CDs on criminal enforcement provisions as they apply to CD piracy is minimal, apart from the associated increases in penalties. As with civil enforcement, the range of infringements which can be prosecuted is reduced to the extent of the 'parallel importing exception', but the enforcement regime applying to piracy remains in place. However, it may be that the changes in commercial practice flowing from liberalisation will prove to have an impact on the practicalities of enforcement. This proposition must be assessed in the light of the roles of public agencies such as the Australian Customs Service (ACS), the Australian Federal Police (AFP) and the Director of Public Prosecutions (DPP). These are considered in detail later in this report.

2. PIRACY AND COUNTERFEITING

Terminology

While the terms ‘pirate’ and ‘counterfeit’ enjoy wide currency and long pedigree, they have no precise legal meaning. As long ago as 1769, in the case of *Millar v Taylor* (1769) 4 Burr 2303 at 2393-99; 98 ER 201 at 252-53, Lord Mansfield CJ used the term ‘pirate’ for the deliberate, unauthorised reproduction of an author’s work. Early legislation, such as the *Copyright Act 1879* (NSW) and the *Copyright Act 1905* (Cth) referred to ‘piracy’ and ‘pirated’ books or artistic works, but Australian statutes since 1912 have referred instead to ‘infringement’ and ‘infringing copies’ (Kelcey 1995, at 232-233). However, courts still regularly refer to ‘pirated’ or ‘counterfeit’ goods when faced with deliberate infringement of copyright or trade marks on a commercial scale.

The terms are used in a wide sense in the 1994 *Agreement on Trade-Related Aspects of Intellectual Property Rights* (TRIPs), (Footnote 14 of Article 51):

- a) ‘counterfeit trade mark goods’ shall mean any goods, including packaging, bearing without authorisation a trademark which is identical to the trademark validly registered in respect of such goods, or which cannot be distinguished in its essential aspects from such a trademark, and which thereby infringes the rights of the owner of the trademark in question under the law of the country of importation;
- b) ‘pirated copyright goods’ shall mean any goods which are copies made without the consent of the right holder or person duly authorized by the right holder in the country of production and which are made directly or indirectly from an article where the making of that copy would have constituted an infringement of a copyright or a related right under the law of the country of importation.

These categories are not mutually exclusive, since a pirated article may also be counterfeit in the sense of being deceptively labeled. Accordingly, the production, importation, distribution and sale of pirated copies of copyright material may also involve breaches of trade mark laws, other intellectual property laws protecting designs etc., and various consumer protection laws.

Worldwide levels

Intellectual property piracy and counterfeiting are an enormous challenge for legitimate business and for law enforcement agencies around the world. Recent estimates of the scale of the problem include:

- annual losses in China due to piracy of American computer software, films, music and other intellectual property of some US\$2 billion prior to official pledges in 1996 to crack down on pirate factories (*TIME Magazine*, June 3 1996, vol. 147, no. 23);
- annual software piracy losses during 1996, 1997 and 1998 of around US\$11 billion worldwide, with pirated software accounting for around 38 per cent of all software in use, according to the Software and Information Industry Association (formerly Software Publishers Association) and the Business Software Alliance joint studies (reported 25 May 1999 at www.bsa.org);

- an increase during 1997-98 of over 38 per cent in US industry losses to music piracy, up from US\$1.25 billion to US\$1.73 billion, according to a study of 62 nations undertaken by the International Intellectual Property Alliance (IIPA), with the US Trade Representative subsequently designating Israel as a 'priority Foreign Country' under its 'Special 301' program identifying countries with inadequate intellectual property protection (reported 18 February 1999 at www.iipa.com);
- worldwide sales during 1998 of pirated music recordings estimated by the International Federation of the Phonographic Industry (IFPI) at two billion units (1.6 billion cassettes and 400 million CDs), representing about one-third of total global sales, and with illegal recordings outnumbering legitimate music sales in 20 countries including much of South East Asia, Eastern Europe and Israel (*Muzi Daily News*, London, 14 June 1999);
- identification by the International Federation of the Phonographic Industry (IFPI) of Hong Kong as the centre of a US\$4.5 billion music piracy business, with seizures during 1998-99 of some 20 million illegal CDs en route from Hong Kong and South East Asia to Latin America via Miami and Paraguay (*USA Today/Associated Press*, 23 November 1999).

The Australian experience

The scale of global intellectual property infringement outlined above makes it unlikely that Australia will ever be in a position single-handedly to protect local markets from piracy and counterfeiting. However, the evidence to date suggests that Australia has a relatively lower level of copyright and trade mark infringement than observed in other countries in the region.

It has been suggested that the strength of Australian intellectual property laws coupled with the low level of informal (street and market) retail sales is a main factor in low local levels of pirate CD sales (*Inquiry into Enforcement of Copyright in Australia*, DOCITA Submission, at 19). Moreover, the Federal Government assured during the liberalisation of parallel importing of CDs that this reform would not result in an increase in CD piracy, and that the increased penalties would, on the contrary, further deter illegal activity (Answers to Common Questions, Senator Richard Alston, Federal Minister for Communication and the Arts, 1998 at www.richardalston.dca.gov.au/cheaper—cds).

Estimated piracy levels

As observed by the Attorney-General's Department, Australia has no public agency responsible for collecting and maintaining consolidated statistics on copyright or other intellectual property infringement (Attorney-General Department's submission to the Inquiry into the Enforcement of Copyright in Australia, at paragraph 84). Civil litigation figures showed some 40 to 50 matters involving copyright infringement during 1996 (with half that level in each of the preceding two years), while criminal prosecutions tend to amount to no more than 12 annually under the *Copyright Act 1968* and the *Trade Marks Act 1995* (A-G's submission at paragraph 84; DPP *Annual Reports* 1989-99, discussed later in this report).

Industry estimates tend to rate the proportion of pirated music recordings sold in Australia at around seven per cent of total sales (*Inquiry into the Enforcement of Copyright in Australia*, IMPI Submission, at par (A)(i)). Comparative figures compiled by the International Intellectual Property Alliance place Australia at the lower end of the range of piracy levels (Table 1, reproduced from the Attorney-General Department's submission to the Inquiry into the Enforcement of Copyright in Australia, at par 88); see further www.iipa.com):

TABLE 1**Piracy levels estimated by the International Intellectual Property Alliance— international comparisons for 1998**

Note: Percentage (%) figures are estimated percentages of total unit sales for the period - those outside brackets are for 1998; those inside brackets are for the period indicated.

Country (in alphabetical order)	Film piracy	CD piracy	Business software
Australia	4% (4% for 1995-97)	7% (4% in both 1995 and 1996)	31% (35% in 1995, 32% in 1997)
Canada	(5% in 1996)	?	(42% in 1996)
Germany	20% (22% in 1997)	N/A (3% in 1995)	28% (33% in 1997) 52% for entertainment software
Italy	30%	20%	44% (43% in 1997) 50% for entertainment software
Singapore	25% (15% in 1997)	19% (30% in 1997)	54% (56% in 1997) 73% for entertainment software
South Africa	16% (10% in 1997)	40% (20% in 1997)	50% (48% in 1997)
Spain	5% (7% in 1997)	5% (5% in 1997)	59% (59% in 1997)
Indonesia	90%	12%	92%

Note: Percentage (%) figures are estimated percentages of total unit sales for the period.

Video piracy in Australia has reportedly decreased from a peak of around 20 per cent around 1986 to a current level of around four per cent, largely due to police involvement in detection and prosecution. However, this level may again be increasing with the advent of video compact discs (VCDs) and the increasing availability and affordability of production technology in the form of CD writers (Inquiry into the Enforcement of Copyright in Australia, Transcripts of Hearings, 2 September 1999).

Commercial forms of piracy aside, there appears to be an increase in private unauthorised copying of CDs, with retailer Harvey Norman reporting that blank recordable compact discs (CD-Rs) were their largest selling item during Christmas 1998 (*Australian Technology News*, 'Huge Sales Point to Rise in CD Piracy', 30 December 1998). This situation can be seen as parallel to the surges of unauthorised home copying that accompanied the introduction in previous decades of blank cassettes and videotapes. More recently, it has become possible to download music in digital form directly from the Internet (in what is called MP-3 format) and, with the use of a readily purchased CD 'burner' (a laser CD writing device), compile CDs according to individual preferences. Such technological developments suggest that concerns over levels of physically imported pirate CDs will progressively give way to a concentration on copyright infringement in cyberspace (Davison 1997; Grabosky and Smith 1998).

The Impact of parallel importing liberalisation

The effect on piracy levels of the liberalisation of parallel importing restrictions in mid-1998 is difficult to estimate with any accuracy. One reason, as already indicated, is that evidence of levels of piracy prior to liberalisation is often anecdotal and in the main originates from industry rather than public agencies (Inquiry into Enforcement of Copyright in Australia, DOCITA Submission, at paragraphs 8-11). The small amount of evidence available tends to be slanted according to the presenter's attitude to the desirability or otherwise of allowing parallel importing. For example, the Australian Consumers' Association (ACA) in its February 1998 Submission to the Senate Legal and Constitutional Legislation Committee considering the *Copyright Amendment Bill (No 2) 1997*, had the following assessment (at 21):

Australia has had periodic 'busts' of pirated material, for example the recent capture of pirated copies of Elton John's tribute to Lady Diana Spencer. But there does not appear to be a large-scale problem in Australia.

The 'bust' referred to occurred in November 1997, and involved 540 copies of unauthorised 'sound-alike' recordings of songs by Elton John and other artists, purporting to be original recordings (Media Release by The Hon. Warren Truss MP, Minister for Customs and Consumer Affairs, 20 November 1997). This seizure by the Australian Customs Service (ACS) was said by the Minister to illustrate the 'use of Customs sophisticated targeting techniques and profiling technology' and was based on a notice of objection directed at such copyright infringement lodged by the Australasian Mechanical Copyright Owners Society. This mechanism is typical of the way in which imported pirate CDs are detected (discussed further in this report along with other aspects of the enforcement role of the ACS), and is not directly affected by the changes to parallel importing restrictions.

This point has been consistently made by those favouring the liberalisation of parallel importing. For example, the Australian Competition and Consumer Commission (ACCC) dismissed piracy concerns as a 'real red herring' in the parallel importing debate (Professor Alan Fels' evidence to the Senate Legal and Constitutional Legislation Committee considering the *Copyright Amendment Bill (No 2) 1997*, reported in the Committee's majority report at par 4.97):

The proposal is simply to allow into this country CDs which are validly released in other countries in accordance with their copyright laws. It is to let in copyrighted products, not pirated products. The reforms have nothing to do with pirates. It will continue to be illegal to have pirates in Australia or to import them. I might mention that one cause of piracy is the high gap between our prices and overseas prices. If the gap closes, you will have less piracy.

As predicted, the price of some CDs has fallen by a margin of around A\$7 following the liberalisation of parallel importing in Australia (*Financial Review*, 29 December 1999). It may be questioned, however, whether this is a sufficient enough reduction to make piracy an unattractive option for those who conduct business at or beyond the margins of legality. For example, it has been estimated that production costs for pirate CDs are as low as US\$0.90 per unit, while selling prices can exceed US\$15 per unit (*Inquiry into the Enforcement of Copyright in Australia*, IFPI Submission, at par 12). In Australia, CD and computer game piracy has been reported among schoolchildren aged as young as 12, equipped only with a personal computer, a \$500 CD-ROM burner and a supply of \$3 blank CDs (*The Daily Telegraph*, 12 January 2000).

The counterargument from industry groups opposing parallel importing liberalisation was that, although the legislative prohibitions on piracy were not thereby directly affected, nonetheless the resulting inflow of uncontrolled imports would ‘provide ideal conditions for the inflow of counterfeit materials’ (ARIA Submission to the Senate Legal and Constitutional Legislation Committee, reported at par 4.98).

At present, there is no data emanating from public agencies such as the Australian Customs Service, the Australian Federal Police or the Director of Public Prosecutions that provides evidence of a significantly increased inflow of pirated or counterfeit goods. Whether the operations of these agencies are likely to be affected in this way by the liberalisation of parallel importing must be assessed by considering in detail the legislative framework within which these agencies operate, and how this has been modified by the recent reforms.

3. AUSTRALIAN CUSTOMS SERVICE

The Australian Customs Service (ACS) has no specific powers *ex officio* in relation to copyright and other intellectual property rights, but does have limited powers of seizure which can, in specified circumstances, be used to detain pirated and counterfeit goods. It is important to distinguish this limited *detention function* from the more general *prohibition controls* exercised by Customs in relation to the import and export of goods. The powers likewise rest on distinct legislative bases.

Customs Act 1901

While the *Customs Act 1901* provides a general mechanism for the prohibition or control of imports, this does not automatically extend to articles (such as pirated or counterfeit goods) that infringe intellectual property rights.

Section 4 defines ‘prohibited goods’ as:

- a) goods whose importation or exportation is prohibited by this Act or any other law of the Commonwealth; or
- b) goods whose importation or exportation is subject to restrictions or conditions under this Act or any other law of the Commonwealth; or
- c) goods subject to the control of the Customs.

However, the fact that importation of certain goods may constitute infringement of copyright or trade mark under Commonwealth legislation governing those particular intellectual property rights does not in itself make those items ‘prohibited goods’ for customs purposes. The prohibition of imports is dealt with specifically in s.50(2), which empowers the Governor-General to make regulations prohibiting the importation of goods either absolutely or conditionally. Pirated and counterfeit goods as a general category are not currently the subjects of any such regulations: see Customs (Prohibited Imports) Regulations.

Copyright Act 1968

Copyright and trade marks legislation in Australia creates a specific role for the Customs Service in relation to the importation of material potentially infringing these intellectual property rights. No analogous provisions appear in the *Patents Act 1990*, the *Designs Act 1906* or the *Circuit Layouts Act 1989*. The provisions regarding copyright material are broadly in line with the requirements of Part III, Section 4, of the 1994 Agreement on Trade-Related Aspects of Intellectual Property Rights, which require member countries of the World Trade Organisation to empower their customs services to seize ‘pirated copyright goods’ on notice from the copyright owner.

Objection procedure

Division 7 of Part V of the *Copyright Act 1968* establishes a procedure whereby a person (the ‘objector’) who is owner or exclusive licensee of copyright in copyright material may lodge with the Customs a notice of objection in relation to the importation of copies of that material (see s135(2)). ‘Copyright material’ means a work, sound recording, cinematographic

film, published edition of a work, or a television or sound broadcast as recorded in a cinematographic film or a sound recording (s134B).

Sub-section 135(4) 'applies to a copy of copyright material if the making of the copy would, if it had been carried out in Australia by the person importing the copy, have constituted an infringement of the copyright in the copyright material'. Thus, the provision clearly covers importation of unauthorised or 'pirated' copies of copyright material. However, s135(10) states (since its amendment in 1998) that importation of a 'non-infringing copy' of copyright material does not constitute infringement for the purposes of s135, and so a notice of objection cannot be lodged in respect of parallel imports allowed under the *Copyright Act 1968*. A 'non-infringing copy' is (for books see s44A and s112A, for sound recordings see s10AA, s44D and s112D) a copy that has been made with the consent of the relevant copyright owner in the country in which the copy was made (provided that country has laws protecting copyright).

Thus, the position since the relaxation of parallel importing restrictions is that the role of the Australian Customs Service is confined to the seizure, on notice from an objector, of imported unauthorised copies rather than unauthorised imports.

