



AUSTRALIAN COMPETITION  
& CONSUMER COMMISSION

# ACCC guidelines

**To assist the Copyright Tribunal in the  
determination of copyright remuneration**

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Australian Competition and Consumer Commission  
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# Executive summary

The Australian Competition and Consumer Commission (ACCC) has developed these guidelines to assist in the determination of reasonable copyright remuneration in proceedings relating to voluntary licences<sup>1</sup> and licence schemes before the Copyright Tribunal of Australia (Copyright Tribunal). The guidelines may also assist collecting societies and copyright users when negotiating reasonable copyright remuneration by providing insight into the economic framework that the ACCC considers could reasonably be adopted, and the approaches that can be used in applying that framework. These guidelines do not seek to provide guidance on non-price terms of copyright licences.

## The ACCC's role in relation to copyright and the Copyright Guidelines

The ACCC is the independent Australian Government agency responsible for ensuring compliance with the relevant provisions of the *Competition and Consumer Act 2010* (the CCA). The ACCC also has a role in assisting the Copyright Tribunal in the performance of its functions under the *Copyright Act 1968* (the Copyright Act). Under s. 157A of the Copyright Act, in making a decision on a reference or application concerning a voluntary licence or licence scheme, the Copyright Tribunal is required to have regard to (among other relevant matters) any relevant guidelines made by the ACCC, if requested by a party to a proceeding. The Copyright Guidelines constitute the guidelines referred to in s. 157A of the Copyright Act. The Copyright Tribunal may also make the ACCC a party to such proceedings, if requested by the ACCC and the Copyright Tribunal is satisfied that it is appropriate to do so (s. 157B). In general, the ACCC will only seek to become a party to Copyright Tribunal proceedings where the ACCC considers it to be in the public interest.<sup>2</sup>

## Collective licensing

The collective management of copyright licensing arrangements by collecting societies can be an efficient way to overcome the high transaction costs of licensing copyright materials for certain uses. However, collective licensing also raises some potential competition issues.

In particular, collecting societies represent copyright owners who might otherwise be in competition with one another, enabling copyright owners to act collectively rather than individually. This raises concerns about the potential creation and exercise of market power, resulting in excessive licence fees or restrictive non-price terms and conditions.

The Copyright Tribunal is intended to act as a constraint on the exercise of market power by collecting societies, by making decisions with respect to the reasonable terms and conditions of copyright licences, including licence fees.

In some markets, collective licensing may be constrained by the availability of substitutes such as direct licensing. However, direct licensing with copyright owners is not always available or efficient. Pricing of copyright material determined by a tribunal can provide an alternative constraint on any market power of collecting societies. While such pricing is to a degree an artificial and imprecise exercise, the ACCC considers that the methodology proposed in these guidelines can provide a counterbalance to any market power of collecting societies in the provision of blanket licences.

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1 Voluntary licences may be distinguished from statutory licences such as those established under Parts III (ss. 47, 55, 59 and 70), IV (ss. 107, 108 and 109), IVA, VC, VD and VII of the Copyright Act.

2 ACCC, Commissioner Ed Willett, Copyright collecting societies, the Copyright Tribunal and the ACCC—a new dynamic (Presentation at the Copyright Society of Australia's conference The Copyright Tribunal's new jurisdiction, 24 May 2007).

## Direct licensing

The ACCC considers that direct licensing between copyright owners and licensees may operate as a competitive alternative and constraint on collective licensing in certain circumstances, in particular, where a user has predictable usage requirements and can identify and negotiate with the copyright owners before the copyright material is required for use.

The ACCC notes that some collecting societies obtain exclusive licences or assignments from copyright owners, partly so the collecting societies can more readily bring enforcement action. As a result of these exclusive licences or assignments, the scope for direct licensing can be precluded or limited (e.g. to contractually created 'opt out' and 'license back' regimes). However, the ACCC notes that there are still avenues for collecting societies to facilitate and improve direct licensing, which is discussed in section 3.2 of these guidelines.

The ACCC considers that, as practices and technology to track usage evolve, it is likely that direct licensing between users and copyright owners will become more prevalent. This may raise the issue of whether and how blanket licences should be adjusted (discounted) to account for any direct licensing.<sup>3</sup> That said, the ACCC recognises that there is limited experience with these issues in Australia.

## Tribunal-determined pricing of copyright material

Determining an appropriate methodology for pricing of copyright material determined by a tribunal is particularly difficult, as copyright material varies greatly in type, volume, and utility, and with many of these factors difficult to quantify. Where the initial costs of creating the original work are hard to track and verify, cost-based pricing methodologies can be infeasible.

Granting copyright (a means of exclusion) means prices above marginal cost are possible, as it removes the ability of users to freely copy material. However, once a work is created, charging above marginal cost is inefficient in the sense that some users that value the work will not use the work.

As a result of these characteristics, determining licence fees using cost-based approaches (such as simple marginal cost pricing or detailed examination of initial costs of production) is problematic. As such, these guidelines do not suggest the use of either of these approaches. Rather, these guidelines have primarily been drafted in response to pricing methodology issues that have previously been in contention before the Copyright Tribunal and offer practical and flexible approaches by which to determine reasonable charges for the use of copyright works.

## Constructing a hypothetical bargain

The focus of the pricing principles set out in these guidelines is on constructing a hypothetical bargain between a licensor and licensee with equal bargaining power. This approach broadly reflects the approach taken by parties before the Copyright Tribunal in a number of cases. This approach involves the following key steps:

1. Estimate the willingness to pay (WTP) of the licensee or end user.
2. Estimate the willingness to supply (WTS) of the licensor.
3. Calculate the value created by the bargain (WTP-WTS) and dividing it between the licensor(s) and licensee to reach a price.<sup>4</sup>

The ACCC considers that this hypothetical bargain approach is a practical means of determining a price that is reasonably reflective of an equal bargaining position having regard to the current regulatory environment and established practices of the Copyright Tribunal and parties to its proceedings.

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<sup>3</sup> If blanket licence fees do not decrease when direct licensing of works in the repertoire occurs, this would reduce the incentive to licence directly.

<sup>4</sup> In the case of multiple licensors, the apportionment of the value between the different licensors may depend on whether they are considered to be 'joint sellers' of rights or 'complementary sellers' of complementary rights.

Given the impracticality of cost-based approaches to determining reasonable remuneration and constraining market power, the ACCC considers that the hypothetical bargain approach is a pragmatic and practical means of determining prices for copyright materials. It results in prices that are reasonably reflective of those that might arise if the parties to the hypothetical bargain had equal bargaining power and thus would share equally in the value created by their dealings with one another.

There may be situations where it is too costly or difficult for the Copyright Tribunal to determine the WTP of the licensee or end user by use of the survey techniques that are discussed in section 6. For example, it may be too costly or difficult to locate or survey the licensees or end users, or the number of licensees or end users may be so small that statistical analysis of choice experiments is problematic and other survey methods are not suitable due to the potential for strategic responses.

Where it is difficult to use surveys to estimate WTP, it may still be possible to identify or to obtain directional insights using what information is available. For instance, the available information might only be sufficient to determine with confidence that WTP or WTS would be more or less than when it was last estimated. In such cases, judgment will likely be required to estimate the key inputs and final price for the hypothetical bargain approach, and the approach is more likely to require supplementation with other approaches.

## Survey evidence and other supporting information

There can be significant issues in applying this economic framework to guide the negotiation or determination of copyright remuneration. As such, these guidelines also seek to clarify implementation and informational issues that could potentially arise in applying this economic framework.

The ACCC recognises that the major issues raised at the Copyright Tribunal have involved the different licence schemes operated by collecting societies holding the various rights in music. In many of these cases, the question of reasonable remuneration has commenced from an analysis of survey data that seeks to estimate users' willingness to pay for copyright material. The design of the survey and recognition of the strengths and weaknesses of particular methodologies is important to the utility of the survey information. In this respect, these guidelines set out a number of considerations when considering survey design and survey evidence.

## Benchmarking

The ACCC notes that the hypothetical bargain approach may not always be practical as it may be too costly or difficult in some circumstances. Benchmarking is an alternative that can be used and this involves the use of appropriate existing rates as a source of information for determining reasonable remuneration. Appropriate benchmarks may include:

1. the existing rate for the licensing of the material
2. rates or tariffs paid for the use of the same copyright material in different uses
3. rates or tariffs paid for the use of similar copyright material in other jurisdictions, and/or
4. rates of tariffs paid in comparable, more competitive markets.

# 1. Introduction

The ACCC's role under the Copyright Act arose out of a review of Australia's intellectual property legislation and the subsequent report in 2000 (the Ergas Report).<sup>5</sup> The review considered the effects of Australia's intellectual property laws on competition and the appropriate balance between competition policy and intellectual property legislation.

In 2001, the then Commonwealth Government provided its response to the Ergas Report. As part of the Government's response, provision was made for the ACCC to issue guidelines for use by the Copyright Tribunal. The Copyright Act requires the Copyright Tribunal, if asked to do so by a party to a proceeding concerning certain (voluntary) licence schemes, to have regard to any relevant guidelines issued by the ACCC.<sup>6</sup> It is within this context that the ACCC has released these guidelines, which constitute the guidelines referred to in s. 157A of the Copyright Act.