Seizure

Section 135(7) of the *Copyright Act 1968* empowers the CEO of Customs to seize goods which are imported for the purposes of trade, which are subject to the control of Customs within the meaning of the *Customs Act 1901*, and which are covered by a current Notice of Objection. It is important to note that the Customs Service does not itself adjudicate on copyright infringement, but is empowered simply to seize any such goods hold them for 10 working days. This may be extended for a further 10 days upon request by the objector if the CEO of Customs considers such a request reasonable (*Copyright Act 1968*, s135AC and *Copyright Regulations*).

As soon as practicable after the seizure, the CEO must serve written notification on both the objector and importer, stating that the seized copies will be released to the importer unless an action for infringement is instituted by the objector in respect of the copies. In 9 out of 10 cases, particularly those involving small consignments of goods, the importer simply consents to forfeiture of the seized copies (see ss135AC and 135AE) rather than defend an action for copyright infringement. In some of the remaining cases, it is the objector who fails to take further action, having already obtained a commercial advantage through the detention period.

Notices of objection

Prior to amendment of the *Copyright Act 1968* in July 1995 to implement Australia's response to the obligations relating to copyright contained in the TRIPs agreement, the objection provisions applied only in relation to printed copies of published literary, dramatic or musical works. Customs has reported that no notice of objection was received under this scheme (*Inquiry into the Enforcement of Copyright in Australia*, ACS Submission, at par 2.3).

Since the inclusion of subject matter other than works, most notably encompassing CD sound recordings, video tapes, computer software, clothing and footwear, notices of objection have become more prevalent. Customs reports having some 52 current notices in place under the

Copyright Act 1968, lodged by 43 companies (*Inquiry into the Enforcement of Copyright in Australia*, ACS Submission, at par 2.11). Of these, however, only two or three relate to copyright in sound recordings (information supplied by ACS).

During the 12 months to 30 April 1999, more than 60 seizures were made by Customs on the basis of copyright infringement, with values of consignments ranging up to \$45- 000, though the majority are valued at less than \$1 000 (Supra, at par 4.2). The fact that the offence provisions, like the seizure provisions, of the *Copyright Act 1968* effectively penalise only those infringements engaged in ‘for the purpose of trade’ (subs.132(1),(2) and (2A)) may provide one incentive for the importation of pirated material in smaller quantities. Another is the disincentive for objectors to enter into potentially costly litigation in relation to small quantities of infringing material (Supra, at 3.6).

Trade Marks Act 1995

The *Trade Marks Act 1995* similarly allows for notices of objection to be lodged with the CEO of Customs in respect of infringing imports. Such notices may be lodged by either the registered owner of a registered trade mark or, in certain circumstances, by an authorised user of the trade mark (s132(1) and (2)); for definitions of ‘registered owner’ and ‘authorised user’ see ss6 and 8). A notice of objection remains in force for two years from the date of the notice unless revoked earlier.

Section 133 provides for the seizure of imported goods which bear a mark which, in the opinion of the CEO of Customs, is ‘substantially identical with, or deceptively similar to’ a trade mark in respect of which a notice of objection has been lodged. Unlike the non-mandatory seizure provisions under copyright legislation, however, s133(2) of the *Trade Marks Act 1995* provides that the CEO of Customs must seize the suspect imported goods unless satisfied that there are no reasonable grounds for believing that the notified trade mark is infringed by the importation. As soon as practicable after seizure, both the objector and the designated owner must be notified in writing. As with copyright seizure, unless the objector commences an infringement action within 10 days (extendible to 20 days on request), the goods are released to the owner. In any case, the goods must be released after 21 days unless a court order provides otherwise.

Commerce (Trade Descriptions) Act 1905

The *Commerce (Trade Descriptions) Act 1905* was intended to protect consumer rather than intellectual property rights. It has, however, been urged as an alternative means for Customs Service to seize pirated or counterfeit goods (*Inquiry into the Enforcement of Copyright in Australia*, MIPI Submission, at par A (iii)(a)). Section 3 provides in part:

‘False trade description’ means a trade description which, by reason of anything contained therein or omitted therefrom, is false or likely to mislead in a material respect as regards the goods to which it is applied, and includes every alteration of a trade description, whether by way of addition, effacement, or otherwise, which makes the description false or likely to mislead in a material respect.

Section 9 creates an offence attracting a penalty of up to \$10 000 for knowingly importing goods bearing a false trade description. Such goods may be forfeited if the description is not rectified by the importer (s.10). However, if the goods can be re-labeled to the satisfaction of Customs they will be released notwithstanding that they may still infringe copyright or other

intellectual property rights (*Inquiry into the Enforcement of Copyright in Australia*, MIPI Submission, at par A (iii)(a)).

Levels of importation of pirated and counterfeit goods

It is difficult to adduce sufficient data on Customs seizures to enable a reliable estimate of levels of importation of pirated and counterfeit goods. One reason for this is that, although Customs publishes an *Annual Report*, it does not provide comparative statistics on seizures identified according to categories including intellectual property infringement. Indeed, one complaint regularly made by industry groups is that there is no government agency responsible for collecting and disseminating such statistics— moreover, it has been asserted that disclosure could constitute a breach of confidence contrary to s16 of the *Customs Administration Act 1985* (*Inquiry into the Enforcement of Copyright in Australia*, MIPI Submission, at paras (A)(i)(a)-(c), (F)). Rather, information passes between Customs and industry groups through community participation programs such as the ‘Frontline’ cooperation program, which had more than 750 members at 30 June 1999. Referrals from Frontline members during 1998-1999 totalled 636 and resulted in the detection of 144 instances of illegal activity, including the seizure of 1 800 CDs of pirated software (Custom’s *Annual Report 1998-99*, at 41).

Inspection levels

Customs physically inspects only a small proportion of the large quantities of imported and exported goods that cross Australia’s borders. Industry group estimates range from as little as .06% (*Inquiry into the Enforcement of Copyright in Australia*, Transcript of Hearings, 26 July 1999, at LCA 14), although these estimates may be specific to particular types of product. Customs officials indicate that a much larger estimate is more realistic, although an overall statistic is not available. It must be remembered that the volumes of goods passing through Australia’s borders are huge, with more than 40 million consignments of small parcels being sent yearly by mail alone, while import entries exceeded 2.5 million in 1998-99 (Custom’s *Annual Report*).

In principle, it would be possible to expand the role of Customs in preventing the importation of pirate and counterfeit goods by augmenting prohibition controls. However, this cannot be done without similar provisions being introduced in trade legislation governing the domestic market (such as the *Trade Practices Act 1974* (Cth)), otherwise this might constitute a ‘barrier to trade’ contrary to WTO principles. Moreover, for Customs to maintain an overly rigorous physical inspection regime would not only involve a great demand on resources but would conflict with the goal of facilitating efficient transport and handling of cargo through Australian ports.

It should also be noted that a significant proportion of the pirated and counterfeit material sold within Australia is locally produced rather than imported. On one estimate, approximately 60 per cent of the illegal clothing on sale in Australian markets is made in ‘sweat shops’ in this country, thus beyond the reach of Customs no matter how many inspections of imports are conducted (*Inquiry into the Enforcement of Copyright in Australia*, ACAG Submission, at 7). The same applies to domestic piracy of CDs, using locally available CD burners and recordable CDs, and to direct download of music in digital form from the Internet.

Parallel importing

The relaxation of parallel importing restrictions in relation to sound recordings (CDs) in mid-1998 makes it more difficult to assess piracy import levels.. This is because action taken by Customs on notices of objection prior to liberalisation was not categorised according to whether the alleged infringement was for unauthorised copying or unauthorised importation. In other words, only an unidentified subset of Custom's seizures before mid-1998 related to pirated CDs as opposed to all CDs for which the importation was unauthorised. Thus, the fact that more than 2 000 music CDs were seized by Customs in 1998 under the *Copyright Act 1968 (Inquiry into the Enforcement of Copyright in Australia, DCITA Submission, at par 14)* does not reveal what proportion were related to piracy rather than unauthorised imports of non-pirated CDs. As a result, this provides little basis on which to make statistical comparisons for the future.

Anecdotal evidence from operational reports of Customs officers indicate a continued and probably increasing flow of pirated and counterfeit material into Australia, particularly in small consignments (information supplied by Customs). For the reasons set out here, it is not possible at present to quantify this evidence.

What can be said is that the liberalisation of parallel importing makes it more difficult to detect pirated material solely on the basis of the descriptions of goods importers must lodge (*Customs Act 1901, ss 68-71*). Before 1998 it was generally known which local distributors were exclusively licensed to import the products of major multinational record companies such as BMG, EMI, Sony, Universal Music and Warner Music (, IFPI Submission, at 2). An unauthorised import could therefore, in some cases, be detected by noting that the addresses of consignor and receiver were not part of the picture of recorded music importation. In the liberalised world of parallel importation, this is no longer possible. Thus Customs is now more dependent on physical inspection (assisted by intelligence from industry sources) as the main weapon in its detection strategy.

4. AUSTRALIAN FEDERAL POLICE

The Australian Federal Police (AFP) is the principal law enforcement agency entrusted with providing police services in relation to Commonwealth laws (*Australian Federal Police Act 1979*, s8). As such, the AFP receives regular referrals in relation to intellectual property infringements in general and the offence provisions of the *Copyright Act 1968* and *Trade Marks Act 1995* in particular. In addition, the AFP is interested in interests in ‘new forms of criminal activity’ and ‘the investigation of economic crime, in all its forms, transactional crime and crime involving information technology and communications (including electronic commerce)’ (*Inquiry into the Enforcement of Copyright in Australia*, AFP Submission, at 2).

Referrals

Referrals, or information alleging the commission of an offence or offences involving intellectual property matters, may be from various sources including:

- individuals;
- industry bodies such as the Australasian Film and Video Security Office, the Anti Counterfeiting Action Group , and the Music Industry Piracy Investigations; and
- Australian Customs Service.

Matters involving infringement of intellectual property rights constitute only a small proportion of the total referrals the AFP receives. Of these, a considerable number are rejected or withdrawn (Table 2). By way of classification, referrals under the *Copyright Act 1968* and *Trade Marks Act 1995* are counted along with corporate and bankruptcy referrals as economic crimes (Table 3).

TABLE 2
Referrals to Australian Federal Police involving intellectual property matters

Year	Accepted	Rejected	Withdrawn	Total
1994-1995	7	Not available	Not available	Not available
1995-1996	5	Not available	Not available	Not available
1996-1997	2	2*	Not available	Not available
1997-1998	2	20	1	23
1998-1999	5	16	1	22

*may be incomplete

Source: Information supplied by AFP, updating information in AFP submission to *Inquiry into the Enforcement of Copyright in Australia*

TABLE 3**Referrals to AFP involving intellectual property
as a proportion of categories of referrals**

Year	Intellectual Property crime	Corporate, bankruptcy and Intellectual Property crime	Total economic crime	Total referrals
1997-98	100% (23)	28% (83)	1.9% (1 222)	0.21% (10 961)
1998-99	100% (22)	25% (87)	2% (1 096)	0.25% (8 731)

Note: Percentages given represent the proportion of intellectual property referrals in relation to total referrals in each category (the numbers in brackets)

Source: AFP *Annual Report 1997-98 and 1998-99*

Case categorisation and prioritisation

Referrals involving intellectual property infringement are evaluated alongside other AFP referrals on the basis of a case categorisation and prioritisation model (CCPM). This involves assessing and weighing the referral against evaluation and prioritisation criteria identified by the AFP (Inquiry into Enforcement of Copyright in Australia, AFP Submission, at 2; Hearings 26 August 1999, at LCA 119) as including:

- availability of limited resources;
- competing priorities;
- level and extent of criminality involved;
- prospects of a successful conviction;
- likely impact and outcome of police involvement; and
- availability of alternative means of resolving the particular case.

Of these, three appear to be particularly significant in determining whether referrals involving intellectual property matters are accepted by the AFP.

(i) Level of criminality

While acknowledging that the application of the CCPM often results in alleged intellectual property infringements not being accepted for investigation, the AFP maintains that it rightly focuses on those ‘matters where there is a high incidence of direct or associated criminality [such that] the matter warrants application of the criminal law’ (ibid). What this means in practice is not altogether clear, however, it has been suggested that this criterion rules out investigation of all but the most serious of infringements (*Inquiry Into Enforcement of Copyright in Australia*, AIIA Submission, at 2):

We understand that in practice the AFP will not undertake an intellectual property matter unless it involves counterfeit products to the value of \$1 million or more. This AFP policy effectively rules out criminal enforcement of the vast majority of intellectual property matters.

The question of organised crime involvement in intellectual property piracy and the importation of counterfeit goods is also of interest (*Inquiry into Enforcement of Copyright in Australia*, Terms of Reference no.1(a)(v)). However, the AFP reports that in copyright cases it has investigated, it 'has not established any significant evidence to substantiate the involvement of organised criminal groups within Australia in copyright infringement' (*Inquiry into Enforcement of Copyright in Australia*, AFP Submission, at 4). This would appear to overlook the overseas role of organised crime groups in producing and distributing pirate CDs and computer software which ultimately find their way onto Australian markets, particularly in South East Asia (*Inquiry into Enforcement of Copyright in Australia*, IFPI Submission, Appendices A and B).

(ii) Prospect of successful prosecution

In regard to this factor, the AFP states (*Inquiry into Enforcement of Copyright in Australia*, AFP Submission, at 4):

In the AFP's experience, the principal practical difficulties encountered in pursuing criminal prosecutions revolve around establishing and proving issues of fact rather than law. That is, obtaining evidence to prove the existence of copyright in a particular case to the required standard. For instance, in December 1998, the Federal Court issued a decision on copyright charges against a person alleged to have possessed two thousand pirated laser discs for the purpose of supply. The Court found only nine discs to be infringing copies citing insufficient evidence in relation to copyright ownership in affidavits supplied by the movie companies in the United States as a deficiency in the crown case.

The case described is *Holder v Searle* [1998] FCA 1775 (discussed further below in relation to the role of the Director of Public Prosecutions). Despite the prosecution's evidentiary difficulties, the case did result in a conviction under s132(2A)(a) of the *Copyright Act 1968*, though without sentence being passed and the defendant instead entering into a cognisance of \$5 000 under s20 of the *Crimes Act 1914* ([1998] FCA 1776). That the AFP regards the penalties imposed in such cases as inadequate is clear from the following comment (*Inquiry into Enforcement of Copyright in Australia*, AFP Submission, at 4):

The level of penalties provided in the Act are [sic] regarded as adequate, however the actual sentences handed down by courts are often relatively low. In a recent matter which commenced in October 1995 and concluded in May 1999, a fine of \$4 900 was imposed which was disproportionate to the effort and resources applied to the investigation.

This case is *Hamm v Middleton* [1999] FCA 777, in which the defendant pleaded guilty to charges arising from the unauthorised importation of laser video discs under s132(1)(b), s132(1)(d)(I) and s132(2A)(a) of the *Copyright Act 1968*. The fines imposed for the three offences were, respectively, \$750, \$1 750 and \$2 000 plus prosecutor's costs fixed at \$400

(totalling \$4 900). In arriving at these amounts the judge (von Doussa J in the South Australian District Registry of the Federal Court) took the following matters into account:

- the case was one of copyright infringement by parallel importing rather than piracy;
- personal circumstances of the defendant (ill health, good character, financial position);
- seriousness of the offending course of conduct (per s16A of the *Crimes Act 1914*);
- potential loss to the victims of the crime; and
- deterrent effect of penalties.

Specifically not taken into account was the loss to the defendant (estimated at \$50 000) occasioned by the forfeiture of the infringing articles under s133(4). The view of the AFP that the fine imposed was ‘disproportionate to the effort and resources applied to the investigation’ appears to ignore many of these factors, particularly the general deterrent effect that even a few well-publicised prosecutions resulting in moderate fines might have on the level of copyright infringement in the business community.

(iii) Alternative Means of Resolution

A significant factor in the police response to allegations of intellectual property infringement is the perception that such matters are essentially commercial disputes best resolved through civil litigation. Reasons for this view include (*Inquiry into Enforcement of Copyright in Australia*, AFP Submission, at 5):

- the lower standard of proof applying to civil matters as opposed to criminal prosecutions (i.e. proof ‘on the balance of probabilities’ rather than ‘beyond reasonable doubt’: see *Evidence Act 1995* (Cth and NSW), ss 140, 141);
- the range and type of remedies available through the civil process ‘having regard to the frequent motivation of complainants being pecuniary satisfaction rather than criminal conviction’;
- the ‘proliferation of commercial bodies tasked with addressing the matter who merely wish to gain access to police powers to ‘prop up’ their own privately funded functions’;
- inconsistency in approach exemplified by the tolerance of imports of counterfeit product such as clothing where the items are for personal use rather than commercial dealing;
- the ‘resource intensive nature of copyright investigations compared with the level of criminality involved – a factor reflected in sentences delivered’; and
- the experience that ‘establishing proof of copyright in individual items is often expensive, impractical and on occasions unsuccessful’.

The last point, illustrated by cases such as *Holder v Searle* (discussed above), appears to have become particularly decisive in AFP decision-making. The Australasian Film and Video Security Office (AFVSO) reports (*Inquiry into Enforcement of Copyright in Australia*, AFVSO Submission, at par 6.3):

The AFP now requires [AFVSO] to provide it basic materials proving ownership before it will proceed to a prosecution. We believe that if ownership was easier to prove, the reluctance of the AFP to prosecute may be partly overcome.

State police services

The reluctance of the AFP to devote resources to investigating intellectual property infringements is shared by most State police services in Australia which often rely on a policy of treating such infringements as 'Federal matters' arising under Commonwealth legislation and therefore the province of the AFP and the Commonwealth's DPP (Inquiry into Enforcement of Copyright in Australia, MIPI Submission, at par (G)).

However, the NSW Police Service is involved in copyright enforcement, as illustrated by the following report (*Inquiry into Enforcement of Copyright in Australia*, NSW Police Service Submission, at 4):

[I]n December 1998, Greater Hume North Anti Theft Unit police met with an investigator of the Music Industry Piracy Investigations (MIPI) concerning CD, digital CD and video piracy. The information report on the matter notes that it is estimated by MIPI that copyright offences alone add up to millions of dollars illegally obtained. A number of businesses in the Cabramatta CBD were identified and investigated under Operation Cedar which has been recognised by ARIA as being Australia's largest CD piracy seizure to date. The Operation was successful due to the coordinated efforts of the external agencies and police.

Offences, search and seizure

Once a referral is accepted (by the AFP or State Police), an investigation is commenced which will ordinarily disclose a number of offences. Given that offences under the *Copyright Act 1968* and the *Trade Marks Act 1995* relate to commercial dealings, such an investigation typically involves a search of retail premises or warehouses in an attempt to identify infringing items. A search may reveal hundreds or even thousands of illegal copies of a sound recording, for example, which will be dealt with together as a single offence or as several offences (see *Holder v Searle* [1998] FCA 1775).

An example of a successful search and seizure operation is given in the AFP's *Annual Report 1997-98* (at 35):

In what has been described by the Australian Film and Video Security Office (AFVSO) as Australia's largest seizure of 'pirated' audio-visual material, AFP officers seized substantial quantities of copied or illegally imported video tapes, CDs, laser discs, video CDs, and digital versatile discs from premises in Sydney's western suburbs. Recording, monitoring and production equipment was also seized in the execution of the search warrant.

The 37-year-old proprietor of a video store was charged with copyright offences following the further seizure of a large quantity of allegedly copied or illegally imported music and video CDs, laser discs, digital versatile discs, and video cassettes. The seizure and arrest comes only two months after federal agents seized a similar variety of allegedly illegal material from the same video outlet. Summonses for copyright offences were being prepared when Customs officers discovered allegedly illegal material from

Hong Kong and Malaysia addressed to the outlet. As in the previous operation, a large amount of technical equipment was seized.

Apart from such notable successes, Australian Federal Police report a low level of offences under the classification ‘Copyright and Patents’ over the last decade, apart from a peak around 1991-1994 (Table 4). At present, there is no reason to expect this level to change given the general tendency for referrals involving intellectual property infringement to be rejected in all but exceptional cases.

TABLE 4

Copyright and patents offences dealt with by AFP during the last 10 years

Year	Reported	Cleared	(%)	Male	Female	Value (\$A)
1989-90	42	27	64	5	1	-
1990-91	81	43	53	15	1	50 000
1991-92	1 246	900	72	32	2	2 151 805
1992-93	763	519	68	15	4	17 840
1993-94	597	247	41	12	2	410 061
1994-95	1 924	303	16	24	5	838 310
1995-96	486	42	9	5	1	630 500
1996-97	145	12	8	11	2	-
1997-98	-	60	-	4	-	-
1998-99	-	32	-	5	-	-

Notes:

1. The classification is based on the Australian National Classification of Offences (ANCO) issued by the Australian Bureau of Statistics in 1985, where ‘Copyright and Patents’ includes both ‘Copyright Act offences’ and ‘Trade Mark/description offences’ (ANCO 1985, S Group 839).
2. The clearance rate by percentage (column 4) does not appear in the AFP reports, but was incorporated into a similar table covering the years 1992-96 in PN Grabosky and RG Smith, *Crime in the Digital Age* (Federation Press, 1998, at 95). From 1997-98 on, the AFP ceased publishing the reported numbers of crimes alongside the numbers cleared, instead adopting the term ‘confirmed offence’, so that such a calculation is no longer possible. A confirmed offence is ‘an offence which has been cleared by one of the following actions: arrest, summons, warrant, voluntary attendance at court, caution, or cleared otherwise’. Confirmed offences identified in one financial year may be the result of a referral from a previous financial year (see 1997-98 and 1998-99 AFP Annual Reports).
3. The value entries for the last three years (column 7) represent a ‘nil amount’ (AFP *Annual Report 1997-98*).

Source: AFP Annual Reports

The effect of parallel importing liberalisation

As with the Customs Service, the liberalisation of parallel importing of CDs means that a smaller class of material will warrant investigation by the AFP. However, there is not likely to be significant change in the numbers of referrals involving piracy accepted by the AFP or in the policy considerations which dictate whether investigative resources are expended on intellectual property matters.

5. DIRECTOR OF PUBLIC PROSECUTIONS

The Office of the Commonwealth Director of Public Prosecutions (DPP) has primary responsibility for the prosecution of criminal offences under Commonwealth law (*Director of Public Prosecutions Act 1983*, ss6, 9). However, the DPP is not an investigative agency and it does not have investigative powers or functions. Rather, it prosecutes cases investigated by police or other investigative agencies. It also provides advice to such agencies during their investigations, particularly in large and complex matters (*Inquiry into Enforcement of Copyright in Australia*, DPP Submission, at 2).

Referrals

As a matter of prosecution policy, the DPP does not accept referrals directly from individuals or industry groups, on the basis that an informant may become liable for prosecution costs in the case of failed or discontinued proceedings. In principle, referrals could be accepted from any government agency charged with the investigation of intellectual property infringements. In practice, however, and in the absence of any other public authority dedicated to performing this function, referrals to the DPP on intellectual property matters come exclusively from the AFP and (less regularly) State police.

Prosecution policy

Prosecution decisions are made on guidelines set out in the Commonwealth's Prosecution Policy (*Inquiry into Enforcement of Copyright in Australia*, DPP Submission, at 2). To decide the threshold issue of whether charges should be laid (or continued), a two-stage test must be satisfied:

1. there must be sufficient evidence to prosecute the case (not just to make out a prima facie case but to ensure reasonable prospects of conviction); and
2. it must be clear from the facts of the case and all surrounding circumstances that prosecution would be in the public interest.

To decide these matters, a brief of evidence is prepared on the information supplied by police. Because of the specialised and complex nature of intellectual property law, Counsel's advice may be obtained during this assessment. Critical issues include whether evidence will be available (in Australia or from overseas) in a form which will be admissible in criminal proceedings in an Australian court. Of particular concern in a number of prosecutions has been the availability and admissibility of evidence establishing ownership of copyright by overseas business groups (for example, *Holder v Searle* [1998] FCA 1775, discussed further below).

Copyright prosecutions

Prosecutions under the *Copyright Act 1968* constitute a small proportion of total matters handled by the DPP. Annual figures rarely exceed a dozen prosecutions per year (Table 5).

TABLE 5

Director of Public Prosecutions copyright prosecutions for 1989-1999

Year	NSW	VIC	QLD	WA	SA	ACT	Total
1989-90	3	1	5		1		10
1990-91	7	1	2	1			11
1991-92	5	2	1	7	2	3	20
1992-93	6	3	2	1		2	14
1993-94	3	1		1	1		6
1994-95	5	4	1	1			11
1995-96	4		3		1		8
1996-97	3						3
1997-98	–	–	–	–	–	–	4
1998-99	–	–	–	–	–	–	12

Notes:

1. In the Annual Reports from 1997-98 on, separate statistics are not given for each State and Territory. Rather, the statistics are classified under the indictable/summary offence distinction. Offences under the Copyright Act are dealt with summarily.
2. Figures for Tasmania and the Northern Territory do not appear in the Annual Reports to 1996-97 since the DPP did not have offices in these jurisdictions until 1997 (Hobart) and 1998 (Darwin). Prior to this, prosecutions were undertaken by the Australian Government Solicitor's Office under s38 of the *Director of Public Prosecutions Act 1983*.

(Source: Annual Reports of the DPP)

The following is a more detailed analysis of prosecutions during the years 1997-98 and 1998-99 (*Inquiry into Enforcement of Copyright in Australia*, DPP Submission, at 2-3):

In 1997-98 there were eight completed prosecutions for copyright offences. Six were referred by the AFP and two by state police. Five defendants pleaded not guilty and four of these were convicted of at least some offences. The other three defendants pleaded guilty. Penalties ranged from non-conviction bonds to small fines up to \$3 000.

In the year up to June 4 1999 there were six completed prosecutions for copyright offences. Four were referred by the AFP and two by state police. One defendant pleaded not guilty and was convicted after a hearing. The other 5 defendants pleaded guilty. Penalties ranged from conviction bonds to fines of \$4 800. Most cases prosecuted lead to forfeiture of seized infringing copies. One case involved some 6 500 articles.

Prosecution is considerably easier on the basis of a guilty plea. However, even where a prospective defendant indicates an intention to plead guilty, there must still be sufficient evidence for charges to be laid. Where a defendant pleads not guilty, and puts the prosecution to proof on every element of the offence, the evidence supporting the case must be accordingly stronger. The overall experience of the DPP is summarised as follows (*Inquiry into Enforcement of Copyright in Australia*, DPP Submission, at 2):

The DPP's general experience has been that copyright cases can be difficult, highly technical and expensive prosecutions with enormous problems in strictly proving ownership of copyright where it is held overseas.

This experience can be illustrated by considering a few prominent copyright prosecutions undertaken during the last decade.

Illustrative cases

Pontello v Giannotis, Pontello v Plenty, Pontello v Ceselli (1989, Federal Court)

These cases arose out of related facts which occurred in New South Wales in the late 1980s, involving the making, distribution and sale of unauthorised (pirate) copies of videos. All three cases are referred to in *Holder v Searle* [1998] FCA 1775, though only *Pontello v Giannotis* and *Pontello v Ceselli* are reported, respectively, at (1989) 16 IPR 174 and (1989) IPR 645.

In *Pontello v Giannotis* the defendant was convicted in the Federal Court under s132(2A) of the *Copyright Act 1968* for possession of infringing articles (pirate videos). In sentencing, the judge (Sheppard J) took into account the defendant's co-operativeness with police, his financial circumstances, and that the conviction was based not on actual knowledge but on the "ought reasonably to know" limb of s132(2A). Although imprisonment was considered, the penalty imposed was conviction without sentence being passed on the defendant entering into a recognizance of \$1 000 to be of good behaviour for three years (see s10 of the *Crimes Act 1914*). The defendant was also required to pay prosecution costs of \$6,500 and the infringing videos were forfeited under s133(4).

In *Pontello v Ceselli* the defendant pleaded guilty in the Federal Court to offences under s132(1)(a), s132(2A) and s132(3) of the *Copyright Act 1968* involving, respectively, the making for sale or hire and the possession of infringing articles (pirate videos), and the making of a plate for infringement (slicks for video cassettes). Convictions had already been recorded under the *Trade Marks Act 1955* for offences arising out of the same facts, with a \$7,250 fine imposed. The judge (Wilcox J) took into account the trade marks offences, the defendant's co-operativeness with police, the "deliberate defiance and [large] scale" of the piracy, and imposed penalties under the copyright sections totalling \$56,900 in fines, remarking:

I think it is realistic to expect that he can raise the money required to pay the fines by mortgaging his home and repaying the mortgage out of future earnings.

In contrast to the reasonably satisfactory outcome (from the prosecution point of view) of cases in which the defendant pleads guilty, stands the situation where the defendant contests the charges and puts the prosecution to proof on all of the elements of the offence. The next three cases illustrate the difficulties.

Lollback v Young (unreported, NSW Local Court, 8 February 1996)

The prosecution in this case failed to prove to the satisfaction of the Court that copyright in the film "Beauty and the Beast" was owned by the Walt Disney Company, despite an affidavit from the Vice-President of the company giving production details and an annexed Certificate of Copyright Ownership from the United States. These were held inadmissible

under the rules of evidence disallowing hearsay evidence except in specified cases (see Evidence Act 1995 (Cth and NSW), Part 3.2). Evidence of production must come from persons with direct (first-hand) knowledge of the facts, though a limited exception for business records (s69) is provided. However, this approach encounters practical difficulties in the variety and dispersed nature of record keeping systems, particularly of large overseas corporate groups which may have multiple subsidiaries and relationships with companies located in tax havens etc. (Inquiry into Enforcement of Copyright in Australia, DPP Submission, at 6).

Holder v Searle (1998, Federal Court)

In *Holder v Searle* [1998] FCA 1775, the defendant was charged with various offences under s132 the Copyright Act 1968 after three Australian Federal Police searches during 1995 of several premises on the Gold Coast revealed some 2,000 video laser discs alleged to have been imported without authorisation. By the time the charges were heard in the Federal Court in 1997 and 1998, the prosecution had decided to proceed in relation to only 11 titles. The offences under s132(1)(a) and (d) in relation to importation and sale of infringing articles were dismissed after adverse rulings on admissibility of evidence establishing copyright ownership rendered the prosecution case irreparably deficient.

In relation to the remaining offence of possession under s132(2A), the prosecution had to prove that copyright was owned by a number of well-known overseas business groups including Twentieth Century Fox Film Corporation, Warner Bros. and Metro Goldwyn Mayer Inc (MGM). Despite the fact that copyright ownership in the United States is regulated by a system of registration, the prosecution had to prove subsistence of copyright under Australian law in terms of acts including “first publication” which would have resulted in copyright ownership had they occurred in Australia. This entailed adducing evidence at considerable expense as to the business and production history of these complex business groups.

After a painstaking inquiry into this evidence, the judge (Spender J) found the offence of possession proved only in relation to two of the titles (a total of 9 infringing discs). One of the more surprising conclusions was that Spender J could not be satisfied that Warner Bros. was “a legal person or entity capable of owning copyright or capable of making a film”.

The penalty imposed was conviction without sentence being passed on the defendant entering into a recognizance of \$5000 to be of good behaviour for 2 years. The prosecution was ordered to pay one third of the defendant’s costs.