The Copyright Tribunal was established to deal with cases where a monopoly or quasimonopoly exists by reason of the role of a collecting society or equivalent licensing body.<sup>7</sup> Generally, the Copyright Tribunal has jurisdiction with respect to:

- statutory licences—which are created by the Copyright Act when specified conditions are satisfied<sup>8</sup>
- voluntary licences—which are the result of negotiation between a copyright owner or its representative and a licensee. In Australia, commonly owners of copyright assign their rights to collecting societies that establish licence schemes for particular industries or classes of users under which they offer 'blanket' protection with standard fees and conditions.

In relation to voluntary licences, the Copyright Act provides for proposed and existing licence schemes<sup>9</sup> to be referred to the Copyright Tribunal by a licensor, a potential licensee or their respective representatives.<sup>10</sup> The Copyright Tribunal can confirm or vary a licence scheme or proposed licence scheme. It may also substitute a new scheme for the one referred to it. When the Copyright Tribunal makes an order confirming a licence scheme, it establishes a scheme of general application, binding all others who use the copyright material to which the scheme relates.<sup>11</sup>

Where a licence scheme applies, applications may be made by persons for refusal or failure to grant a licence under the scheme, or on the basis that the charges or conditions are unreasonable in their particular case.<sup>12</sup> Where a licence scheme does not apply, application may be made by persons who require a licence where there has been a failure to agree on the grant of a licence.<sup>13</sup>

The Copyright Tribunal has the power to make orders regarding the charges and conditions to apply under a licence scheme, or, depending on the circumstances in which the application is made, those charges and conditions that the Copyright Tribunal considers "reasonable in the circumstances" in relation to the granting of a particular licence.<sup>14</sup> The Copyright Tribunal has interpreted this standard

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5 Intellectual Property and Competition Review Committee (IPCRC), *Review of intellectual property legislation under the Competition Principles Agreement*, IPCRC, ACT, September 2000 (the Ergas Report).

6 *Copyright Act 1968* (Cth), s. 157A.

7 *Australasian Performing Right Association Ltd and Australasian Mechanical Copyright Owners Society Ltd* [2009] ACopyT 2, [30].

8 This includes the statutory licences established under Parts III (ss. 47, 55, 59 and 70), IV (ss. 107, 108 and 109), IVA, VC, VD and VII of the Copyright Act.

9 Copyright Act, s. 136: 'licence scheme' means a scheme (including anything in the nature of a scheme, whether called a scheme or tariff or called by any other name) formulated by a licensor or licensors and setting out the classes of cases in which the licensor or each of the licensors is willing, or the persons on whose behalf the licensor or each of the licensors acts are willing, to grant licences and the charges (if any) subject to payment of which, and the conditions subject to which, licences would be granted in those classes of cases. A 'licence' in this context is defined in s. 136 to mean a licence granted by or on behalf of the owner or prospective owner of the copyright in a work or other subject matter to do an act comprised in the copyright.

10 Copyright Act, ss. 154-156.

11 *Phonographic Performance Co of Australia Ltd under s. 154(1) of the Copyright Act 1968* [2010] ACopyT 1, [7].

12 Copyright Act, ss. 157(1) and (2).

13 Copyright Act, s. 157(3).

14 See Copyright Tribunal webpage for further details, <http://www.copyrighttribunal.gov.au/about>.

as requiring, in relation to price terms or pricing formulae, that the remuneration be ‘reasonable or equitable’.<sup>15</sup>

The Copyright Tribunal can admit the ACCC as a party to proceedings concerning licence schemes if the ACCC applies and the Copyright Tribunal is satisfied that it is appropriate.<sup>16</sup>

## 1.1 Scope and purpose of the Copyright Guidelines

These guidelines have been drafted in the context of the current system of collective licensing and the operation of the Copyright Tribunal, as set out in the Copyright Act. These guidelines and the views of the ACCC within these guidelines are reflective of these parameters.

The intended scope of the Copyright Guidelines referred to in s. 157A of the Copyright Act can be ascertained from the Government response to the Ergas Report—namely that the guidelines should relate to matters the ACCC considers to be relevant to the determination of reasonable remuneration and other conditions of licences that are subject to determination by the Copyright Tribunal.<sup>17</sup>

The purpose of the Copyright Guidelines can also be ascertained from the Government response to the Ergas Report:

*...the main purpose of the guidelines would be to facilitate licence negotiations and minimise resort to the Tribunal for a determination. In the event that negotiations failed and one or other party applied to the Tribunal, recourse to the Tribunal would not be restricted in any way. The nature of the ACCC’s guidelines would be advisory, not determinative.<sup>18</sup>*

The ACCC considers that the Copyright Guidelines should focus on providing a framework that focuses on countering any market power held by collecting societies and providing material to assist parties preparing economic evidence to support their claims. Indirectly, they can also facilitate licence negotiations and thereby reduce the number or scope of matters requiring determination by the Copyright Tribunal, as well as assist the Copyright Tribunal in matters that are brought before it. These guidelines apply to the determination of charges; they do not seek to provide guidance on non-price terms of copyright licences.

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<sup>15</sup> See *Performance Company of Australia Limited under s. 154(1) of the Copyright Act 1968* (Cth) (CT 1 of 2012) ([2016] ACopy T 3), [14] and [35].

<sup>16</sup> Copyright Act, s. 157B. The ACCC has been a party to two proceedings before the Copyright Tribunal: *Phonographic Performance Co of Australia Ltd under s. 154(1) of the Copyright Act 1968* [2010] ACopyT 1; and *Australasian Performing Right Association Ltd and Australasian Mechanical Copyright Owners Society Ltd* [2009] ACopyT 2.

<sup>17</sup> Australian Government, Information Package: Government response to the Advisory Council on Intellectual Property Recommendations (Part 1), Attorney-General’s Department, ACT, August 2001, section 9—Collecting societies.<http://arts.gov.au/resources-publications/publications/government-response-advisory-council-intellectual-property-rec-0>.

<sup>18</sup> Ibid.



# Part A: The economics of copyright and copyright licensing

## 2. The economics of copyright

These guidelines:

- explore the economic rationale for copyright and for collecting societies, and some associated competition concerns
- explain what the ACCC considers to be the appropriate economic approaches to determining matters relevant to copyright remuneration within the context of the matters that have been considered by the Copyright Tribunal to date.

### 2.1 Copyright material as public goods

Open competitive markets are generally the best way to ensure that the resources of an economy are put to their most efficient use so as to maximise society's welfare. However, markets may fail to promote efficiency and welfare in some circumstances, including in the provision of so-called 'public goods'. Public goods are products (goods and services) that are both non-excludable and non-rivalrous in consumption. If a product is non-excludable, once the product has been made available, users who have not paid for it cannot easily be prevented from accessing or using it. Difficulty in excluding non-payers means that users of the material are able to benefit whether or not they make any contribution to covering the costs of production of the material.

Non-rivalry in consumption means that one person's consumption of a good does not reduce the consumption of the good available to others; hence, the opportunity cost (i.e. the alternative option foregone) of that consumption is zero. Individual physical assets that embody information (such as a music CD) may be partly rivalrous in consumption, as one person listening to it may prevent another person from listening to that particular physical CD. However, the consumption of the music that is embodied on the CD is not rivalrous. If one consumer has a copy of the music, it does not prevent other consumers from separately listening to the music.

An unregulated market is unlikely to produce the socially optimal amount of a public good because the non-exclusionary nature of the good means consumers would be unwilling to pay for a good that they can otherwise obtain for free. Thus, once copyright material is created, the price paid by users for consuming the material would be close to zero. This would result in efficient use of existing works, however it would reduce financial incentives for the creation of new works. This would not be a desirable outcome. Where the price paid for copyright works is, or is close to zero, there is likely to be insufficient incentive for investment in production of creative materials, as creators or producers would not expect to receive an adequate return on those investments, even though such investment could be valued by society.

Copyright can go some way to addressing the market failure that arises from the public good characteristics of copyright material by conferring a bundle of exclusive economic rights with respect to the copyright materials, including the right to copy, publish, communicate and publicly perform the copyright material. The grant of these rights to producers of creative material enables them to exclude potential users from consuming a copy of the creative material for the duration of the copyright term. A right to exclude certain users enhances creators' ability to receive remuneration for their creative efforts. This potential for remuneration enhances the incentives for production of such material for many producers.

### 2.1.1 Copyright and incentives

Correction of one type of market failure can sometimes create another, and trade-offs may be needed between the benefits and costs of the remedy. In relation to copyright materials, social welfare is maximised by unrestricted access to the material once created. However, as noted, such unrestricted access results in insufficient financial incentives for creation. As a result, the copyright system involves finding the right balance between the benefits of enhancing incentives for creation of copyright material with the cost of restricting access to that material.

Copyright limits the degree to which new works can copy or resemble existing works. There are also variations in consumer preferences for works. As a result, copyright materials tend to be differentiated products. When products are differentiated, the owner of a particular product can raise prices without losing all of their demand, because they will be able to keep those purchasers who place the highest value on the particular work that they offer. This provides each producer with a degree of power over price—a degree of market power.