Donnelly v Hughes (unreported, Federal Court, Brisbane Registry, 8 December 1999)

The most recent example of prosecution failure is *Donnelly v Hughes*. In this case, the DPP was faced with the problem of proving as an element of the offence of possession of infringing articles under s132(2A) of the Copyright Act 1968 the absence of a licence agreement authorising the defendant’s business to sell and distribute certain sound recordings in Australia. Among the documents seized along with a large number of allegedly infringing compact discs in 1996 were four licencing agreements purporting to be between Australian companies controlled by the defendant and a number of “licence brokers” in the United Kingdom and the United States. Although the prosecution brought evidence to the effect that a different company had exclusive distribution rights within Australia, this contractual arrangement was not accepted by the court as establishing that the impugned licencing agreements were not genuine. Without actually determining the question whether the latter

agreements in fact authorised the defendant to distribute the recordings in Australia, the judge (Spender J) held that – as the prosecution could not prove beyond reasonable doubt that the defendant knew or ought to have known that no licence existed – the knowledge requirement of a s132(2A) offence could not be made out. He dismissed the case and ordered that the defendant’s costs be paid by the DPP.

The Effect of Parallel Importing Liberalisation

Although the DPP will no longer be undertaking prosecutions based entirely on unauthorised importation of non-pirated sound recordings, as in *Hamm v Middleton* (discussed above in relation to AFP operations), it can be predicted on the basis of cases like *Holder v Searle* and *Donnelly v Hughes* that difficulties will continue to attach to the issues of proof of copyright ownership and absence of licence as elements of offences under the *Copyright Act 1968*. Given that there is normally a time lag of at least 2 years between the laying of charges and determination of a contested prosecution in court, it is too early to know whether the mid-1998 amendments will have any effect on copyright prosecutions, for example, by making civil litigation comparatively easier through the “reversal of onus” provisions of s130A.

Trade Marks Prosecutions

In comparison to copyright prosecutions, DPP prosecutions under the *Trade Marks Act 1995* (and its predecessor 1955 statute) are considerably simpler. The main reason is that the trade marks regime in Australia – unlike the copyright regime – operates through a system of registration, making proof of ownership or licencing matters far less problematic. Annual prosecution numbers are similar to those for copyright (Table 6).

TABLE 6

DPP trade mark prosecutions 1992-1999

Year	NSW	VIC	QLD	WA	SA	ACT	Total
1992-93	8	6		4	3	1	22
1993-94	4	3	2		4		13
1994-95	16	2	1		1		20
1995-96	5				6		11
1996-97	7	2	1		1		11
1997-98	–	–	–	–	–	–	3
1998-99	–	–	–	–	–	–	12

Notes:

1. No data appear in the *Annual Reports* in relation to the *Trade Marks Act* for the years 1989-92.
2. In the *Annual Reports* for 1997-98 on, statistics are not given for each State and Territory separately, but are classified only under the indictable/summary offence distinction. Offences under the *Trade Marks Act* are dealt with summarily.

(Source: Annual Reports of the DPP).

CONCLUSION

There is at present little evidence of a significant increase in levels of CD piracy in Australia following the liberalisation of parallel importing in mid-1998, at least as far as is indicated by the published statistics of agencies such as the Australian Customs Service (ACS), Australian Federal Police (AFP) and Director of Public Prosecutions (DPP). While this may be explicable partly in terms of the significant time lag between the instigation of prosecutions and final determination by courts, there is also little in the way in which these agencies contribute to the enforcement of intellectual property protection that has been directly affected by the legislative changes.

Changes in levels of piracy and counterfeiting in the past have been attributable as much to advances in technology as to reform of the legislative framework for intellectual property protection, and it is arguable that with the advent of recordable CDs and direct digital downloads of music from the INTERNET this will once again be the case. Thus, while there will always be a proportion of imported CDs which are pirate copies – and the opportunities for this form of piracy are somewhat increased (along with penalties) by the liberalised parallel importing regime – the greater danger is from new forms of piracy both domestically and via international electronic rather than physical transfer.

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Melbourne	6 March 1998
Canberra	12 March 1998

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Australian Consumers' Association (ACA)
Australian Copyright Council (ACC)
Australian Customs Service (ACS)
Australian Record Industry Association (ARIA)
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Canberra	12 August 1999
	26 August 1999
	2 September 1999
Sydney	6-7 September 1999
Canberra	30 September 1999
Brisbane	5 October 1999

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Attorney-General's Department (A-G)
Australasian Performing Rights Association (APRA)
Australian Consumers' Association (ACA)
Australian Copyright Council (ACC)
Australian Customs Service (ACS)
Australian Federal Police (AFP)
Australian Information Industry Association (AIIA)
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APPENDIX 6: PARALLEL IMPORTING REVIEW (NZIER)

The economic effects of lifting the ban in NZ

Report to the Intellectual Property and Competition Review Committee

February 2000

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Preface

The New Zealand Institute of Economic Research (NZIER), based in Wellington, was founded in 1958 as a non-profit making trust to provide economic research and consultancy services. Best known for its long-established *Quarterly Survey of Business Opinion* and forecasting publications, *Quarterly Predictions* and the annual *Industry Outlook* with five-yearly projections for 25 sectors, the Institute also undertakes a wide range of consultancy activities for government and private organisations. It obtains most of its income from research contracts obtained in a competitive market and trades on its reputation for delivering quality analysis in the right form, and at the right time, for its clients. Quality assurance is provided on the Institute's work :

- by the interaction of team members on individual projects;
- by exposure of the team's work to the critical review of a broader range of Institute staff members at internal seminars;
- by providing for peer review at various stages through a project by a senior staff member otherwise disinterested in the project;
- and sometimes by external peer reviewers at the request of a client, although this usually entails additional cost.

Authorship

This report has been prepared at NZIER by Joanna Smith and Peter Clough, and reviewed by Alex Sundakov and Stephen Gale. The assistance of numerous interviewees is gratefully acknowledged, but responsibility for the contents of the report lies solely with the authors.

EXECUTIVE SUMMARY

In May 1998 the New Zealand government amended the Copyright Act 1994, lifting the restrictions on parallel importing. The purpose of this report is to examine the economic effects that this legislation change had on three specific markets for intellectual property: books, music compact discs and computer software. It compares an international price analysis to one conducted by NZIER prior to the amendment.

Opponents to the law change predicted a flood of cheap imports, and warned of trade sanctions. Neither has materialised, and the effect of introducing parallel importing, to date, appears muted. However, although tangible impacts on volumes and prices have been small, the possibility of parallel importing has exerted pressure on the market place.

Isolating the direct effects of the legislation is difficult, as a number of other factors have impacted on the markets studied. The weak New Zealand dollar proved unfavourable to potential importers, and was an inhibitor to any significant volume of parallel imports. The growth of the internet continued through the period, and combined with general market liberalisation, contributed to an already increasingly competitive environment.

Claims of an increase in pirated products entering the country are hard to substantiate. There is evidence that the manufacture of illegitimate copies of music CDs and software was on the rise anyway, with low cost replication aided by improved technology. Although penalties for importing pirated goods were raised, the onus remains on the commercial sector to lodge notices (formal notification of goods suspected to be at risk of piracy) with Customs. Even prior to parallel importing, Customs did not stop goods at the border without a notice in place. Moreover, counterfeiting within New Zealand may also be a concern.

A number of improvements can be associated with parallel importing. New Zealand prices for books and CDs now rival the rest of the world, as do release dates for new title CDs. Delivery speed has improved, with customer orders able to be filled in a matter of days instead of weeks or months. Access to a full range of titles is possible, with availability enhanced by electronic links with suppliers around the world.

Retailers' negotiating power with suppliers has strengthened, partly due to consolidation of buying power in some markets, but also to the threat of parallel importing maintaining competitive discounts. Minor efficiency gains on the part of some distributors have been reported.

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Introduction

In 1998, NZIER undertook for the New Zealand Ministry of Commerce an economic analysis of the removal parallel import restrictions in place at that time. The report focused on three key markets for copyright goods: motor vehicles, books and music compact discs. The study concluded that net welfare benefits to consumers could be gained by removing the ban in these markets, and product markets in general.

The New Zealand restrictions on parallel importing were lifted in May 1998, allowing importation of copyright material through other than the authorised channels of distribution. NZIER has been asked to revisit the 1998 study, providing an updated empirical analysis of prices in the book and CD market, and looking also at the market for computer software.

This report will test the propositions that:

- the removal of parallel importing restrictions leads to substantial reduction of price arbitrage between national markets, with a gain to consumers in the previously restricted markets
- that this effect is mainly achieved through the *threat* of parallel importing changing the behaviour of licensed distributors, rather than through significant volumes of parallel imported goods.

In the next section, the framework and context of the study is explained. Section 3 describes the methodology employed, whilst Sections 4 to 6 focus on the individual markets of books, music compact discs and computer software.

Background framework

Parallel importing involves the sourcing of legitimate copyright goods for resale, through distribution channels other than the authorised copyright owner. There are a number of situations typically described as parallel importing, including when:

- a good is exported, then imported back into the originating country;
- unauthorised imports are competing with domestically-produced goods; and
- unauthorised imports are competing with authorised imports (Chard and Mellor, 1989).

Here, unauthorised imports are legitimate copies, but entering the country through other than the authorised channel. Strictly speaking, only the third scenario is a case of *parallel* importing, although reference is often made to any or all described.

A lifting of the restriction governing parallel imports may have altered the way market participants behave. In aggregate, have those changes been good for New Zealand? The measure economists use for analysing changes of this kind is total welfare, reflecting both changes in price and volume imported following the change. For this study reliable volume figures are not available but certain inferences can be drawn from observed changes in prices.

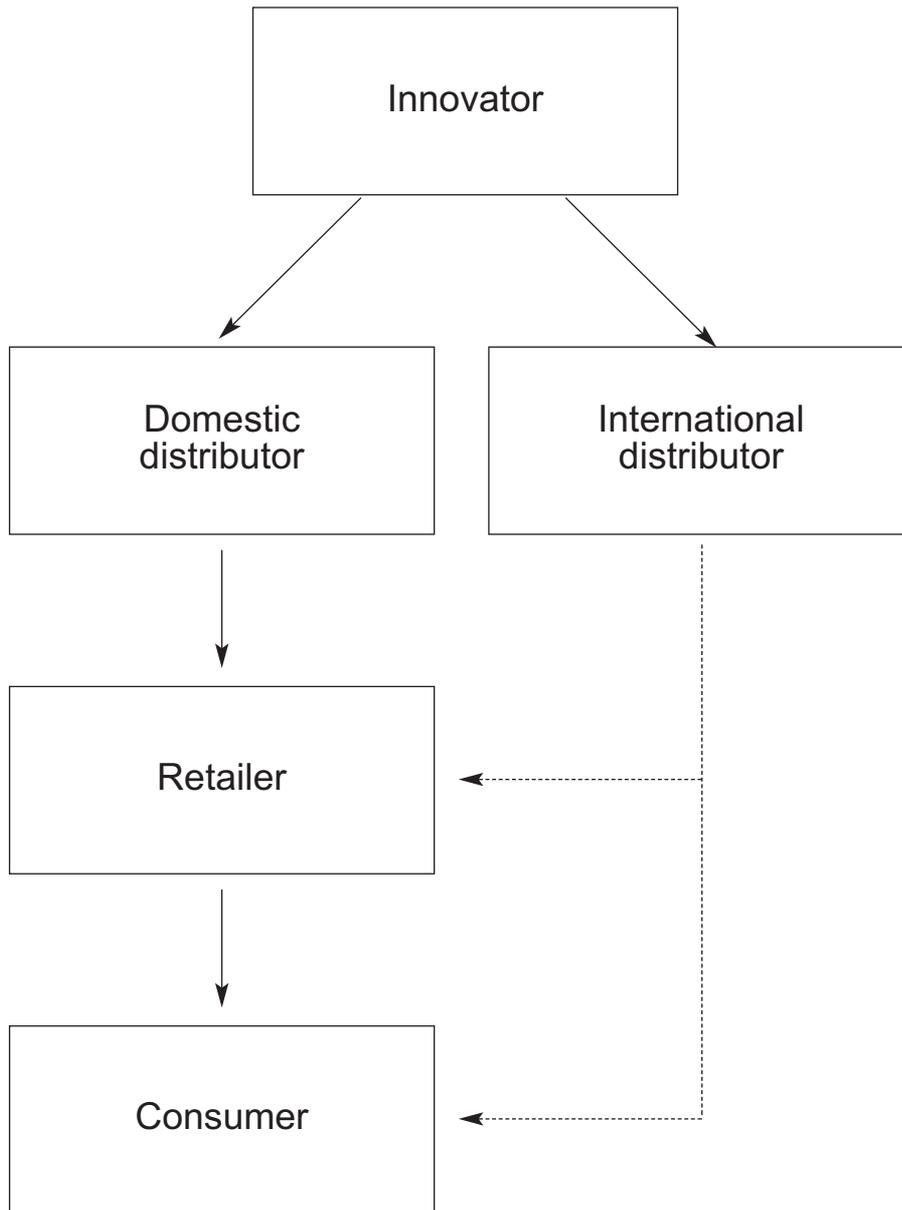
Distribution channels for parallel imported goods

A parallel importing restriction allows the copyright holder or innovator to determine the mechanism of distribution for their product within a country. This generally means there is a single 'legitimate' channel for the distribution of the innovator's goods for resale, i.e. there is an exclusive distributor.⁴³⁴ The implication is that they can control the supply of goods onto the market, so as to affect prices received and the economic surplus they receive from their sales.

Figure 1 provides a simplified illustration of the chain of supply for imported goods. Where there is a ban on parallel importing, the basic structure will resemble that on the left hand side of the diagram, but the lifting of the ban introduces new opportunities for direct supply from international distributors, as illustrated on the right hand side. Other variations may include having several authorised distributors within a single market, or there may be a wholesaler between the distributor and the retailer. For the purposes of this report whether an authorised distributor is solely a distributor (e.g. a wholesaler) or also a publisher is immaterial, and the terms are used interchangeably.

⁴³⁴ Consumers have the right to parallel import for personal use but no one is able to import the product for resale.

FIGURE 1: MARKET STRUCTURE WITH PARALLEL IMPORTING



—> Authorised distribution channel - - - - -> Parallel imports

Source: NZIER

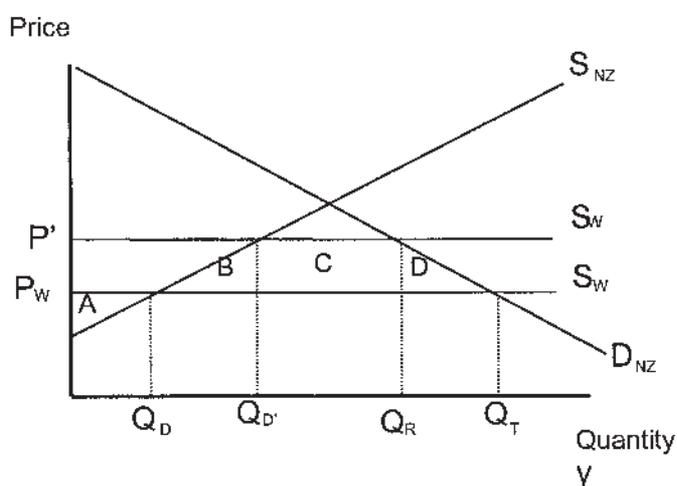
A parallel importing restriction only ‘bites’ if it allows the innovator to achieve better returns by protecting the domestic distributor against competition from international distributors. Simply removing the parallel importing restriction will not result in the importation of parallel goods, unless it is possible to purchase the good in another country, pay transport costs and local taxes and still be able to sell the good at a price competitive to that of the incumbent distributor. There are many markets where the removal of the restriction will not present any new opportunities. But in cases where the local market is quantity constrained i.e. the domestic distributor is unable to supply all that is demanded at the going price, some consumers may be willing to pay a premium for parallel imported products. Such quantity constrained situations are quite likely to reflect monopolistic pricing, and present opportunities for parallel importing at lower prices.

Effects of parallel importing on economic welfare

This section summarises the welfare theory underlying the analysis in later sections of this report. Welfare is defined as the sum of the consumer surplus and the producer surplus. Consumer surplus can be described as the value received by those consumers who would be willing to pay more for a good than the market price they pay. It can be represented graphically as the area below the demand curve but above the equilibrium price of the good. Producer surplus is the extra value received by those producers who would be willing to sell a good for less than the market price they receive. It is represented by the area above the supply curve (which represents the production cost of the good) and below the equilibrium price of the good.

The effect of restricting trade, as through a ban on parallel importing, is illustrated in Figure 2. Under free trade, facing a world price of P_w and domestic supply and demand curves of S_{NZ} and D_{NZ} respectively, total consumption on the domestic market will be Q_T , with Q_D supplied by local suppliers and $(Q_T - Q_D)$ imported. At this level of consumption consumers enjoy a surplus equivalent to the entire area above the price line (P_w) and below the demand curve (D_{NZ}), and in addition local suppliers earn a producer surplus equivalent to area A.

FIGURE2: WELFARE EFFECTS OF TRADE RESTRICTIONS ON A DOMESTIC MARKET



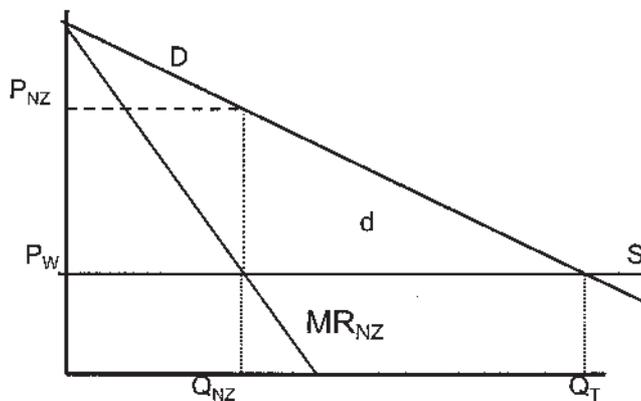
Source: NZIER

A ban on parallel importing allows specified authorised distributors to set higher prices (P'). As a result, demand drops to Q_R . The welfare consequences are that total consumption contracts (by $Q_T - Q_R$), resulting in a deadweight loss of consumer welfare represented by areas B and D; and area C is the additional cost placed on consumers (producer revenue which is transferred to foreign suppliers).

In the case of branded products which are well differentiated from other products on the market, the motivations of an authorised distributor can be likened to that of a monopolist in a highly product-specific sub-market, as illustrated in Figure 3 below. Branded products like books and CDs can be landed at P_w and have perfectly elastic supply, i.e. the supply curve is effectively the same as the world price line. But an importer exercising monopoly control over supply of certain titles will have no interest in supplying the market to its total potential

level (Q_T). Rather, the importer will seek to maximise its producer surplus by supplying to the point where its marginal cost of supply equals its marginal revenue (MR_{NZ}). The domestic price rises accordingly to P_{NZ} and the market is supplied with only Q_{NZ} , resulting in a consumer deadweight loss of d . The importers also capture a surplus from consumers $[(P_{NZ} - P_w)Q_{NZ}]$.

FIGURE 3: MONOPOLISTIC PRICING UNDER TRADE RESTRICTIONS



Source: NZIER

This welfare analysis illustrates a number of implications of trade restrictions such as a ban on parallel importing.

- The commercial incentive to maximise producer surplus is likely to be welfare reducing because of the deadweight loss borne by consumers, unless the demand is totally inelastic.
- Even in the absence of reliable trade volume figures, identifying unrealised arbitrage opportunities through inter-country price comparisons can be indicative of this monopolistic behaviour.
- A public policy which endorses trade restrictions causing monopolistic behaviour and static deadweight loss must implicitly put greater weight on other expected benefits, e.g. the dynamic effect of innovation, or the projection of cultural identity. The nature of these other benefits is outlined below.

Consequences of lifting parallel importing restrictions

Prior to the lifting of New Zealand's ban on parallel importing, a number of effects were expected to result from the law change. These included observable increase in competition for the affected product markets, manifested in lower prices, a greater diversity of sources and distributors, and more responsive service from the suppliers and distributors. Further consequences thought likely included greater market segmentation and product differentiation, in particular with unbundling of product and after sales services, as distinct from monopolistic tendency to 'gold-plate' products with added services which most consumers may neither want nor use. There might also be some changes in quality of goods,

where ostensibly the same product is released onto different markets with different specifications; but potentially inferior quality of parallel imported goods is not necessarily a problem *per se*, unless the consumer is misled into believing they are purchasing a product of higher quality than it is, an effect which could be minimised by labelling and laws against passing off.

These are all effects which might be observed in the market in the relatively short term. There are also a number of less visible effects possible from the lifting of the ban.

Pricing strategies

The ability of an authorised distributor to control the flow of a particular copyright good onto the market clearly affects the pricing strategies open to the distributor, creating a degree of market power which allows it to act more as a price maker than a price taker. Parallel imports weaken this market power and benefit consumers in the short term, but also reduce the options for local producers.

Given a monopoly in the supply of a local artist's or author's work in the domestic market, a publisher may try to expand export sales by 'dumping' their work at lower prices in overseas markets than in the domestic market, where demand is likely to be more inelastic. Parallel importing undermines such price discrimination, which requires the monopoly to be enforceable and proof against foreign wholesalers arbitraging back into the home market at a lower price.

Another argument sometimes put forward for restricting parallel importing is that less profitable emerging (local) artists can be cross-subsidised out of the economic rents earned by publishers on their authorised imported copyright works. While it is hard to verify this without knowing the counterfactual – how much would publishers invest in emerging artists in the absence of super-profits – there are reasons to expect most rent is expropriated by overseas copyright owners. Artists have a unique 'brand', whereas there is competition amongst potential agents to be authorised distributors in various markets, so if there are rents to be made the overseas copyright owner is in a strong bargaining position to increase the supply price it offers to the local distribution agent.

Incentives to innovate

The rationale for protecting copyright is the ability to capture the maximum return from the risks incurred in creating and launching a new product. Consumer choice could be restricted, and investment in innovation and new products could be sub-optimal if this ability is weakened by parallel importing undermining the ability to price discriminate to fully exploit each individual market.

There are competing views on the legal interpretation of copyright entitlements which cannot be decided here. One suggests that the innovator's copyright on a product is 'exhausted' when it is first sold into a market, so the copyright owner cannot expect additional royalty if it is subsequently sold into other markets. The opposing view is that innovators have a right to earn a distinct return for the use of their product in each separate market, by exploiting the differences in demand in each market.

In economic terms property rights of any sort only emerge where it is worthwhile for them to do so, i.e. the value of the rights exceed the transaction costs of establishing them. Copyright confers primarily private benefits, but it is difficult to specify private supply contracts to enforce the ability to price discriminate between markets. This argument is insufficient justification for the state to intervene with trade restrictions unless there is some other demonstrable public benefit, given the deadweight losses in consumer welfare which are likely to result.

At the global level, inability to exploit copyright may have some effect on innovation incentives, but the admission of parallel imported products into a small country accounting for only a fraction of global sales is unlikely to have much effect on the investment decisions of international innovators. More significant consequences of lifting the restriction are the implications for trade relations between New Zealand and its source countries, or retaliatory withdrawal of some copyright products from the market as a warning to other larger countries against lifting their restrictions, an effect which may become apparent in surveying the changes in particular markets.

Free-riding on promotional efforts

When a parallel importing restriction is lifted, domestic agents may fear that parallel importers will free ride on their investment in promotional and marketing activity, their likely reaction being to reduce such activity or target it more closely. This may lead to information deficiencies and restriction of consumer choice. A similar issue emerges in after-sales service, where authorised distributors may feel obliged to complete warranty repairs on parallel imported products for which they have received no revenue, in order to protect the reputation of the brand. Such changes in pre- and after-sales may be detectable in surveying the changes in particular markets.

Piracy and theft of copyright material

The sale of pirated products undermines the incentive to innovate by reducing the return received by the innovator. A system of exclusive distribution supported by a parallel importing restriction improves monitoring of the entry and sale of goods, because there is only a single 'authorised' distributor. If a copyright good appears outside this distribution channel it is either a pirated copy or an unauthorised parallel import, but it may be difficult to distinguish between them. So parallel imports could increase the likelihood or the opportunity for pirated products to be introduced, an effect which could be investigated through incidents reported to the Customs service.

Summary

The welfare effect of lifting the ban on parallel importing involves a larger gain to consumers than the loss of super profits to producers. There exists a trade-off between the short-term static gains to consumers, and the longer-term dynamic effects on incentives to innovate, and the availability of products. Quantitative data for welfare analysis since the ban was lifted are not available, but it is possible to examine prices and assess changes qualitatively through surveying industry players.

METHOD OF REVIEW

The legislation changes

In 1998, the New Zealand Government amended the *Copyright Act 1994*, permitting parallel importing. Part of the rationale governing the change was that it was expected to result in lower prices paid by consumers. Data gathered in the 1998 NZIER report showed that whilst prices of CDs in Australia and New Zealand were broadly comparable, both were around 10 per cent higher than in some US outlets (when tax exclusive prices were considered). Other predictions included a more extensive range of products available, and goods being made available earlier.

The NZIER report and other contemporaneous commentaries concluded that, due to the size of the New Zealand market, parallel importing would be unlikely to have any significant effects on international incentives for innovation. More pertinent issues for New Zealand include whether lifting the ban influences the cross-subsidy paid to local artists by international companies, affecting domestic innovation, or whether it would cause adverse repercussions in trade relations, or retaliatory withdrawal from the market by some brand distributors.

There was also reported risk of increased piracy in the CD market with the prospect of more importing channels opening up with parallel importing. The legislation change increased penalties for importing pirated works, in an attempt to combat this.

Data analyses

There is limited quantitative data on sales volumes or prices with which to examine the impact of parallel importing, and what there exists is insufficiently disaggregated by source. To examine the effects of changes in New Zealand's law, this review reports on qualitative interviews with players in affected markets, limited quantified analysis of movements in prices, and assessment of observed changes against the framework described above.

In order to compare price analyses from the present study with the 1998 report, the previous study's methodology is replicated as far as possible. New Zealand retail prices of best-selling books and CDs are compared with those in Australia, the United States, the United Kingdom and Germany. Every attempt was made to revisit the original sources, where these were documented. In each case, list prices were obtained of the best-selling titles in New Zealand, then corresponding prices were found for the equivalent set of titles in these overseas markets, or at least a reduced sample with as many of these titles as could be found on the overseas listings. The overseas prices were converted to New Zealand dollars at an appropriate exchange rate, then indirect taxes removed from these prices. Since NZIER does not hold historical price data for software, the approach for this market depended solely on interviews to identify pricing strategies before and after the reform.

Where these tax-exclusive prices differ markedly between countries, there is likely to be opportunity for arbitrage between them. Where they are the same across countries, there may still be arbitrage opportunities if the unit cost of transport is less than the retail margin, since parallel importers would most likely source their supplies at wholesale prices. In short, given the data limitations, this price comparison can identify where arbitrage is likely, but cannot categorically state where it is not. However, where the tax-exclusive price in New Zealand is

less than that in other countries, there are unlikely to be opportunities for arbitrage into New Zealand.

Interviews

Perspectives of people in the respective industries were sought in order to gain a more comprehensive understanding of changes within the markets, to obtain estimates of volumes of parallel imports since the legislation change, and also to qualify the results of the price comparisons. Efforts were made to canvas a range of viewpoints throughout the affected industries, although some sub-sectors were more forthcoming than others (refer Table 1, below). Interviews followed a loose questionnaire format, the template for which is attached to this report (Appendix 1).

TABLE 1: INDUSTRY PLAYERS APPROACHED/INTERVIEWED

	Books	CDs	Software
Copyright holders/distributors	*Publishers (international and local companies) *Writers' Groups	*Record companies (international and local companies)	Software companies (international and local companies)
Industry bodies	*Retailers' and Publishers' representative	*Industry representatives	Industry representatives
Consumer groups	*Consumers' representative *Library representatives	*Consumers' representative Radio representatives	*Consumers' representative
Retailers	*Large chains *Franchise stores *Independent stores *Internet company	*Record company *Large retail chain	*Large retail chains

* denotes interview/discussion conducted

BOOKS

Market structure

The current market structure for books in New Zealand can be divided between publisher/wholesalers and retail outlets. At the wholesale level most lead titles are distributed by New Zealand branches of international publishers such as HarperCollins, Longman Paul, Penguin and Random House, the majority of which also carry New Zealand authored books. There is also a large number of 'indigenous' New Zealand publishers, some of which are primarily in the business of book publishing, some producing books as an adjunct to newspapers and periodicals publishing, some attached to research institutions and other bodies such as university presses, specialist publishers such as Butterworths and Brookers, legal publications and various other assorted small publishing businesses. Many New Zealand publishers focus on the local market and their print runs are small by international standards: more than 2 000 books is a large print run and more than 5 000 a best-seller.

The retail level comprises four general categories of operations. The Blue Star Group (Whitcoulls, London Bookshops, Bennetts, and Books and More) and The Warehouse together account for the largest market share, with their mass-market focus, and narrow range of best-selling titles. Whitcoulls alone accounts for around 50 per cent of the book market. Franchise firms such as Borders and Dymocks carry a broader range, and larger stock, offering a 'bookshop experience' to the browsing public. There are a number of stores including Parson's and Unity, which have established a 'niche' in the market, targeting a particular clientele, and focusing on providing a specialist service. In addition, there are small independent stores, which carry a narrow range of lead titles, and stock a variety of other types of goods.

New entrants to the market include the arrival of Borders Books and Music from Australia, and the emergence of The Warehouse as an aggressive price competitor. There are now also domestic Internet retailers such as Flying Pig, as well as the existing overseas sites.

There is a general perception in the industry, that there is less room for mid-sized operations, with pricing pressure from the big chains and The Warehouse forcing firms to withdraw, or concentrate on a particular market niche. The large operations can achieve economies of scale in purchasing, and cut margins on selected titles, in a way that the smaller retailers are unable to compete with.

On the whole, existing supply networks have been maintained by retailers. Apart from a perception that parallel importing has been largely unprofitable over the period since the legislation change, there is a desire to maintain good relationships with local distributors, and hence discounting arrangements. Related to this loyalty issue is the threat of distributors relocating to Australia if sufficient profit margins cannot be maintained in New Zealand. This may endanger not only supply links, but marketing and support provided by distribution companies. Publishers may be able to undertake contractual arrangements, prohibiting supply through unauthorised channels.

Market behaviour

Interviews were conducted with retailers and distributors, as well as consumer, writer, and industry representatives. There was general consensus regarding the nature and volume of parallel importing, as well as market structure and behaviour.

As stated in the 1998 report, a certain amount of parallel importing was already occurring in the book market prior to the law change. Although previously illegal, retailers sometimes sourced titles from overseas when they were unobtainable from local suppliers, largely to fill customer orders.⁴³⁵ Small, one-off quantities were tolerated by local distributors. However, the majority of New Zealand distributors provide an indent service for such requests, and most retailers consulted suggest this is likely to be more cost-effective for the retailer than undertaking parallel importing themselves.