Still, the mere grant of these exclusive rights rarely raises competition concerns under the CCA. While for some individual works there are few alternatives for some consumers, for most works, substitutes are readily available. Additionally, barriers to entry in the production of copyright material are generally low enough that new competing materials are able to be created.

The ACCC does, however, note that, while the grant of copyright to individual copyright owners/creators is unlikely to raise competition concerns, the practice of collective licensing may raise concerns under the CCA, including potential issues under s. 45 (cartel conduct) or s. 47 (exclusive dealing) of the CCA. Generally, concerns arise due to the market power collecting societies gain through their position as the controller of copyright material on behalf of all (or the vast majority of) copyright owners, and the diminution of competition between copyright owners. The issue of collecting societies' market power is considered further below.

### 2.1.2 Transaction costs and licensing

There are transaction costs associated with licensing and enforcing copyright. For copyright owners, transaction costs include the costs of administering copyright, such as the costs of negotiating licences, monitoring compliance and taking infringement action, if necessary. Users also incur transaction costs in locating copyright owners, negotiating licences and ensuring compliance with copyright laws.

High transaction costs can cause market failure if they deter otherwise beneficial transactions. Transaction costs can be disproportionate to the value of the transaction where copyright materials have a relatively small value to many users. For example, the relatively high transaction costs a cafe would incur in seeking out the copyright owners of all of the songs played to the public in the cafe. In those circumstances, it is possible for transaction costs to exceed the value of entering into a licensing arrangement so that licensing will not take place even though it is socially beneficial to do so.<sup>19</sup> A number of features of copyright contribute to potentially high transaction costs by making it more costly for potential licensees to identify, contact and negotiate individual terms of use with the rights holders, including:

- the large volume of copyright material being produced
- the large volume of copyright material that has already been produced
- the large number of potential creators of copyright material
- the potentially large numbers of users of copyright material who may be difficult to identify and whose particular demand for copyright material may not be well known (for example, a cafe playing the radio)
- that there is no requirement for copyright material to be registered.

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<sup>19</sup> WJ Gordon, Fair use as market failure: A structural and economic analysis of the 'Betamax' case and its predecessors, (1982) 30 *Journal of Copyright Society of the USA* 253.

## 3. Collective licensing

The collective management of licensing arrangements by copyright collecting societies is proffered as a solution to the potential market failure arising from high licensing transaction costs. While the existence of collecting societies may create efficiencies by providing a single point of access to copyright material and reduce various transaction costs, collecting societies can also have considerable market power. As a result, concerns may arise where collecting societies are able to exercise this market power. This issue is further discussed in section 4 of these guidelines.

The ACCC considers that, while collective licensing plays a valuable role in efficient copyright licensing, the direct licensing of copyright material from the copyright owner (discussed below) can provide a degree of competitive constraint on collecting societies. To the extent that direct licensing, or the potential for direct licensing, can provide a competitive constraint, this may ameliorate the potential issues arising from collecting societies' market power. Care should therefore be taken to ensure that current and future licensing practices do not dampen incentives for direct licensing.

### 3.1 Reduction of transaction costs

The collective administration of copyright through a collecting society is one way to reduce high transaction costs and improve the effectiveness of copyright regimes. Copyright collecting societies act on behalf of certain copyright owners to facilitate the administration of copyright licences. Such organisations grant licences for the use of copyright material, collect royalties from users of copyright material and distribute revenue to owners of copyright.

By providing a single point of access to the rights to use certain copyright material, collective licensing can potentially deliver substantial benefits through transaction cost savings to copyright owners and potential users. This can be particularly desirable where entering into direct licences would either be prohibitively expensive or impossible in practice. For example, individually licensing each song that is played on a radio in a gymnasium, restaurant or cafe would be costly and practically impossible for most businesses.

Collecting societies typically offer blanket licences, which permit use of the collecting society's entire repertoire. Blanket licences can reduce transaction costs by allowing licensees to obtain a single licence covering all copyright material they need to access. This can be particularly valuable for those users who do not know in advance which copyright material they will use and have little control over this usage, such as a cafe which plays music over the radio.

However, blanket licences can, in some circumstances be inefficient; for example, if a potential licensee with predictable usage requirements only wishes to use certain material covered by the blanket licence. In such circumstances, it may be more efficient for potential licensees to negotiate directly with copyright owners.

#### 3.1.1 Loss of competition

Although collective licensing is a solution to potential market failure arising from high transaction costs, its benefits must be balanced against the costs associated with the creation and potential exercise of market power. Specifically, collective licensing often brings together copyright owners and works that would otherwise compete against one another. By enabling competitors to act collectively, licence fees will potentially be higher, and other licensing terms and conditions more restrictive, than would be the case if competition between copyright owners was retained.

The extent of cost efficiencies and network effects associated with collective licensing is such that it is usually most efficient for a single collecting society to administer a particular collective licensing scheme. This reduces the prospect of competition between collecting societies constraining blanket licence fees. Network effects arise when a product becomes more valuable as the number of customers consuming it increases, thus providing an advantage to firms that have an existing customer base over rivals and prospective entrants that do not. For example, users of copyright material such as music will

be more likely to use the collecting society that has the greatest repertoire of copyright material they desire. Similarly, creators and owners of musical works will be drawn to licensing their copyright material to the collecting society with the greatest number of users.

## 3.2 Direct licensing

Direct licensing allows a user to license or acquire the rights to specific copyright material for a particular use from the owner of the specific copyright materials. Digital technologies have the potential to reduce the transaction costs of administering copyright and give copyright owners increased technical control over access to and use of copyright material which may, in certain circumstances, provide an alternative to collective administration. For users, digital technologies may lower search costs by providing a means to easily locate relevant copyright material and identify the copyright owner.

As technology continues to develop in the future, the ACCC considers this may lead to more efficient methods of licensing and may provide greater ease and efficiency in direct licensing. In addition, developments in the management of copyright material may provide copyright owners with a means to directly engage in the pricing of their material for certain groups of licensees.

Direct licensing typically occurs before the copyright material is used. In most instances, this means that potential licensees can choose between a number of competing, substitutable copyright materials. Therefore, the price of a direct licence will typically be constrained by competition among copyright owners.

As a broad principle, the ACCC considers that collective licensing of copyright material via blanket licences should not impede efficient direct licensing. The ACCC considers that competitive market solutions are preferable in general and should be encouraged where possible. If licensees have the option of negotiating a licence directly with the copyright owner, it is likely to place some competitive constraint on collecting societies in setting blanket licence terms and conditions.

### 3.2.1 Direct licensing as a competitive constraint on collective licensing

In the current copyright regulatory framework, the ACCC notes that the competitive constraint offered by direct licensing on the prices and terms set by collecting societies in relation to blanket licences is likely to be limited by:

- existing collective licensing arrangements (which may prevent or limit direct licensing)
- the absence of effective mechanisms for reducing blanket licence fees to take account of any direct dealing.

The feasibility of direct licensing as an alternative to, and competitive constraint on, collective licensing will also likely depend on the usage requirements of users. In this regard, the ACCC notes that there are three broad categories of licensees:

1. Licensees with predictable rights usage requirements who, if direct licensing is available and can be accessed efficiently, would only use direct licensing and not acquire a blanket licence. For example, a party has chosen in advance a particular set of copyright materials, such as all music by a certain artist. The party thus only requires a licence to use those materials. In some circumstances, direct licensing of specific material may be cheaper than a blanket licence. However, this would depend on pricing of the direct licence and the volume and use of material, as compared with the blanket licence fee.
2. Licensees with semi-predictable rights usage requirements who may use direct licensing in certain circumstances but may also need to acquire a blanket licence for the remainder of their usage needs. E.g. a party who could identify a need for the use of only a particular set of copyright materials and also the need for a blanket licence to cover all materials in a repertoire managed by a collecting society.
3. Users who have unpredictable usage requirements and are unlikely to utilise a direct licensing mechanism, even if it is available, e.g. those who are likely to only find a blanket licence useful.

Where direct licensing arrangements are available they are a particular constraint on collecting societies in relation to the prices and terms of their licences offered to the first category of users, as the direct licence will be a close substitute for a blanket licence (provided there is a sufficiently large number of users within this category). However, direct licensing in relation to the second category of users would only be a direct competitive constraint on the prices and terms of licences set by collecting societies if the price paid by a user for a blanket licence was reduced to take account of any copyright material that the user accessed through direct licensing. On the other hand, direct licensing would generally not act as a significant constraint on the price and terms of licences set by collecting societies in relation to the third category of users except in limited circumstances.<sup>20</sup>

The ACCC considers that where direct licensing is used and a blanket licence is still required for the remainder of the licensee's usage, that users' blanket licence fees should be reduced. This is further discussed in section 3.2.2.

Any competitive constraint provided by direct licensing will only exist where the collective licensing arrangements do not deter direct dealings between copyright owners and users of the copyright material. The ACCC considers that collective licensing arrangements should not limit the ability of parties to conduct direct licensing negotiations. For example, where collecting societies have exclusive licences, appropriate opt-out or license back arrangements can provide the desired flexibility.