The volume of parallel imports has remained small, with retailers preferring to source locally, and looking overseas only when a title is not available from their New Zealand wholesalers.

⁴³⁵ It is to be noted that such importation, when there is no local supply source, is not strictly 'parallel', but usually referred to as such by the industry.

Most retailers stated that local suppliers are price competitive, and that they are concerned to stay on good terms with their major distributors. Some reported that New Zealand suppliers have 'sharpened their act', cutting margins and improving their service. The possibility of parallel imports has been accredited by some retailers with giving them a degree of leverage when negotiating prices with wholesalers.

There is now stiff competition in the area of best-sellers, where some retailers claim their margins have dropped right down. There is general agreement in the industry that New Zealand prices are among the lowest in the world.

It is, however, hard to isolate the effect of the legislation change. The exchange rate over the period was unfavourable to importers, discouraging much parallel importing. This, combined with the cost of delivery has often made it cheaper to source locally. Furthermore, the time frame may be insufficient for the full impact of the change to have taken effect.

There are other factors contributing to a competitive environment. Some retailers report taking advantage of lower air-freight prices, enabling faster delivery responses. Information technology has improved such that on-line catalogues are available. In addition, the growth of Internet shopping has impacted on the market. Consumers are increasingly likely to undertake their own price and availability comparisons, putting pressure on retailers to access stock quickly and cheaply, or risk losing customers to the Internet. Timing and availability were recurring concerns of retailers.

The most significant impacts of parallel importing have been:

- improved speed in filling customer orders;
- improved availability and access; and
- earlier release of new titles.

Prior to the amendment, local copyright owners could manipulate release dates (for example, to coincide with Christmas). With the threat of parallel importing, it is now less feasible to hold back titles (although Christmas still imposes some seasonality on global publishing).

International price comparison

Sample

A list of annual best-sellers was obtained from Booksellers New Zealand (Appendix 2). The list comprised thirty titles in three genres – fiction, non-fiction and New Zealand – and was compiled by taking those titles most often on the fortnightly *Bestsellers List*. It covered the twelve-month period to 19 November 1999. The order listed does not represent ranking. For purposes of comparison, the base sample used in the 1998 NZIER report was used and adjusted in the same way as the 1999 data.

Price

Prices were acquired from three local retailers, as well as a domestic website. List prices (before member discounts, for internet purchases) for paperbacks were compiled, and the lowest available New Zealand price used in analysis. The sample is not as large as the

previous study, and displays a smaller range of prices, as only paperback prices were selected.

Retail prices for the same selection of books were obtained from the internet for four other countries: Australia, USA, UK and Germany. Again, paperback list prices were used (unless hardback only available). Some caution should be exercised in examining these prices, as internet prices may not accurately reflect those in 'bricks and mortar' retail outlets. Industry representatives assert that UK prices are typically higher than in the US, and New Zealand is generally cheaper than its major trading partners. Furthermore, the format of paperbacks varies (there are four 'sizes' of paperback) which affects the pricing (it was not always possible to determine from the source which format was given). Hence in the book market, it is hard to compare 'apples with apples'.

The list includes New Zealand titles, which may be considered a further sample bias. The survey does not compare each country's best-selling titles, but reflects New Zealand demand.

The aim was to compare consumer prices excluding the distorting effects of local taxes. Thus, the prices implicitly include wholesaler and retailer margins. Where one country's price is substantially lower than that of another, there exists an arbitrage opportunity, given that transport costs are (reportedly) a small portion of the total cost of supply. Arbitrage would involve purchase at wholesale prices. We have no reliable way of removing the retail margin from the comparison, so if the retail margin is greater than the transport cost per unit, there could still be arbitrage opportunities, where prices are about the same. Prices for comparison therefore had indirect (sales) taxes removed, and a simple average taken over the sample available for each country.⁴³⁶

Results

Converting the currencies using the average monthly exchange rate for December 1999 revealed New Zealand prices to be lower than those in Australia, the UK and the US, and on a par with those in Germany. The nominal average price of the selection in New Zealand was around 12% lower than in early 1998, but those in Australia, the US, and UK had increased over the period since the last report.

Before the lifting of the parallel import ban in 1998, the mean price in New Zealand of the sample of best selling books was on a par with that in Australia, but the price in the US was about 25% lower than in New Zealand. This suggests there would have been opportunities for profitable arbitrage from the US into New Zealand at that time, and that this would have withstood significant shifts in the exchange rate. For the sample of best selling titles at the end of 1999, however, prices in New Zealand are such that there appear to be no significant arbitrage opportunities in any of the other countries, and there may be opportunities from New Zealand to some of them.

These results are summarised in the following table. The relative price of books at the end of 1999 appears high in all countries considered except Germany. This may reflect the selective nature of the reduced sample for comparison: books found in both New Zealand and the

⁴³⁶ Indirect tax rates used: NZ 12.5%, and Germany 7%. Books are (currently) exempt from sales tax in Australia. US and UK prices were before tax.

other country may contain some which are sufficiently uncommon overseas for their price to push up the mean. Cross-country comparison of the prices of the individual books in the sample shows that in the US and Germany there are about as many individual books whose prices exceed those in New Zealand as there are whose prices are less, which is what would be expected if the mean were an accurate of central measure of the sample. Australia and the UK had higher prices than New Zealand for the majority of books in its sample, which may either indicate a distorted mean or that these selected books really are more costly in these countries.

As with the last report, altering the exchange rates to demonstrate a stronger New Zealand dollar affected the outcomes. The assumption here is that the price in New Zealand remains unchanged, which is probably unlikely in the event of major exchange rate fluctuations. Two sets of alternative exchange rates were used, based both on those used last time, and consideration of the averages over the 1996-99 period. The exchange rate was not altered for Germany, as the rate used corresponded closely to the longer term average. As expected, strengthening the NZ dollar reduced New Zealand's apparent price competitiveness but did not obliterate it. Anecdotal evidence from the industry that an exchange rate of around US\$0.68 would be a critical threshold for parallel importing to look attractive (a rate which has not prevailed since June 1997), provides a benchmark for this band of values.

TABLE 2: INTERNATIONAL PRICE COMPARISON – BOOKS

Exchange Rates as at 31/12/99: NZ/AU=0.7943, NZ/US=0.5085, NZ/UK=0.3153, NZ/DM=0.9826

Prices exclude indirect taxes, \$NZ

	NZ	AUS	US	UK	GER
Number of titles in sample					
1998	100	95	66	40	–
2000	30	26	18	22	13
Average price					
1998	22.73	22.66	16.58	22.96	–
2000	19.89	23.86	22.80	23.98	19.31
Average NZ price – reduced sample (1)					
1998		22.83	22.09	20.34	–
2000		20.64	20.02	20.64	18.88
Average price as % of NZ					
1998		99	75	113	–
2000		116	114	116	103

Note:

- (1) The average price in NZ for just the sample of titles available in each country, eg. just the 9 available in Australia in 1998, and the 28 in 2000. The ratios below compare these prices with the corresponding prices in the other countries in the row above.

Source: NZIER Book Price Survey

TABLE 3: INTERNATIONAL PRICE COMPARISON – BOOKS**Exchange Rate Assumptions: NZ/AU = 0.85, NZ/US = 0.57, NZ/UK = 0.34**

	AUS	US	UK
Average price (\$NZ)	22.30	20.34	22.24
Average NZ Price for reduced sample (1)	20.64	20.02	20.64
Average price as % of NZ	108	102	108

Note:

- (1) The average price in NZ for just the sample of titles available in each country. The ratios below compare these prices with the corresponding prices in the other countries in the row above.

Source: NZIER Book Price Survey

TABLE 4: INTERNATIONAL PRICE COMPARISON – BOOKS**Exchange Rate Assumptions: NZ/AU = 0.89, NZ/US = 0.62, NZ/UK = 0.4**

	AUS	US	UK
Average price (\$NZ)	21.29	18.70	18.90
Average NZ Price for reduced sample (1)	20.64	20.02	20.64
Average price as % of NZ	103	93	92

Note:

- (1) The average price in NZ for just the sample of titles available in each country. The ratios below compare these prices with the corresponding prices in the other countries in the row above.

Source: NZIER Book Price Survey

Analysis – Book market

The purpose of this research is to test two propositions:

1. That removal of parallel importing restrictions leads to substantial reduction of price arbitrage between national markets;
2. That this effect is mainly achieved through the threat of parallel importing, rather than through significant volumes being parallel imported.

The questions asked when consulting industry players have therefore aimed at establishing whether there has been any significant change in the volume of books being parallel imported; whether there has been any change in prices associated with the restriction being lifted; whether there has been any change in the behaviour of the authorised distributors, or changes in the behaviour of the retailers with whom they deal which may have prompted the distributors themselves to change their behaviour. A further question arising out of this is how much, if any, of the effects seen can be attributed to the lifting of the parallel importing restriction, given the other changes taking place in the New Zealand book market?

Prices and volumes

There are no sufficiently comprehensive and disaggregated official or industry statistics available to identify whether there has been a marked change in volume of books imported, and parallel imported, over the period of this study. Those consulted in the study were close to unanimous that volumes since the ban lifting were not significantly different from what they would have expected without the law change. They also reported no substantial change in the pattern of their supply arrangements: retailers still prefer to source through their local wholesalers except in cases where they cannot meet the timeliness of supply. This partly answers the second of the propositions above; for if there is any change attributable to parallel importing, it cannot be attributed to the volumes coming in, but rather to the possibility of such volumes arriving. The lifting of the ban could therefore be said to have made the book market more contestable.

The industry consultees were also close to unanimous in suggesting that prices were not any different from what they would have expected without the law change. Some retailers and wholesalers hinted that they might have expected prices to have crept up with the relative decline of the New Zealand dollar against the currencies of its main trading partners, but this had not happened. This is broadly consistent with the results of the international price comparison, which show the crude average price of top-selling titles in New Zealand to have declined slightly from 1998 to the end of 1999; and also show their price to have lowered relative to the average price of the same titles in other major markets. This price comparison needs to be treated with some caution, since it is an eclectic selection of books, is not weighted by each title's volume of sales, and the crude average could be distorted if one year's best-seller list happened to have a higher proportion of more costly books than the other. However, it provides some corroboration that the New Zealand book market has resisted the tendency for cost-plus price creep in face of the deterioration in the exchange rate over this period, and it is not inconsistent with the proposition that parallel importing and perhaps other factors have improved the competitive disciplines in the market. Holding down the price of books will have provided some benefit to the book-buying public, assuming their buying patterns have not radically altered.

Market behaviour and structure

Retailers have not reported any change in their selling behaviour, pricing and discounting which could be attributed to parallel importing, nor to the sourcing of their supplies. The existing wholesalers appear to have maintained their position as first preference suppliers, except on infrequent occasions when a book is out of their stock and cannot be procured quickly from their overseas parent supplier. There has been one significant new entrant to the retail market over this period, Borders Books and Music, a branch of an American company which was widely expected to source most of its stock through parallel importing. In the event it has increasingly been sourcing its stock from New Zealand based wholesalers. Another relatively recent entrant in the book market is The Warehouse, a nation-wide chain of cut-priced general merchandise stores which has parallel imported a number of other branded products on a sporadic basis since the law change. They too are also sourcing books from local wholesalers, which suggests they are competitive on price and service grounds with the alternative overseas sources.

There are various explanations as to why the local wholesalers are holding their own. One is that the weak exchange rate has not favoured parallel importing, although since this affects imports to wholesalers and parallel importers alike there must be other factors at work here.

A likely contender is scale economies in distribution and bulk purchasing power enjoyed by the incumbent wholesalers. Most retailers suggested they could just not match the local wholesalers' price by seeking an alternative source, except on rare occasions. Another common comment was that retailers were reluctant to upset arrangements with their major suppliers to obtain short term gain, implying that supply security was an issue for them.

This loyalty of retailers to the local wholesalers, along with the publisher/wholesalers' willingness to turn a blind eye to small cases of parallel importing before the ban was lifted, suggests a rather cosy, co-operative industry which might not be replicated in larger, more competitive markets. Other suggested reasons for such loyalty were the intangible hint that some wholesalers had 'sharpened their act', and the ease of trading with a closer rather than a remote supplier. New Zealand reportedly has a significant proportion of its books supplied on a 'firm sale' rather than 'sale or return' basis, which puts a high degree of risk on the retailer when ordering books and might suggest they would be indifferent as to whether they were supplied locally or from afar for these firm sale books. Retailers might be held captive if the local wholesalers were limiting their sale or return facility to the top titles, which are likely to be the ones most readily available for parallel importing.

What proportion of the effects above can be attributed to parallel importing? Retailers and publisher/wholesalers were unanimous that the effect of parallel importing could not be disentangled from other changes in the market place. Prime among these were the expansion of The Warehouse's low price book business concentrating on lead titles, and the emergence of a near dominant player in the Blue Star/Whitcoulls group of companies. These two were engaged in price competition for market share which was putting pressure on small generalist retailers and wholesalers alike. Internet sales from companies like Amazon.com and Barnes&Noble.com were also contributing to price competition, particularly since no Goods and Services Tax is collected on books from these sources as they arrive in the country. The volume of internet sales is however still small. The prospect of parallel importing is a contributing factor to price competition, but by no means the only or even the major one.

The interview responses played down the impact of parallel importing on the New Zealand book market. Some wholesalers and retailers suggested it was too early to discern any significant effect of parallel importing. Wholesalers in particular suggested that with a stronger New Zealand dollar, there may have been more parallel importing, greater pressure on margins, and the likelihood of some wholesalers closing down their New Zealand operations and servicing the market from Australia, with the implication of more remote and less attentive customer servicing. Since the exchange rate improvement would benefit imports of books by wholesalers and parallel importers alike, the logic of this chain of events is obscure. It is possible that as the New Zealand dollar strengthened and imports became cheaper, wholesalers might find themselves disadvantaged by an increasing proportion of NZ-dollar denominated costs incurred in their operations in New Zealand, relative to parallel importers – primarily warehousing and marketing office costs. Parallel importers might also be able to take advantage of changes in relative exchange rates between specific countries: for instance, they might be better placed to benefit from a move against the US dollar than a publisher/wholesaler contractually tied to a UK parent company. However, there was only one retailer who indicated how high the NZ dollar would have to rise before such a shift of operations would be observed (US\$0.68, a rate last observed in June 1997). Some companies have already relocated to Australia, such as Oxford University Press, a relatively specialist, low volume wholesaler. But since this occurred under apparently favourable exchange rate conditions, other factors clearly apply.

Another issue raised by the publisher/wholesalers was that, given some future squeeze on their margins, they would be less able and willing to support New Zealand authors: the implication being that, by undermining their ability to price discriminate between markets internationally, they would be unable to cross-subsidise emergent local authors within New Zealand, with their support of local talent contracting and concentrating on more well-known authors. It is too early since the law change to establish whether there has been any appreciable change in support. In principle it would be possible to examine local authorship in titles available, and new local titles coming on stream each year, in the major publishers' listings, to identify changes in local author support over time, but there are no readily available data with which to do this.

Industry consultees reported two or three cases where New Zealand authored books remaindered on overseas markets had been imported back into New Zealand for sale at less than the locally available price. This would lend weight to the argument that parallel importing undermines the ability of New Zealand authors to engage in 'dumping' to expand their markets overseas, although the scale of this effect may not yet be significant. Authors collect reduced, or no royalties on remaindered books, which further undermines authors' incentives to seek markets overseas.