### 3.2.2 Adjusting blanket licence fees

Even if appropriate opt-out or license back arrangements are in place, incentives to undertake direct licensing may be dampened if there is not an effective mechanism for adjusting a blanket licence fee to take into account the value of copyright material that is licensed directly. If such a mechanism is absent, users who engage in direct licensing, yet also need to obtain a blanket licence for the remainder of their usage requirements, may effectively be paying twice for the use of some material.

In order to ensure that direct licensing is promoted where it is efficient and feasible, the ACCC considers that blanket licence fees should be reduced to reflect the licensee's lower willingness to pay for the remaining repertoire that excludes the works that have been directly licensed.<sup>21</sup> That said, the ACCC acknowledges that given the current practices of, and technology used by, collecting societies, users and owners of copyright material, there is no universal methodology by which one can determine how much a blanket licence fee should be reduced if direct licensing occurs. The ACCC notes that this may be resolved as practices and technology advance, and direct licensing becomes more feasible.

The ACCC notes that the US courts have some experience in determining what is known in that jurisdiction as an Adjustable-Fee Blanket Licence (AFBL). This is a blanket licence with 'carve-outs' for works directly licensed from copyright owners. The US experience provides some guidance as to how an AFBL could be constructed.

In particular, the AFBL usually consists of three elements:

1. A blanket licence fee that would be paid by the licensee if all of the licensee's requirements are obtained from the collecting society—i.e. there is no direct licensing. The blanket licence fee is the *maximum* value of an AFBL.
2. A floor fee that reflects the value of the services provided by the collecting society in collating and maintaining its repertoire. The floor fee may also contain the incremental costs that the collecting society incurs in administering an AFBL. The floor fee is the *minimum* value of an AFBL.
3. A direct licence ratio that is used to adjust the blanket licence fee to account for the value of a licensee's direct licences with copyright owners.

The difference between elements one and two above is a measure of the value of the rights covered by the blanket licence fee. It is this figure that the direct licence ratio is applied to.

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<sup>20</sup> Direct licensing may indirectly constrain the blanket licence fee for all users. This could occur if enough users who can make use of direct licences constrain the blanket licence fee, and that blanket licence fee is offered to all users.

<sup>21</sup> In order for this to be implemented, it would be necessary to ensure that an adjustment is done on terms that are 'at arm's length' or only between unrelated parties. Otherwise, a user could negotiate a very high price for a direct licence with a friend or related party. This could have the effect of greatly reducing the blanket licence fee.

The AFBL fee can then be derived as:

*AFBL = Blanket fee—[(blanket licence fee - floor fee) x direct licence ratio].*

A reasonable AFBL fee should:

- seek to reflect what a licensee would expect to pay in a competitive market or bargaining process between a willing buyer and willing seller
- not deter direct licensing by ‘double charging’ direct licensees for rights they have already paid for.

A collecting society’s administrative and overhead costs are likely to be the starting point for estimating a floor fee. However, care must be taken to ensure that these costs are not excessive due to a lack of competitive pressure. It may be difficult to determine the incremental costs that a collecting society would incur in establishing and administering an AFBL until there is more experience with such licensing. However, experience in jurisdictions such as the US may provide some guidance as to the likely magnitude of incremental costs.

The inputs into the calculation of a direct licence ratio will vary from case to case. However, as a general principle, the ratio should be variable rather than fixed to allow the AFBL to vary according to changes in a licensee’s direct licensing arrangements.

An AFBL fee will likely vary across licence schemes and licensees reflecting differences in:

- the value of repertoire that individual licensees have licensed directly with copyright owners
- the licensees’ willingness to pay for a blanket licence.

## 3.3 Collecting societies and market power

### 3.3.1 Market power and pricing

These guidelines proceed from the perspective that a collecting society offering a blanket licence may have market power. The determination of reasonable remuneration should take into account the potential for proposed collective licensing schemes to reflect the exercise of a collecting society’s market power.

In this regard, the Copyright Tribunal was formed with a view to countering market power in respect of the collective exercise of rights conferred by the Copyright Act:

*In Australia the Copyright Tribunal was established by s. 138 of the Copyright Act in response to the perceived need to control the exercise by collecting societies or other organisations of the rights given to them by copyright owners in respect of the public performance and broadcast of their musical works and sound recordings.<sup>22</sup>*

In making determinations about the reasonableness of proposed collective licensing schemes, the Copyright Tribunal can act as an important constraint on the exercise of a collecting society’s market power.

In previous decisions, the Copyright Tribunal has sought to constrain market power by determining reasonable remuneration based on an existing market rate or on the basis of a hypothetical bargain. The latter approach seeks an outcome that balances the bargaining power of the negotiating parties. Both approaches can be pragmatic potential solutions to determining reasonable remuneration in the absence of feasible cost-based approaches. These concepts are further discussed in sections 5 and 6 respectively.

Similarly, the approaches to determining remuneration set out in Part B of these guidelines are primarily designed to counter the market power of collecting societies and lead to pricing outcomes that are closer to those that would have prevailed had competition existed between copyright owners.

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<sup>22</sup> Copyright Law Review Committee (CLRC), *Jurisdiction and Procedures of the Copyright Tribunal*, CLRC, 2000, p. 14.

In particular, these approaches seek to preserve competition between individual copyright owners where this is feasible, and place a constraint on a collecting society's market power where competition is not feasible.

# Part B: Pricing Principles

## 4. Pricing to constrain market power

### 4.1 Focus of the pricing principles—countering market power

The ACCC acknowledges that it is difficult to determine economically efficient remuneration for copyright material. While the ability to exclude and, therefore, charge a price for the use of copyright material is widely accepted to induce greater investment in the production of copyright material, there is much less rigorous evidence on how sensitive the production and subsequent use of copyright materials is to different price levels. Charging even a small positive price will deter some efficient usage and, therefore, will always be an efficiency trade-off between the creation and usage of copyright material.

Price determination for copyright material can affect social welfare (the value or utility that society derives from goods or services) in a number of ways:

- by affecting the amount of use of copyright materials—for example, the number of movies purchased for private use
- by influencing incentives to invest in the production of copyright materials
- by affecting the incentives to make investments to subsequently use copyright works. Investments can include:
  - from investing in new equipment (e.g. a Blu-ray player) to play movies, developing an innovative use for recorded music in delivering entertainment/nightclubs/gymnasium classes
  - developing entirely new applications, such as applications that can assist consumers identify and/or provide information concerning a copyright work, such as how it can be accessed, or
  - developing innovative online digital sales platforms for the retail supply of copyright works.

Attention is often focused on the second of the three items above, partly because the purpose of copyright is to permit excludability, leading to the potential to charge a price for the use of copyright material. However, pricing of the use of copyright material not only affects incentives for the production of copyright material, it also affects the use of those works. Price levels and price paths can also affect the incentive for users to make investments reliant on the use of copyright materials. These other price effects, in turn, also affect social welfare.

It is difficult to directly or analytically quantify these effects. Pricing to directly target some optimal level of production and use of creative material appears impossible. There are difficulties in determining optimal levels of production and subsequent use, and the relationship between price levels and these factors is complex. Instead of directly targeting optimal levels of production and use of copyright materials, the primary focus of these pricing guidelines is on countering market power associated with collective licensing.



## 4.2 Pricing methods

### 4.2.1 The ACCC's recommended approaches

The ACCC notes that the Copyright Tribunal has considered a range of approaches in making pricing determinations, including benchmarking, construction of a hypothetical bargain and judicial estimation (which takes into account a range of factors).<sup>23</sup>

Of these broad approaches, the ACCC recommends the following methods as appropriate for pricing copyright materials, if feasible in the circumstances of the particular case:

- benchmarking—using appropriate rates (which should preferably, as far as possible, be grounded in a more competitive market) as a source of information for determining remuneration
- construction—constructing a hypothetical bargain between a willing, but not anxious, licensor and willing, but not anxious, licensee by applying an economic model to construct an appropriate licence fee level.

Where possible, both approaches should be used as a cross-check against one another. If there are substantial differences between prices determined using the two approaches, then further investigation may be required.

These methods are discussed in sections 5 and 6. Each of these approaches has been developed from the point of view of explicitly countering any market power possessed by the collecting societies.

Where it is difficult to use surveys to estimate WTP, it may still be possible to identify a reasonable range or to obtain directional insights using what information is available. For instance, the available information might only be sufficient to determine with confidence that WTP or WTS would be more or less than when it was last estimated. In such cases, judgment will likely be required to estimate the key inputs and final price for the hypothetical bargain approach, and the approach is more likely to require supplementation with other approaches. In circumstances where construction is problematic, regard may still be had to the overall principles set out in this guidance.

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<sup>23</sup> *Phonographic Performance Company of Australia Limited under s. 154(4) of the Copyright Act 1968 (Cth)* [2007] ACopyT 1, [11]; *Phonographic Performance Co of Australia Ltd under s. 154(1) of the Copyright Act 1968* [2010] ACopyT 1, [114]; *Australasian Performing Right Association Ltd and Australasian Mechanical Copyright Owners Society Ltd* [2009] ACopyT 2, [35].

# 5. Benchmarking

The benchmarking approach uses appropriate existing rates as a source of information for determining reasonable remuneration. In accordance with the objective of addressing market power, the benchmarking approach is about finding price indications that are more reflective of competition than may be the case for blanket licences.

Consistency with appropriate benchmarks can give greater confidence that a proposed licence scheme is reasonable. Conversely, if the appropriate benchmark(s) differ substantially to the remuneration that is provided for in a licence scheme then its reasonableness may be open to question.

## 5.1 Appropriate benchmarks

Appropriate benchmarks may include:

- the existing rate for the licensing of the material. This could be a rate determined by previous negotiations or by previous determinations
- rates or tariffs paid for the use of the same copyright material in different uses
- rates or tariffs paid for the use of similar copyright material in other jurisdictions, and/or
- rates or tariffs paid in comparable, more competitive markets.

The Copyright Tribunal has utilised a ‘market rate’ benchmark and has also undertaken ‘comparison with other jurisdictions’ and ‘comparison with rates set by other licensors’.<sup>24</sup>

The Copyright Tribunal in the proceedings regarding the licence fee for nightclubs considered the market rate to be ‘the rate actually being charged for the same licence in the same market in similar circumstances’.<sup>25</sup> For clarity, these guidelines refer to this concept of ‘a rate actually being charged’ as the ‘existing rate’. This is because the term ‘market rate’ may have other implied meanings besides the rate actually being charged.<sup>26</sup>

## 5.2 Existing rate

Existing rates for the particular copyright material in question may be an appropriate benchmark for determining reasonable remuneration. However, existing rates will be less appropriate if they reflect the exercise of market power.<sup>27</sup> Market power may affect rates even if those rates are determined by arms-length negotiation between the collecting society and licensee(s).

One approach to considering the appropriateness of existing rates as a benchmark would be to consider the balance of bargaining power between the parties who negotiated the existing rates. If this is roughly equal, then the existing market rates determined by negotiation between the parties are less likely to reflect the exercise of market power by either party and may therefore be an appropriate benchmark. Generally speaking, if there is evidence that bargaining power is unequal, then existing market rates are more likely to reflect the exercise of market power by one of the negotiating parties and may not be an appropriate benchmark for assessing the reasonableness of proposed rates.

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<sup>24</sup> *Phonographic Performance Company of Australia Limited under s. 154(1) of the Copyright Act 1968* (Cth) [2007] ACopyT 1, [11].

<sup>25</sup> *Ibid.*

<sup>26</sup> For example, ‘market rate’ could be interpreted as meaning only a rate set in a market, rather than a rate set via regulatory or judicial determination. By contrast, the term ‘existing rate’ encompasses either a rate arrived at in a market (i.e. by negotiation), or a rate resulting from a determination, either of which may inform a fresh determination.

<sup>27</sup> *Audio-Visual Copyright Society Ltd v Foxtel Management Pty Ltd (No 4)* [2006] ACopyT 2, [131].

The following factors could also be relevant when considering the use of existing rates as an appropriate benchmark for determining reasonable remuneration:

- Changes in demand and/or supply conditions since the previous rates were determined. If demand and/or supply conditions have changed, then information about those changes should be combined with the knowledge of the existing rate to make a new estimate.
- On the supply side, consideration should be given to changes in the composition of the collecting society's repertoire, the composition and magnitude of the collecting society's administrative costs and the collecting society's arrangements with copyright owners.
- On the demand side, consideration should be given to factors which may have altered the value of the copyright material to users, including changes in the availability of substitutes for the copyright material licensed by the collecting society, the ability of licensees to obtain licences direct from copyright owners, and the way that the copyright material is used by licensees.

## 5.3 Rates for same material in different uses

In some instances, it may be possible to identify an appropriate benchmark where the same copyright material has been used for a different purpose or supplied to a different type of end-user. For example, rates charged for individual use of protected material could be an appropriate benchmark for determining rates for public performance of the same material.

To illustrate, an appropriate benchmark in determining a reasonable blanket licence fee for performance rights for the broadcast of recorded music in a fitness class, could be the sum of individual licences that would otherwise be required to allow participants in the fitness class to listen individually to the performances. If each exercise class required 10 songs that are updated every three months, and can be purchased for individual use from a digital music retailer for \$1.50 per song, then total monthly song purchases per person would be \$5.<sup>28</sup> This means that the blanket licence fee should not exceed \$2.50 per person, assuming equal division of willingness to pay between the licensee and collecting society. The retail prices for individual downloadable songs are likely to be an appropriate benchmark as they are competitively constrained by alternative sources of recorded music for personal use and thus less likely to reflect the exercise of market power.

## 5.4 Rates in other jurisdictions

Licensing arrangements for comparable schemes in other jurisdictions may be an appropriate benchmark in some circumstances. However, some caution is recommended when using rates in other jurisdictions, as differences between the nature of the copyright material that is being licensed, its use and the way in which remuneration is determined will need to be taken into account. Further, consideration should also be given as to whether the rates were determined in a manner that permitted or reflected market power of the participants. The ACCC notes that there may be some difficulties in ascertaining this where there is insufficient availability of information or evidence from negotiations.

Some jurisdictions have multiple collecting societies for the same types of works. Rates determined for licensing of copyright material in comparable situations where there is competition between collecting societies could be an appropriate benchmark. However, in practice, there is seldom competition between different collecting societies in Australia and there appear to be very few examples of competition between collecting agencies in other jurisdictions. One example is the U.S. performing rights organisations American Society of Composers Authors and Publishers (ASCAP) and Broadcast Music Inc. (BMI). BMI, a smaller collective, was used as a benchmark for the fee that could be charged by ASCAP to licensees.

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<sup>28</sup> \$5 per month = 10 songs x \$1.5 per song ÷ 3 months. This example is adapted from paragraph 147 of the affidavit of Joshua Gans filed by the ACCC in *Re Phonographic Performance Company of Australia Limited under s. 154(1) of the Copyright Act 1968* (Cth), Australian Copyright Tribunal, CT1 of 2006.

# 6. Constructing a hypothetical bargain

## 6.1 Introduction

The hypothetical bargain approach refers to a hypothetical bargain between a willing, but not anxious, licensor and a willing, but not anxious, licensee.<sup>29</sup> This description is symmetrical and implies that neither party has particular power over the other. In this sense, it reduces the effect of any market power held by the collecting society. It does so by assuming symmetry in power between the parties.

The use of a construction approach such as this allows economic principles to be applied in determining a licence fee.

Using this method, determining the licence fee consists of two steps:

1. Calculate the economic surplus that is likely to be generated from the licensing transaction being negotiated compared with the outcomes that would arise should the licensing transaction not take place.
2. Division of this surplus between the negotiating parties by setting a price.

These steps are outlined here. An example calculation is in Appendix 1.

## 6.2 Step 1: Calculating the surplus

The surplus, or value, of a transaction is the difference between the buyer's willingness to pay (WTP) and the seller's willingness to sell (WTS).

WTP is the price at which a potential purchaser of a product is indifferent between purchasing the product and not purchasing the product. It depends, among other things, on the value of the next best alternative for the purchaser if they choose not to purchase the item (that is, what is the next best alternative foregone).

WTS is the price at which a potential supplier is indifferent between selling the product and not selling the product. It is the minimum price the supplier would accept and still choose to supply. The WTS depends on the alternatives available to the supplier if they choose not to supply the item. With regards to a creator of new copyright material, alternatives could include using the resources that go into the product to produce something else.

## 6.3 Willingness to pay

### 6.3.1 Methods for estimating WTP

This section provides a high-level overview of the key considerations relevant to estimating licensees' WTP for copyright material. The main economic tools for estimating WTP are revealed preference methods and stated preference methods.

#### Revealed preference methods

Revealed preference methods typically use information from existing markets for the product that show consumer preferences. The most direct revealed preference method of estimating WTP is the use of market prices for the product itself.<sup>30</sup> Market prices can be the floor price for estimating the WTP of users who actually purchase in the market.

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<sup>29</sup> *Phonographic Performance Co of Australia Ltd under s. 154(1) of the Copyright Act 1968* [2010] ACopyT 1, [114].

<sup>30</sup> Other revealed preference methods rely on prices in proxy markets, such as the travel cost method and hedonic pricing. They appear difficult or impossible to apply to copyright.

For example, if a user pays \$10 for a product, we can infer that the user's WTP for that product is at least \$10. Similarly, if the user does not purchase the product, we can infer that the user's WTP is less than \$10.

The ACCC recognises that revealed preference information will often be of limited utility in estimating the WTP for copyright material. In copyright contexts, the ACCC expects that stated preference methods will usually be required to obtain useful estimates of the distribution of WTP.

## Stated preference methods

Stated preference methods involve the use of a survey where respondents state their preferences in response to specific questions related to a hypothetical consumption trade-off. Stated preference methods seek to estimate the WTP of a sample of the population for a particular product or service. From these responses, it is possible to infer information about the distribution of WTP for the population as a whole.