From the consultations it is not clear whether small publishing companies had formed a view distinct from that of the major publishers, and some seem not to have considered parallel importing to have affected them at all. In part this may reflect the small scale and somewhat introspective characteristics of New Zealand publishing. Many New Zealand publishers concentrate on books aimed at the local market, with little thought of widespread overseas sales. Their lack of concern with parallel importing may be justified if the sub-market they serve is sufficiently differentiated from the mass of books available from overseas sources. But where books from different countries are regarded as commodities and substitutable for each other, publishers will find it hard to compete with imports, given local publishing costs, and local publishers may be forced to change the mix of books they offer, concentrating more on the non-substitutable niches in the market.

MUSIC COMPACT DISCS

Market structure

The current market structure for music CDs in New Zealand can be divided between publisher/wholesalers and retail outlets. At the wholesale level around 90 per cent of the market is controlled by four international 'record label' companies—Warners/EMI, Sony/CBS, Bertelsman/RCA and Universal/MCA/Polygram. Wholesalers have not yet moved into retailing in the way that, for example, Virgin and EMI have done in other countries. There are also some international labels imported by independent wholesalers, who often act as authorised distributors, and also some local production of discs and tapes.

At the retail level there is a competitive market of outlets with increasing prominence of retail chains such as Sounds, as well as expansion into the CD market of general retailers such as The Warehouse. Borders Books and Music has also entered the Auckland market, raising expectations it would source largely from parallel imports. Structural changes have occurred in the retail sector, with some firms consolidating to strengthen their market share, but there is not yet the degree of market concentration into a few large firms as has occurred

in the book market. There are also some Internet and mail order retail outlets, whose market share is small but growing.

Although retailers can still only source particular CD titles from the artists' contractual record company, firms now have the option of approaching that company overseas. As the retail chains may prefer to source locally where possible (maintaining a favourable relationship with their suppliers), it seems likely that itinerant traders are responsible for much of the volume of parallel imports. Retail chains are very price conscious, and are reportedly cutting margins right back and securing larger discounts from wholesalers both through negotiating power and the threat of parallel importing. The New Zealand-based record companies are reportedly reducing profit margins in order to maintain their own market share.

As with the book market, small- and mid-sized independent retail operations are losing ground and exiting the market (such as Truetone). This cannot be solely attributed to parallel importing, as the competitive nature of the industry was already changing. The presence of The Warehouse, for instance, would have stimulated aggressive pricing even in the absence of the legislation change.

Market behaviour

The consensus of interviewees was that New Zealand CDs are among the cheapest in the world. They also assert that prices were internationally comparable before the legislation change. It was stated that since parallel importing, prices have remained steady rather than rising, as might have been expected with a deteriorating exchange rate. Companies appear to be taking less profit in order to maintain market share.

The retailers surveyed maintained they have parallel imported only small quantities, and these largely to satisfy customer orders. With such orders, the issue may be largely one of access and availability, rather than price, with consumers paying a premium for specialist titles. Furthermore, the CD market is said to be 'repertoire-driven', with demand depending on the number of albums released by particular artists rather than price.

On the other hand, some industry representatives reported large shipments of parallel imports flowing into the country. The number of supply nations has, according to one source, expanded from seven, to over twenty, including some 'non-traditional' countries such as India and China. It is claimed that these are old and back-catalogue titles, which may have been 'sabotaged' (tracks deleted or altered to satisfy local censorship laws), and may not have involved payment of royalties.

A concern with the influx of parallel imports is that pirated copies will be more difficult to detect. Some interviewees regarded the toughened penalties for importing pirated copies as ineffective, due to the complexity of the notice system. At present, the onus is on record companies to notify the Customs department if they suspect pirated works are entering the country.

Another problem is that, with higher numbers of importers, and goods coming from outside the authorised channels, it is more difficult to trace the origin of imported goods. However, with other factors such as technological developments aiding the ease and cost of replication, it is likely that incidence of piracy would have been a major concern in the absence of parallel importing. A report produced by A.J. Park and Son for the Ministry of Commerce in

1998 provided evidence that film and video pirating was already becoming more prevalent in New Zealand, and that the piracy rate of software was estimated to be about 34%. One issue for consideration, is whether responsibility for combating piracy lies collectively within the commercial sector, or whether it should be more stridently addressed by public policy.

Some industry spokespeople asserted the pertinence of the cross-subsidy argument, whereby financial commitment from record companies to local artists bears a direct relationship to profits. This argument is fundamentally not about artists' rights (which are still protected by copyright law) but funding of local creative talent. Whether the source of such funding should be the responsibility of international companies is open to debate. It also implies that the 'creativity industry' needs protection, a position not necessarily in step with the thrust of New Zealand's recent market reforms.

International price comparison

Sample

A list of fifty best-selling CDs (as at 26 December 1999) was obtained from a local retailer (Appendix 3). Double CDs were excluded from the sample prior to analysis. For purposes of comparison, the base sample used in the 1998 NZIER report was used and adjusted in the same way as the 1999 data.

Prices

New Zealand prices were provided by a local retailer. These were compared to the New Zealand website consulted by the previous study, and found to be consistently lower. Overseas prices were taken from the internet. As with books, list prices were used, had indirect taxes removed, and were then averaged over the available sample.⁴³⁷

Results

Compact discs in New Zealand were seen to be cheaper than all other countries considered, except Germany. Industry sources report that retail prices in Germany are the second highest in the world (behind Japan), so these results should be viewed with caution. Prices in the UK are also known to be high (around \$50 per top-list title). It is possible that the internet prices were stated at cost (as some New Zealand retailers' websites do).

⁴³⁷ Indirect tax rates used: NZ 12.5%, Australia 22%, UK 17.5%, Germany 16%. US prices were before tax.

TABLE 5: INTERNATIONAL PRICE COMPARISON – CDS

Exchange Rates as at 31/12/99: NZ/AU=0.7943, NZ/US=0.5085, NZ/UK=0.3153, NZ/DM=0.9826

Prices exclude indirect taxes

	NZ	AUS	US	UK	GER
Number of titles in sample					
1998	12	9	9	6	10
2000	47	28	42	37	36
Average price (\$NZ)					
1998	27.00	27.17	24.25	33.77	28.21
2000	27.57	29.62	35.91	31.37	21.08
Average NZ price – reduced sample (1)					
1998		27.05	26.96	27.20	26.92
2000		27.45	27.51	27.44	27.46
Average price as % of NZ					
1998		100	90	124	105
2000		108	130	114	77

Note:

- (1) The average price in NZ for just the sample of titles available in each country eg. the 9 available in Australia in 1998 and the 28 in 2000. The ratios compare these prices with the corresponding prices in the other countries in the row above.

Source: NZIER CD Price Survey

Compared to the 1998 findings, the nominal average price of the selection was basically unchanged in New Zealand, lower in the UK and Germany, and higher in Australia and the US. Using a stronger New Zealand dollar erodes the slight price advantage over Australia. As with books, in varying the exchange rate the underlying assumption is that the price in New Zealand remains unchanged, which is probably unrealistic in the event of substantial exchange rate fluctuations.

TABLE 6: INTERNATIONAL PRICE COMPARISON – CDS

Exchange Rate Assumptions: NZ/AU = 0.85, NZ/US = 0.57, NZ/UK = 0.34

	AUS	US	UK
Average price (\$NZ)	27.68	32.03	29.09
Average NZ Price for reduced sample (1)	27.45	27.51	20.64
Average price as % of NZ	101	116	106

Note:

- (1) The average price in NZ for just the sample of titles available in each country. The ratios below compare these prices with the corresponding prices in the other countries in the row above.

Source: NZIER CD Price Survey

TABLE 7: INTERNATIONAL PRICE COMPARISON – CDS

	AUS	US	UK
Average price (\$NZ)	26.43	29.45	24.73
Average NZ Price for reduced sample (1)	27.45	27.51	27.44
Average price as % of NZ	96	107	90

Note:

- (1) The average price in NZ for just the sample of titles available in each country. The ratios below compare these prices with the corresponding prices in the other countries in the row above.

Source: NZIER Book Price Survey

Analysis – Music CD market

As with the examination of books, the purpose of this research is to test two propositions:

- That removal of parallel importing restrictions leads to substantial reduction of price arbitrage between national markets;
- That this effect is mainly achieved through the threat of parallel importing, rather than through significant volumes being parallel imported.

The experience in the CD market since the lifting of the ban on parallel importing appears to have been remarkably similar to that for books. The market was widely regarded to be already price competitive by international standards. The prospect of parallel importing has reportedly already enhanced the negotiating power of retailers, who are themselves facing a fiercely competitive local market, and wholesalers appear to be holding or cutting margins as a result. As for books, industry participants note that prices for CDs have not risen since the law change, as well they might given the weakening of the New Zealand dollar over that period. There may have been slightly more parallel importing of CDs than of books, but it is still at a low level, and any effect the law change may have had will have been through the threat of parallel importing rather than the actual volumes involved.

Where there is a difference between CDs and books is in the more pronounced divergence of opinion between retailers and producer/wholesalers about the effect of the law change. While retailers regard the lifting of the ban as a non-event, they do not appear to relish the prospect of its return. Producer/wholesaler representatives, in contrast, are strong advocates for some return to restriction, and claim to have support from the artists on this matter.

This difference may reflect the greater incentive that record label companies have to shore up through legislation a position which technology is rapidly undermining. The companies undertake four functions: finding artists, making records, distributing records and marketing them. A major strength the large companies enjoy is economies of scale in distribution and manufacturing. At present local artists have needed the companies to secure exposure in international markets. But as hardware manufacturers provide cheaper means to make records, and internet technology provides easier access for artists to reach and sell directly to

a world-wide market, the economies of scale cease to provide a barrier to entry into the music business.

Piracy among CDs is less easily detected than is counterfeiting of books, and likely to be more lucrative given the cost of producing/copying CDs and the larger rents earned by the higher echelons of the musical entertainment business. Notices for labels thought to be at risk of piracy can be lodged by copyright holders with national customs agencies, who are obliged under inter-governmental agreement to be alert for counterfeit material. However, the Customs department report that no notices have yet been submitted by the industry.

As with books there are a number of other pressures and changes on the market which may be accounting for recent behaviour, and which make the role of parallel importing difficult to disentangle. General commercial pressures appear to be producing the same divergence within the retail market, between the lead title purveyors who engage in high volume competitively discounted sales, and niche retailers serving specialist or more eclectic markets. Medium-sized retailers carrying a broad range of stock find it increasingly difficult to compete. A similar fragmentation of the market is observed amongst commercial radio stations who are significant consumers of CDs, who are increasingly tailoring their offerings to specific sub-groups of listeners. All these factors can be expected to have exerted downward pressure on prices, irrespective of any changes in the parallel importing regime.

Security of supply issues still appear to make the local authorised distributors the preferred suppliers of many retailers. In addition, the risk to quality in parallel importing music CDs may be stronger than for books – some copyright editions are doctored for sale in certain markets, although this may not be apparent until the CD is played. These factors may reinforce the advantages of dealing with established authorised suppliers compared to parallel importing from unknown suppliers.

The price comparison shows that for the CDs selected in 1998 prior to the lifting of the parallel importing ban, there appeared to be arbitrage opportunities from the US into New Zealand, but not with any other country. For the CD selection sampled at the end of 1999 there were apparently no arbitrage opportunities other than from Germany, a result regarded as anomalous by industry participants consulted in the interview survey. This would appear to lend support to the interview participants who regarded New Zealand CDs to be price competitive with other countries around the world. The parallel importing possibility, amongst other factors, may have contributed to keeping prices down.

SOFTWARE

Market structure

There are three main sub-markets for software: business, recreational (games) and educational. Embedded software componentry is not considered in this report. The focus is rather on software packages available at the retail level. Games represent the biggest market in New Zealand, and are reliant on timing and being current. Educational software has more of a static interest level, whilst the demand for office software is a function of such factors as reputation of supplier and provision of back-up service.

Much software is currently supplied through a range of electrical retail outlets, many of them national chains selling household appliances, computer hardware and software to use on them. General merchandise retailers such as The Warehouse have also moved into this market, with a greater emphasis on software applications than the associated hardware. Few of these retailers have 'exclusive' distribution rights to any major software. Some book retailers also sell software.

At the wholesale level, major software companies have authorised distributors in New Zealand; some of which may be subsidiaries, others independent importers. There are also a number of small firms which may deal in particular types of software, customise it for particular uses, and maybe even develop software programmes of their own for retail sale. There are no firm data on respective market shares.

Analysis

There has been some parallel importing, particularly direct out of the US, with New Zealand reportedly getting some programme titles and formats at a lower price than they have been released in the country of origin. This appears to be a case of dumping in New Zealand's favour. Some software retailers report that they have been able to substantially lower their prices for educational software, as a result of the opportunity for parallel importing. Products not relying on timing, can be sourced at the end of their 'life cycle' (of packaging and promotion) from the US, and competitively priced in New Zealand. There are some reports of substantial volumes of parallel imports in educational software. One large retail chain indicated that parallel importing has provided an opportunity to alter their supply networks. This has not, however, affected the range of titles they stock.

Parallel importing appears to be not such an issue for new title games, where speed is of importance. New titles cannot be parallel imported in time to offset the expense of so doing i.e. most parallel importing of software appears to be of products which are already established and, as such, trailing the 'leading edge'.

Perhaps the biggest concern to the software market is piracy. Microsoft NZ claim to have lost \$15 million to counterfeits in 1998, up from \$9 million the previous year (although, according to Customs, this claim has yet to be supported by any concrete evidence or statistics). In an effort to 'protect their patch', Microsoft only sell to licensed dealers, and only provide support to NZ bought and registered products.

Unlike the book and CD markets, where a single purchase entails little after care, software can require a high level of technological back-up service as well as upgrade facilities (with business/office packages rapidly becoming obsolete). Companies may capitalise on a first purchase, offering discounts on subsequent sales (such as upgrades and associated software) and additional services. They may seek to maintain their reputation by providing good service and maintenance, and thus discouraging purchasing from alternative sources.

A distinctive feature of software marketing is that almost all programmes are sold under strict licence terms with potential to restrict their unauthorised on-selling or dissemination. This provides a stronger legal protection than for books or CDs, although this is offset by the ease of copying software and the difficulty of monitoring its subsequent use. Parallel importing can still feature in authorised channels: when the title loses its 'fashion status', it can enter a 'secondary market' and thence be imported for re-sale. Importation of such products has occurred in New Zealand, selling sometimes for a third of the initial retail price. This in turn

creates a degree of market segmentation: cheap imports attract a sub-market of consumers who would not otherwise have purchased software, whilst retailers selling at premium prices focus on those willing to pay for timeliness, and possibly packaging, service and reputation.

There was a concern that parallel imported software packages would either free ride off authorised dealers' support services, or consumers of such would be left without back-up support. One large retailer, engaged in parallel importing, interviewed said that in cases where the particular package requires support, they have arranged with a local company to provide this. For other titles, there can be such a considerable price difference between the parallel import, and that acquired through an authorised channel, that this should act as a signal to consumers that some degree of unbundling of product and service has occurred. Commenting on the goods market in general, the consumers' representative we consulted indicated the need for buyers to be wary, particularly of itinerant traders.

In summary, of the three markets examined, the software market is the one in which parallel importing appears to have had the greatest impact on volumes imported. It has also had a noticeable effect on prices, with the expansion of a secondary market in old 'trailing edge' programmes sold at much reduced prices from the corresponding new programme, and appealing to a different type of buyer. Because software is an ephemeral product with limited currency, needs technical support and undergoes continuous upgrade and improvement, the suppliers of new software appear to have cemented their authorised distributors through licensing and restricted back-up services, despite the lifting of the parallel importing ban. Piracy remains a concern, but much of this relates to domestic copying and it has not been possible to verify an increase associated with parallel importing into New Zealand.