Stated preference methods are generally preferred for estimating the WTP for copyright material. They have been used in several recent cases before the Copyright Tribunal.<sup>31</sup> The ACCC considers that the use of appropriate stated preference methods is a useful approach for estimating WTP for copyright material and thus a potentially useful input for the construction of a hypothetical bargain. However, the application of stated preference methods is complex, and care must be exercised to ensure that a particular application is suitable for determining remuneration by particular users for access to the repertoire of a particular collecting society.

Notably, all stated preference methods can be subject to bias: strategic bias, information bias and hypothetical bias.

- **Strategic bias** refers to the situation where respondents deliberately misrepresent their preferences or refuse to respond to survey questions for strategic reasons (i.e. if the respondent has an incentive to overstate/understate their true WTP). This is the most critical bias from the point of view of copyright price determination.
- **Information bias** is where the survey results are dependent on the information provided to respondents. The amount that respondents are willing to pay for the good being valued depends on the quantity and quality of the information provided to them, including the way questions are constructed.
- **Hypothetical bias** refers to the fact that respondents are not making real transactions and thus may misstate their WTP.

There are two main groups of stated preference methods likely to be useful for estimating WTP:

- contingent valuation
- choice experiments.

### **Contingent valuation**

The contingent valuation method is a survey-based approach that asks people directly what they are willing to pay for the product being valued. It uses sample surveys to elicit respondents' WTP for products in a hypothetical market.

If the contingent valuation approach is well designed and pre-tested, the respondents' answers could provide useful information about an individual's WTP. These can then be used to derive an estimate of WTP for the sample which can be used to infer information about WTP of the population from which the sample is drawn. Compared to other techniques, contingent valuation studies tend to be less complex and require simpler statistical methods, software and expertise.

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<sup>31</sup> See e.g. *Phonographic Performance Company of Australia Limited under s. 154(1) of the Copyright Act 1968* (Cth) [2007] ACopyT 1.

However, contingent valuation is a controversial method of estimating WTP. This is because the straightforward manner in which questions relating to WTP are asked makes contingent valuation prone to a number of biases. Appendix 2 provides further information on contingent valuation, including the design of contingent valuation surveys and examples of strategic bias that may arise.

### **Choice experiments**

Choice experiments are part of a broader category of approaches for estimating WTP known as choice modelling.<sup>32</sup> Choice modelling is based on the idea that a good can be defined in terms of its attributes. For example, the key attributes for a gymnasium class product might be the type of accompaniment to the instructor (music, beat machine, silence), price (\$), availability of kiosk on site (yes, no), distance to nearest public car park (km). Choice modelling focuses on the choices made when people are presented with alternatives that differ on key attributes. When individuals make their choice, they are implicitly making trade-offs between the levels of the attributes in the different alternatives presented.

Choice experiments are useful as often the copyright material is just one element of providing the ultimate value for consumers. For example, the copyright music component of a gym class is only one element of the value created by a gym class. The choice experiment approach can be used to estimate WTP for the individual attribute of the copyright music. Appendix 2 provides information on good choice experiment designs and further information on the advantages and disadvantages of choice experiments.

The ACCC considers that choice experiments have key advantages over contingent valuation. Choice experiments are less likely to be influenced by biases in the estimation of WTP. For example, choice experiments can reduce the scope for strategic bias as WTP is neither open-ended nor directly asked. As a result, choice experiments are more likely to accurately reflect WTP than contingent valuation.

### **Utility of survey data**

The utility of any survey data in negotiating or determining a licence fee will turn on its reliability, impartiality and responsiveness to the key factors that affect the WTP for the use of the works in question.

The ACCC notes the following comments from the Australian Competition Tribunal regarding the utility of survey evidence generally:

*Consideration must be given at least to the types of questions asked, the wording of those questions, the sample of respondents, the number of non-respondents and the timing of the survey. Problems in any of these can lead to the survey results being largely valueless or potentially inaccurate.*<sup>33</sup>

Further guidance on how to undertake surveys and present survey data for the purpose of a proceeding is provided in a Federal Court of Australia practice note.<sup>34</sup>

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32 Other choice modelling approaches (such as contingent ranking, paired comparisons, contingent (conjoint) rating) are generally less useful for direct estimation of WTP. Contingent ranking is a ranking of a set of options. Paired comparisons involve choosing the preferred option out of two choices, indicating the strength of the preference on a numeric or semantic scale. Contingent (conjoint) rating has a number of scenarios presented one at a time and rated on a numeric or semantic scale. These last two methods are particularly avoided for economic valuation due to the problematic assumptions required in the form of cardinality of rating scales or an implicit assumption that ratings across individuals can be compared: IJ Bateman, RT Carson, B Day, M Hanemann, N Hanleys, T Hett, M Jones-Lee, G Loomes, S Mourato, E Ozdemiroglu, D Pearce, R Sugden, and J Swanson, *Economic Valuation with Stated Preference Techniques—A manual* (2002).

33 *Envestra APT Allgas Energy Limited* [2012] ACompT3, [162].

34 See Federal Court of Australia, Survey Evidence Practice Note (GPN-SURV), <http://www.fedcourt.gov.au/law-and-practice/practice-documents/practice-notes/gpn-surv>.

## 6.3.2 Whose WTP is relevant?

### Licensee versus the licensee's customers

A licensee's WTP for the copyright material is the relevant WTP for the purpose of determining reasonable remuneration using a construction approach. Licensees' WTP will typically reflect the contribution of the licensed material to the licensees' profit compared with the next best alternative. However, due to difficulties in accurately measuring the WTP of licensees, in practice it may be necessary to estimate the WTP indirectly by not estimating the WTP of the licensee, but of the licensee's customers. This may be necessary because:

- licensees have a direct strategic incentive to understate their WTP if they know the purpose of a survey is to determine copyright prices (although this may be mitigated through the recommended use of choice experiments)
- there are only a small number of potential licensees, where survey evidence and its statistical interpretation generally relies on a larger number of respondents.

### WTP—marginal consumer versus average consumer

If it is necessary to estimate licensees' WTP indirectly by focusing on their customers' WTP for the copyright material, customers' WTP should be measured by reference to their next best alternative option to use of the copyright material. For example, a customers' WTP for the broadcast of recorded music in a fitness class may be measured by reference to their WTP for a fitness class with a basic beat as a backing track if this is the next best alternative.<sup>35</sup>

As discussed above, measuring the WTP of customers is often preferable to the WTP of licensees, given the inherent difficulties in accurately determining the WTP of licensees. However, if a licensee's customers differ in their WTP, an issue arises as to which customer's WTP is the best proxy for the licensee's WTP. The ACCC considers that it is preferable to use an estimate of the WTP of the marginal consumer (that is, the consumer with the lowest WTP) rather than the WTP of the average customer. This is because profit maximising businesses compete to attract marginal consumers, those who are just willing to pay the additional cost of supplying them. A licensing arrangement based on the average WTP of a business's customers would likely result in the business setting prices above the level that the marginal consumer would otherwise be willing to pay thus leading to deadweight loss and inefficiency. Identifying the marginal customers is unlikely to be practical, but the WTP of the bottom 5 per cent of customers from a survey sample may, as an example, provide a reasonable estimate.

The use of the WTP of the marginal consumer does not imply that price ends up equal to marginal cost. The division of the surplus means that price will exceed marginal cost. Prices above marginal cost contribute to the recovery of fixed costs and are part of the incentive for the creation of new works.

Box 2, in Appendix 1, provides a stylised example which demonstrates the difference between the prices set based on the use of the WTP of the marginal consumer and the prices set based on the WTP of the average consumer.

### Non-users of the copyright material

Where the copyright material in question forms a component of a broader service (such as music in a fitness class at a gym, where not all gym members might use the fitness class), there may be a question as to if or how to consider the WTP of people who do not use the product in question. It is possible that non-users may consider themselves to have a WTP above zero, for example, if they think there is a chance they will use the product later.

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<sup>35</sup> This example is adapted from paragraph 98 of the affidavit of Joshua Gans filed by the ACCC in *Re Phonographic Performance Company of Australia Limited under s. 154(1) of the Copyright Act 1968* (Cth), Australian Copyright Tribunal, CT1 of 2006.

The ACCC notes that there have been instances of non-user WTP being considered for inclusion in the overall WTP estimates.<sup>36</sup> However, the ACCC considers that the WTP of current non-users should generally be excluded from the determination of copyright fees. Any inclusion of non-user WTP estimates presents several difficulties, including:

- It can be conceptually difficult to work out what any non-user WTP represents. As a result, it is difficult to construct appropriate survey questions, and it is difficult to accurately weight the WTP estimate.
- Non-users are likely to be less familiar with the product, making it less likely that they have an accurate understanding of their own WTP for the product, with or without the incorporation of the copyright material. Errors in their comprehension can produce inaccurate estimates of their WTP.
- The pool of non-users is potentially very large, so even small errors in estimating their WTP can have large effects on prices.

In some cases it is possible that the option to use a product in the future may be of sufficient importance to warrant examining the option value to non-users of using the product in the future. It is also possible that there is a pool of people who are known for some reason to currently be excluded from using the product, but who would ordinarily be considered possible or probable users. However, determining the option value to non-users requires careful examination. It is not enough to simply claim its importance. To justify inclusion of a value for non-users would require specific investigation of the issue. This would generally mean the development of an alternative set of stated preference questions or studies. For the reasons given above, the results from such studies need to be treated with caution.

### 6.3.3 Substitution—the next best alternative

A key issue in determining WTP is to ensure that the next best alternative is correctly identified. This is because WTP for the copyright material will depend critically on its incremental value compared with the next best foregone alternative. Identification of this alternative will also help to determine which attributes should be included in a choice experiment.

## 6.4 Estimating WTS

The WTS concept relies on determining what the alternative to participating in the exchange is for the producer. For many products, the next best alternative for a seller is the price that can be received from selling to an alternative buyer. However, for copyright materials, selling to another buyer does not stop the copyright owner from selling to an extra buyer (due to the non-rivalrous nature of most copyright materials). This means that a common reasonable assumption in copyright is that the WTS is equal to the marginal cost of supply.

### 6.4.1 Assessing the costs incurred by collecting societies

In general, for the supply of existing copyright material, the marginal cost is quite low and may be close to zero. Nevertheless, such costs should include the marginal administrative costs for the monitoring and enforcing of copyright on behalf of copyright owners for each additional licence granted. These administrative costs are distinct from the fixed administrative costs, which will have no price effect.

Any costs incurred by collecting societies represent funds that are not available for distribution to members of the collecting society. These costs also have the ability to raise prices for licensees if they form the basis for price determination and are marginal costs. Consequently, it is important that any allowance for administrative costs of the collecting society in estimating the WTS is kept at efficient levels.

However, the operating costs of collecting societies are not necessarily transparent, meaning that neither licensees nor the owners of the copyright material may have the means to discover these costs or impose cost discipline on the administrators of the societies.

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<sup>36</sup> *Phonographic Performance Co of Australia Ltd under s. 154(1) of the Copyright Act 1968* [2010] ACopyT 1.



One method to determine an allowance for collecting societies' operational costs in these circumstances is to use benchmarks, particularly benchmarks that are the result of strong oversight of society administrative costs, and otherwise to critically assess claimed costs.

## 6.5 Step 2: Division of the surplus—setting the price

Having determined WTP and WTS, the surplus can be determined as the difference between WTP and WTS. The final step in the determination of reasonable remuneration using the bargaining approach is to divide the surplus between the bargaining parties, in this case between the collecting society and licensees.

Given that the bargain is intended to reflect a situation where the market power of collecting societies is constrained, the ACCC considers that a reasonable assumption is to consider that both parties have equal bargaining power over the surplus available, resulting in an assumption of an equal division of the surplus between the parties.

On the assumption of equal division of the surplus between the buyer and seller, the price that would result from a hypothetical bargaining process would be:

$$P = \frac{1}{2} (WTP - WTS) + WTS$$

In other words, the seller would receive half the surplus, plus its cost of supply.

A simple example of this method is shown in Appendix 1, Box 1.

### 6.5.1 Multilateral negotiation

The potential for multiple parties to be involved in the provision of copyright material can complicate the construction of the hypothetical bargain. For example, it is not uncommon for a user to require a licence from both the PCCA and APRA to perform certain musical works in public. The identification of the next best alternatives of the copyright user and the methods for determining the division of the surplus may be altered by the existence of multiple parties in the provision of copyright products.

#### Joint licensors

In this scenario, two collecting societies are required for a licensee to use the relevant copyright material. The analysis largely proceeds as outlined above. The key difference between this scenario and where there is only one licensor is that this scenario needs to consider how to divide the surplus when the two collecting societies are jointly necessary for the use of the copyright product.

An intuitive version of how this surplus gets divided is that both the users and the joint parties are needed to obtain the surplus. The price is set to divide the surplus in half. The joint providers then divide their half of the surplus in half again, based on each of them having equal bargaining power. In this setting, each of the joint providers receives one quarter of the total surplus produced.

#### Complementary licensors

In this scenario, two collecting societies may be required for a licensee to use some, but not all, of the relevant copyright material. The licensee could choose to obtain a licence from one collecting society for a specific use of the material which does not require a licence from the other (the complementary licence).

For example, consider two separate collecting societies for a piece of recorded music: one collecting society representing the composer of the music or the sounds (rights relating to the underlying 'musical work', Licence A) and another collecting society who holds the rights in relation to the sound recording (rights relating to the aggregate of sounds embodied in a particular recording, Licence B). The collecting society representing the composer rights may allow a performance or recording of the music that is not a sound recording covered by the other collecting society (such as a performance by a cover band). In such a scenario, the repertoire of the composer collecting society (and its ability to allow other recordings) may be a substitute for a licence from both the composer collecting society and the sound

recording collecting society. A licence for the sound recording is therefore complementary to a licence for the copyright in the underlying musical work.

In such a scenario, the estimation of WTP needs to consider what the possible next best alternatives are for the users. That is, the discrete choice modelling needs to be designed to answer questions such as:

- What is the value to the user of a product using only one of the licensors' material? i.e. licence to reproduce the musical work (Licence A).
- What is the additional value to the user of a product using both of the licensors' material? i.e. licence to reproduce both the musical work and the particular sound recording (Licence A + B).

As such, determining the WTP for the complementary licence (Licence B in this scenario) may involve considering the difference in value between alternatives. The WTP for Licence B can be determined by comparing the value to the user of Licence A + B relative to the value to a user of only Licence A. It is also possible that the WTP for Licence B can be determined by comparing the value to the user of Licence A + B relative to the value to a user who has no licence at all. Deciding the relevant next best alternative therefore requires consideration of the costs and benefits to the user of the possible next best alternative. For example, in this scenario, the next best alternative could be Licence A (including any costs of a cover band) or it could be having no music at all.

The selection of the next best alternative and the difference in the value between these alternatives leads to an estimate of WTP for a complementary licence. The selection of the next best alternative may also determine the number and type of parties required to create the surplus, and so determine the parties that will share the surplus.

- Where multiple parties are necessary to create the surplus then the Shapley Value<sup>37</sup> is the relevant concept for determining their share of the surplus.
- In situations where the surplus sharing can be considered as a series of bilateral bargains, the equal sharing rule may be applied one or more times to split the surplus. In these cases, the equal sharing rule gives the same outcome as the application of the Shapley Value concept.

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<sup>37</sup> The Shapley Value can be used to allocate surplus among a set of parties. Each party gets a surplus equal to the average 'contribution' the party makes to each 'coalition' the party could belong to. A coalition is any subset of parties. The contribution a party makes to a particular coalition equals the surplus that coalition makes with the party in the coalition, less the surplus that the coalition makes when the party is not part of that coalition.

# Appendix 1

## Constructing a hypothetical bargain: calculating price

### **Box 1: Derivation of price in a hypothetical bargain**

In this example, the seller's WTS is \$1, reflecting its cost of supply. The buyer's WTP is \$5.

Thus, the total surplus generated by the transaction would be:

$$WTP - WTS = \$5 - \$1 = \$4$$

As the total surplus is positive, the transaction will take place and the parties will bargain over the division of the total surplus between themselves.

Assuming equal distribution of the total surplus between the buyer and seller, the price would be:

$$Price = \frac{1}{2} (\$5 - \$1) + \$1 = \$3$$

Thus the seller would recover its costs of \$1 and receive half of the total surplus, reflecting the difference between the seller's WTS (\$1) and the price it actually receives (\$3).

The buyer also gains \$2 in surplus, reflecting the difference between the buyer's WTP (\$5) and the price actually paid (\$3).

### Box 2: Remuneration based on WTP—marginal user versus average user

The following example assumes that stated preference survey methods have been used to estimate the WTP for access to a collecting society's repertoire of a sample of 10 members of a given population of users. The estimated WTPs are shown in the following table.

Potential licensee Number	Willingness to pay	Consumer surplus if p = 4.5*	Consumer Surplus if p = 3**
1	10	5.5	7
2	9	4.5	6
3	9	4.5	6
4	8	3.5	5
5	8	3.5	5
6	6	1.5	3
7	6	1.5	3
8	5	0.5	2
9	5	0.5	2
10	4	0	1
<b>Average WTP</b>	<b>7</b>		
<b>Total consumer surplus</b>		<b>25.5</b>	<b>40</b>

\* Price determined using WTP of average user.

\*\* Price determined using WTP of marginal user.

Assume estimated WTS is two. If remuneration is based on the WTP of the average user then the price of a blanket licence would be:

$$P = \frac{1}{2} * (7 - 2) + 2 = 4.5$$

Using the sampled members to demonstrate, one potential licensee (number 10) would not be willing to pay this price and would not obtain a blanket licence. This is an inefficient outcome as their WTP is equal to or greater than WTS.

Under this arrangement, the collecting society would issue nine blanket licences. Its total revenue would be 40.5 (9 x 4.5). Total cost is 18 (9 x 2) and therefore economic profit is 22.5. Note that the positive economic profits here do not necessarily mean that the producers of copyright make a positive economic profit overall, due to the initial cost of producing the works.

The WTP of the marginal user is lower than the WTP of the average user. In this example, the marginal user has a WTP of 4. If remuneration is based on this WTP, the price of a blanket licence would be:

$$P = \frac{1}{2} * (4 - 2) + 2 = 3$$

In this case, all potential licensees whose WTP is equal to or greater than WTS would purchase the blanket licence.