Conclusions and implications

In analysing the economic effects of lifting the ban on parallel importing in New Zealand, this report sought to address two key questions: did the removal of the restrictions lead to a substantial reduction in price arbitrage between national markets, and if so, was this effect achieved mainly through the threat of parallel importing?

Books

Price analysis of best-selling book titles revealed a change in the relativity between countries. Prices in New Zealand compare now more favourably with other countries, than was reported in NZIER's 1998 analysis (prior to the legislation change). The improved competitiveness of New Zealand prices, combined with a weakened exchange rate, has reduced the potential for price arbitrage between countries. Where relative prices are similar, the outcome will depend on the margins imposed at retail and wholesale level, and associated costs of importation (including transport and local taxes).

Within the book market, the legislation change has contributed towards improvement in availability, access, speed of delivery, and timing of release dates. There has been a 'blanding down' of stock held, with a narrower range of titles on retailers' shelves, but improved accessibility through ordering and indent services. These gains to consumers are partly also in response to the 'price war' between the dominant players, involving trimmed margins and fighting for market share. Smaller retailers have struggled to replicate these results, and there has been some restructuring within the retail sector; a hollowing out of mid-sized,

generalised booksellers and greater concentration at the mass market and niche ends of the market.

Existing supply networks have remained largely unchanged, with no significant volumes of parallel imported books featuring in the market. Local publishers/wholesalers have provided competitive prices, ensuring maintenance of domestic distribution networks. There is some evidence from the industry that the possibility of parallel importing has encouraged wholesaler efficiency and service.

Incentives for local writers are potentially threatened by importation of overseas remainders of New Zealand titles. There are reports of occasional imports of New Zealand titles undermining local book prices; were the volume of these to increase, a more substantial threat to domestic innovation may arise.

Music CDs

The structure of the music CD retail market has consolidated somewhat since the introduction of parallel importing. The competitive nature of the industry ensured aggressive marketing prior to the change, with prices, release dates and availability rivalling international markets. Industry consultees suggest that parallel importing inhibited any price rises, which may have been expected with a depreciating dollar. As in the book market, the threat of parallel importing has reportedly armed retailers with greater negotiating power when approaching distributors.

The issue of piracy is more of a concern in the market for CDs than for books. Record companies and industry representatives regard increased importation of illicit copies as one of the major impacts of parallel importing. There may also be qualitative differences, with some lower cost markets supplying different editions. As with the book market, there is the issue of how parallel importing affects incentives of local artists. This was the key area of divergence detected between retail and wholesale responses in the interviews conducted, as distributors claim a direct relationship between profit margins and support provided to local musicians. Furthermore, they assert that parallel importing impacts directly upon the funding they contribute.

Software

Significant volumes of parallel imports have been more evident in the software market. Unlike the book and CD markets, where parallel imports have furnished retailers with bargaining power over their wholesalers, in the software market, such distribution may have been previously unavailable, with companies selling only to authorised dealers. Parallel importing allows retailers to source goods from overseas, when they have reached the end of their shelf life. Such titles are then able to legitimately enter a secondary market, and be on-sold. The nature of such a sub-market therefore precludes new release games, which rely on being 'hot' or current. Business/office software has been largely unaffected by the legislation change, as very little parallel importation has occurred in this area. Retailers of parallel imports have aimed at the home market; educational and some 'home office' software such as drawing/desk-top publishing packages. One large retailer said that where after-sales support is required, they have arranged such services with a local company, for the particular title.

The issue of piracy is pertinent to the software industry, with reported increases in illegitimate copies being directly linked to parallel importing. There is, however, a paucity of statistical data to confirm these claims.

Overall

The following effects anticipated from allowing parallel importing appear to have occurred:

- lower prices: in software; and prices held in books and CDs
- diversity of sources: in software
- improved responsiveness of service: in books in particular
- product differentiation/market segmentation: in software, books and CDs.

The overall impact of parallel importing must be analysed in the context of a weak exchange rate, a growing internet market, and an increasingly competitive retail sector. This said, the legislation change has provided an opportunity for retailers to assess their existing supply networks, and consider overseas alternatives. On the whole, New Zealand distributors, at least in the book and CD markets, have been generally shown to be competitive by international standards. Where inefficiencies of supply were occurring, retailers have been able to exert pressure on their local sources to improve their prices and service. The result for New Zealand consumers has been prices, access and availability rivalling the rest of the world.

The Australian Federal Government has recently introduced parallel importing of music CDs. Some downward movement in nominal prices since the legislation change has been detected. Partial reform of the book market in 1991 was also found to have some effect on international price differentials. Nevertheless, despite eliciting similar price responses, across the board lifting of restrictions in the Australian market may have more substantial effects than the change in New Zealand, due to differences in market structure between the two countries.

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Questionnaire

Research into the implications of lifting the parallel importing ban.

Introduction

Parallel importation involves importing genuine copyright goods for resale by an agent who is not the local authorised dealer. As you may be aware, New Zealand's restrictions on parallel importing were lifted in 1998. This change made it possible to legally import copyright goods without the permission of the company owning the copyright.

NZIER is currently updating a study conducted prior to the legislation change. We would like to discuss with you the views of your organisation about the impacts the availability of parallel imports have had on the _____ market.

Sub markets

One of the important things to note is that there are different parts of the _____ market that may have been affected differently by changes to the law. As we discuss the issues, perhaps you could think about the different sub-markets that exist within the whole _____ market and let us know if you think the sub-markets have been affected differently.

Welfare effects

Prices

The main reason that the changes to parallel importing laws was enacted, was the perception that parallel imports would reduce prices paid by New Zealand consumers, making them better off.

- Have there been price changes as a result of the restrictions being lifted?
- How has the structure of pricing changed e.g. list price versus discounting?
- What are the key drivers of prices e.g. are exchange rates a major factor or is it mainly demand driven?

Volume

- Is volume sensitive to price or vice versa? Do consumers demand more if the price falls?
- Is security of supply an issue?
- What is your perception of the quantity of parallel imports since the ban was lifted?

Quality

- Have there been changes in quality over time?
- Have parallel imports affected the quality of the goods? If so, how?
- Pirated goods?

Market structure

- How has the market altered since the parallel importing restrictions were changed?
- Would you have expected these changes had the ban not been lifted?
- Has the internet had an impact on domestic sales through personal importing? Will this have an effect in the future?

Distribution

- How has access to new products changed?
- Have distribution channels been altered? If so, how?
- Have pre or after sales support changed? If so, what are some of the motivations behind the change?

Players

- Have the players in the market changed? Have existing players left? New players entered?

Books – NZ Publishers

- Do you see your market as differentiated from the general book market?
- Is demand affected by the price of other titles?
- Has your policy regarding overseas markets altered since the legislation change?

Book price comparison

International Comparison of Bestselling Book Prices

Title	Author	Publisher	Exchange Rates as at 31/12/99: Lowest available prices			
			NZ	less GST	AUS	NZD
New Zealand						
1 The Vinter's Luck	Elizabeth Knox	Victoria UP	19.95	17.73	17.95	22.60
2 Blokes and Sheds	Jim Hopkins and Julie Riley	HarperCollins	19.95	17.73	-	-
3 Both Sides of the Moon	Alan Duff	Vintage/Random House	24.95	22.18	17.95	22.60
4 Only Their Purpose is Mad	Bruce Jessen	Dunmore Press	27.95	24.84	24.95	31.41
5 Inventions from the Shed	Jim Hopkins and Julie Riley	HarperCollins	19.95	17.73	19.95	25.12
6 Legends of the All Blacks	Keith Quinn	Hodder Moa Beckett	29.95	26.62	-	-
7 Jeff and Josh's World Cup Guide	Ron Palenski, Jeff Wilson, Josh Kronfeld	Hodder Moa Beckett	9.95	8.84	-	-
8 Reconnaissance	Kapka Kassabova	Penguin	24.95	22.18	19.95	25.12
9 What Becomes of the Broken Hearted?	Alan Duff	Vintage/Random House	19.95	17.73	17.95	22.60
10 Top of the Morning Book of Epitaphs	Compiled by Brian Edwards	Tandem Press	7.95	7.07	-	-

Fiction

11 Memoirs of a Geisha	Arthur Golden	Vintage/Random House	21.95	19.51	16.95	21.34
12 The Testament	John Grisham	Century/Random House	19.95	17.73	16.95	21.34
13 The Pilot's Wife	Anita Shreve	Little Brown/Penguin	21.95	19.51	17.95	22.60
14 The Street Lawyer	John Grisham	Arrow/Random House	14.95	13.29	15.95	20.08
15 The Snow Falcon	Stuart Harrison	HarperCollins	19.95	17.73	15.95	20.08
16 Jessica	Bryce Courtenay	Penguin	19.95	17.73	16.95	21.34
17 Monsoon	Wilbur Smith	Macmillan	24.95	22.18	25	31.47
18 Message in a Bottle	Nicholas Sparks	Bantam/Random House	17.5	15.56	14.95	18.82
19 Die Trying	Lee Child	Bantam/Random House	17.3	15.38	15.95	20.08
20 Black Notice	Patricia Cornwell	Little Brown/Penguin	29.95	26.62	24.95	31.41

International Comparison of Bestselling Book Prices

Title	Author	Publisher	Exchange Rates as at 31/12/99: Lowest available prices			
			NZ	less GST	AUS	NZD
Non-Fiction						
21 Rich Dad, Poor Dad	Robert T. Kiyosaki	Tech Press/Addenda	27.95	24.84	19.95	25.12
22 Angela's Ashes	Frank McCourt	HarperCollins	19.95	17.73	17.95	22.60
23 Don't Sweat the Small Stuff	Richard Carlson	Bantam/Random House	19.95	17.73	14.95	18.82
24 Cashflow Quadrant	Robert T. Kiyosaki	Tech Press/Addenda	29.95	26.62	19.95	25.12
25 Under the Tuscan Sun	Frances Mayes	Bantam/Random House	24.95	22.18	19.95	25.12
26 A Kentish Lad	Frank Muir	Corgi/Random House	26.95	23.96	19.95	25.12
27 Why Men Don't Listen and Women Can't Read Maps	A and B Pease	Pease Training	34.95	31.07	22.95	28.89
28 Desert Flower	Waris Dirie	Virago/Penguin	19.95	17.73	16.95	21.34
29 Bella Tuscany	Frances Mayes	Anchor/Random House	27.95	24.84	19.95	25.12
30 The Liver Cleansing Diet	Dr Sandra Cabot	Women's Health Adv. Serv.	24.95	22.18	19.95	25.12
Average price				19.89		23.86

Source: NZIER Book Price Comparison

CD Price comparison

International Comparison of Bestselling CD Prices			Exchange Rates as at 31/12/99, Sample minus double CDs					
Title	Artist	Distributor	NZ	AUS				
				less GST	AUD	less GST	NZD	
1	Come on Over	Shania Twain	Universal	29.95	26.62	24.95	20.45	25.75
2	S Club	S Club 7	Universal	29.95	26.62	–	–	–
3	All the Way... A Decade of Song	Celine Dion	Epic/Sony	29.95	26.62	–	–	–
4	Kiri Maori Songs	Kiri te Kanawa	EMI	29.95	26.62	–	–	–
5	The Irish Tenors	The Irish Tenors	Warner	33.95	30.18	–	–	–
6	Ricky Martin	Ricky Martin	Col/Sony	29.95	26.62	29.95	24.55	30.91
7	Sacred Arias	Andrea Bocelli	Universal	29.95	26.62	29.95	24.55	30.91
8	Songs from the Last Century	George Michael	Virgin	33.95	30.18	29.95	24.55	30.91
9	By Request – Greatest Hits	Boyzone	Universal	29.95	26.62	–	–	–
10	The Ego Has Landed	Robbie Williams	EMI	33.95	30.18	–	–	–
11	Californication	Red Hot Chili Peppers	Warner	33.95	30.18	29.95	24.55	30.91
12	Enrique	Enrique Iglesias	Universal	29.95	26.62	–	–	–
13	Westlife	Westlife	BMG	29.95	26.62	29.95	24.55	30.91
14	Overnight Success	Dave Dobbyn	Col/Sony	29.95	26.62	–	–	–
15	Chant Down Babylon	Bob Marley	Universal	29.95	26.62	–	–	–
16	Mix	Stellar	Epic/Sony	29.95	26.62	–	–	–
17	Greatest Hits – Cher	Cher	Warner/Universal	27.95	24.84	29.95	24.55	30.91
18	Reload	Tom Jones	Mush/BMG	29.95	26.62	29.95	24.55	30.91
19	Turn it on Again – The Hits	Genesis	Virgin	33.95	30.18	19.95	16.35	20.59
20	Invincible	Five	BMG	29.95	26.62	29.95	24.55	30.91
21	Baby One More Time	Britney Spears	BMG	29.95	26.62	29.95	24.55	30.91
22	The Party Album	The Vengaboys	BMG	29.95	26.62	–	–	–

International Comparison of Bestselling CD Prices			Exchange Rates as at 31/12/99, Sample minus double CDs					
Title	Artist	Distributor	NZ	AUS				
				less GST	AUD	less GST	NZD	
23								
24	Queen – Greatest Hits III	Queen	EMI	33.95	30.18	19.95	16.35	20.59
26	Infinity	Deep Obsession	Universal	29.95	26.62	–	–	–
27	MTV Unplugged – The Corrs	The Corrs	Warner	29.95	26.62	–	–	–
29	Issues	Korn	Epic/Sony	29.95	26.62	29.95	24.55	30.91
30	Pokemon	Soundtrack	Warner	33.95	30.18	19.95	16.35	20.59
31	Romanza	Andrea Bocelli	Universal	29.95	26.62	29.95	24.55	30.91
32	Human Clay	Creed	Epic/Sony	33.95	30.18	–	–	–
33	Classics in the Key of G	Kenny G	BMG	33.95	30.18	–	–	–
34	Affirmation	Savage Garden	Warner/Roadshow	29.95	26.62	29.95	24.55	30.91
35	Clapton Chronicles	Eric Clapton	Warner	29.95	26.62	29.95	24.55	30.91
36	Millenium	Back Street Boys	BMG	29.95	26.62	29.95	24.55	30.91
37	Time	Ardijah	Warner	33.95	30.18	–	–	–
38	Charlotte Church	Charlotte Church	Col/Sony	29.95	26.62	–	–	–
39	There is Nothing Left to Lose	Foo Fighters	BMG	29.95	26.62	29.95	24.55	30.91
40	Heart and Soul	New Songs from Alilly McBeal	Epic/Sony	29.95	26.62	29.95	24.55	30.91
41	The Battle of Los Angeles	Rage Against the Machine	Epic/Sony	29.95	26.62	29.95	24.55	30.91
42	Willenium	Will Smith	Col/Sony	29.95	26.62	29.95	24.55	30.91
43	The Best of Me	Bryan Adams	Universal	33.95	30.18	29.95	24.55	30.91
44	Hooray for Boobies	Bloodhound Gang	Universal	33.95	30.18	29.95	24.55	30.91
45	Supernatural	Santana	BMG	29.95	26.62	29.95	24.55	30.91
46	Play	Moby	Mush/BMG	29.95	26.62	–	–	–
47	The General Electric	Shihad	Warner	29.95	26.62	29.95	24.55	30.91
48	Midnite Vultures	Beck	Universal	29.95	26.62	29.95	24.55	30.91
50	Rainbow	Mariah Carey	Col/Sony	29.95	26.62	29.95	24.55	30.91
			Average price		27.57			29.62

Source: NZIER CD Price Comparison