Under this arrangement, the collecting society would issue 10 blanket licences. Its total revenue would be 30 (10 x 3). Total cost is 20 and therefore the economic profit is 10. Similar to the above, positive economic profits here do not necessarily mean that the producers of copyright make a positive economic profit overall, due to the initial cost of producing the works.

This example highlights a potential issue when setting the price using WTP of the average user—the potential for a loss of beneficial consumption due to prices that are higher than the WTP of some users who have a WTP greater than the WTS.

# Appendix 2

## Stated preference methods

The ACCC considers that, on balance, a carefully designed choice experiment is significantly more likely to provide more useful information about WTP than a contingent valuation approach. Contingent valuation approaches may be more useful in the early stages of the overall estimation process to provide indications of the likely range of values consumers place on copyright. They may also be more useful in situations where the copyright does not form an attribute of a final product (such as music in a cafe, where the music is one part of what the cafe offers), but is the complete product itself.

### Contingent valuation

The contingent valuation method is a survey-based approach that asks people directly what they are willing to pay for the product being valued. It uses sample surveys to elicit respondents' WTP for products in a hypothetical market. The name of the method refers to the fact that the values revealed by respondents are contingent upon the constructed or simulated market presented in the survey.

There is no standard approach to the detailed design of contingent valuation surveys. Nevertheless, each application consists of several elements:

- a scenario or description of the (hypothetical or real) product the respondent is being asked to value
- a valuation question designed to elicit information on WTP from the respondent
- information on the characteristics of the respondents (for individuals these might include age, gender, income, location etc.). This information can be used to see if and how WTP changes with the characteristics of respondents, and to determine how well the sample reflects the population
- a method for administering the questionnaire. This may be face-to-face interview, by mail, telephone or via the internet.

There is also the more general issue, inherent in statistical sample design, of ensuring the sample is suitably representative of the population.

### Biases in contingent valuation approaches

Contingent valuation is prone to a number of biases. The most critical bias from the point of view of copyright price determination is strategic bias. Strategic bias refers to the situation where respondents deliberately misrepresent their preferences or refuse to respond to survey questions for strategic reasons. For example:

- A respondent may have an incentive to understate their true WTP. This might occur if the respondent thinks that the purpose of the survey is to formally determine how much respondents will pay for the good being valued. This is a serious problem for copyright determinations.
- A respondent could have an incentive to overstate their true WTP for a product. This might be the case if the product is still under development and market research is being performed to determine demand levels for the product. In that case, if a respondent believed that the product or good being valued will only be brought into existence if surveyed WTP is high, the respondent may then have an incentive to overstate their WTP. Alternatively, a respondent might not actually have to pay for the product in question. In that case, a respondent could state a high WTP in order to raise the costs of its competitors.

## Choice experiments

Choice experiments are part of a broader category of approaches for estimating WTP known as choice modelling.<sup>38</sup> Choice modelling is based on the idea that a good can be defined in terms of its attributes. Choice modelling focuses on the choices made when people are presented with alternatives that differ on key attributes. For example, an individual's choice of gymnasium class product may differ depending on the distance to the nearest public car park—that is, the quantification of that particular attribute, which in this example is the distance. Choice experiments are the choice modelling approaches most likely to be used to directly estimate WTP. Choice experiments seek users' preferences for the individual characteristics or attributes of a product. In a choice experiment, respondents are generally asked to choose between two (generally hypothetical) scenarios; or to choose between two scenarios and the status quo. Each scenario is composed of a number of attributes. To be able to estimate a monetary value for changes in the attributes, one of the attributes must be a monetary item—a price. Respondents are presented with a series of such choices to make. Valuations of products and their attributes can be inferred from the choices made and the monetary trade-offs implied by the choices.

A good choice experiment design will focus on the attributes that actually determine which choices consumers make. The selection of attributes should be based initially on particular theories or hypotheses and may be informed by literature reviews, focus groups or prior iterations of surveys. It is also important that the choices presented in a choice experiment questionnaire are realistic for respondents. The levels of attributes should generally span the range over which respondents have preferences. For the various bundles, this includes specifying a wide and plausible range of monetary values for use in the questions. While generally not preferred for direct WTP estimation for copyright, it is possible that the contingent valuation approach described in the previous section may provide some information about the range of monetary values to include in a choice experiment.

The statistical analysis of choice data involves the use of an appropriate econometric model to specify the relationship between the choices made and the various attributes.<sup>39</sup> The model specifies how the attributes contribute to the total utility that a person attaches to each alternative. The specific choices that respondents make are then used to form estimates of the WTP for different levels of the attributes in making these choices.

### Advantages of choice experiments

The ACCC considers that choice experiments are the preferable stated preference method for estimating WTP with respect to copyright material. The choice experiment approach is particularly useful where the use of copyright material is just one attribute of the final good or service consumed, as choice experiments make product attributes explicitly known and separated. As copyright material is often bundled with a range of other products/services, it can be difficult to isolate the value derived from the use of the material from the value of the bundle as a whole. For example, the profits that a nightclub can earn from playing recorded music will depend on other factors such as the venue's amenities, location and so forth. The Copyright Tribunal has previously considered cases where copyright materials were assumed to be an attribute of some other broader final product (such as music in a nightclub).<sup>40</sup>

The ACCC considers that one of the key advantages of choice experiments is that they can reduce or eliminate the scope for bias, which may be present in contingent valuation.

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38 Other choice modelling approaches (such as contingent ranking, paired comparisons, contingent (conjoint) rating) are generally less useful for direct estimation of WTP. Contingent ranking is a ranking of a set of options. Paired comparisons involve choosing the preferred option out of two choices, indicating the strength of the preference on a numeric or semantic scale. Contingent (conjoint) rating has a number of scenarios presented one at a time and rated on a numeric or semantic scale. These last two methods are particularly avoided for economic valuation due to the problematic assumptions required in the form of cardinality of rating scales or an implicit assumption that ratings across individuals can be compared: IJ Bateman, RT Carson, B Day, M Hanemann, N Hanley, T Hett, M Jones-Lee, G Loomes, S Mourato, E Ozdemiroglu, D Pearce, R Sugden, and J Swanson, *Economic Valuation with Stated Preference Techniques—A manual* (2002).

39 Using the choices of the respondents, the probability of making a choice is modelled as a function of the attributes, including price. This usually involves developing a random utility model. Within this, utility is often modelled as a simple linear combination of costs and attributes.

40 Phonographic Performance Company of Australia Limited under s. 154(1) of the *Copyright Act 1968* (Cth) [2007] ACopyT 1.

## ***Strategic bias***

Choice experiments can reduce the scope for strategic bias as WTP is neither open-ended nor directly asked. Because the monetary value associated with a particular attribute is not directly asked, it may not be clear to respondents who wish to act strategically which option they should choose if they wish to misrepresent their WTP.<sup>41</sup>

## ***Hypothetical bias***

Choice experiments may also reduce the occurrence of hypothetical bias. Hypothetical bias is an apparent tendency, especially in contingent valuation studies, to overestimate real WTP values. Academic debate continues over the exact prevalence and cause of this bias. A plausible suggestion is that respondents do not easily hold all other things constant when thinking about hypothetical scenarios. For example, respondents considering a future hypothetical scenario might expect higher incomes in the future. In this case, responses are based on a future with less binding income constraints, and as such WTP may be overstated relative to the current situation.<sup>42</sup> This difficulty may be somewhat alleviated in a choice experiment, as it asks the respondent to compare competing scenarios. As such, a user's bias is more likely to be present in each scenario that is presented, thus reducing the impact of the bias.

## **Disadvantages of choice experiments**

Despite the advantages outlined above, one concern with choice experiments is the inability of respondents to make consistent choices. This concern may be overcome by keeping the number of options and attributes low for each scenario presented. By reducing the number of scenarios presented, the phenomena of 'non-trading' (where respondents prefer the status quo over alternative options) can also be mitigated.<sup>43</sup>

Choice experiments rely heavily on the accuracy and completeness of the attributes used to describe the product. Any exclusion of relevant attributes has the potential to result in biased estimates. However, as the number of attributes increase, the required sample size increases exponentially<sup>44</sup>, and the potential for respondent fatigue and non-trading also increases. These factors introduce a real tension in the selection of attributes that are important to the choice decision.

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41 The monetary value of a particular attribute is hidden in the sense that a respondent may not be able to simply say which option gives a higher price to the copyright attribute, as the option will generally vary on other dimensions as well.

42 JC Whitehead and GC Blomquist, 'The use of contingent valuation in cost-benefit analysis', in A Alberini & J R Khan, eds, *Handbook on Contingent Valuation* (2006), pp. 92-115.

43 A further practical suggestion here is to randomise the question and answer order in the survey presentation. This may reduce the likelihood and some of the effects of non-trading.

44 IJ Bateman, RT Carson, B Day, M Hanemann, N Hanleys, T Hett, M Jones-Lee, G Loomes, S Mourato, E Ozdemiroglu, D Pearce, R Sugden, and J Swanson, *Economic Valuation with Stated Preference Techniques—A manual* (2002).



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