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Difficulties between the pro-competitive community and Intellectual Property

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INTRODUCTION

Overview of economists view of Intellectual Property/ Patents /Copyright

I welcome the opportunity today to discuss the interaction of intellectual property law with competition policy. The Australian Competition and Consumer Commission (the Commission) is not opposed to intellectual property laws but has long held the view that it is not in the interest of society for intellectual property protections to be used for anti-competitive purposes.

Intellectual Property laws encourage innovation by granting exclusive property rights. Without them, third parties might copy the products, produced through the application of the Intellectual Property, without paying the appropriate remuneration. This could be a disincentive to creating Intellectual Property.

Legislative Review

The National Competition Policy (NCP) requires all legislation that potentially restricts competition under the Competition Principles Agreement to be reviewed. This agreement between the Commonwealth and State and Territory Governments provides that legislation, which restricts competition, should be retained only if the benefits to the community as a whole outweigh the costs, and if the objectives of the legislation can only be achieved by restricting competition.

INTELLECTUAL PROPERTY AND COMPETITION REVIEW COMMITTEE

In June 1999, the Commonwealth Government established the Intellectual Property and Competition Review Committee, to examine the competition aspects of intellectual property legislation, under the Competition Principles

Agreement.

Mr Henry Ergas, Managing Director of the Network Economics Consulting Group Pty Ltd, chaired the committee whose terms of reference included reviewing the *Copyright Act 1968*, the *Designs Act 1906*, the *Patents Act 1990*, the *Trade Marks Act 1995* and the *Circuit Layouts Act 1989*.

The Committee reported to the Government on the parallel importing provisions of the Copyright Act in June last year. It issued its final report, *Review of Intellectual Property Legislation Under the Competition Principles Agreement*, in September 2000.

The Committee recommended a many changes to Australia's intellectual property laws in an attempt to improve the balance between those laws and competition policy. The Commission welcomed the report as a valuable contribution to the debate about the interaction between Intellectual Property law and competition policy and generally strongly supports its findings.

SECTION 51(3)

Section 51(3) of the Trade Practices Act 1974 exempts conditions of licences and assignments from sections 45 (agreements that substantially lessen competition), 47 (exclusive dealing) and 50 (mergers that substantially lessen competition), to the extent that they relate to the subject matter of the relevant intellectual property, or, in the case of trade marks, only to the extent that they relate to the kinds, qualities and standards of goods bearing the trade mark.

There is uncertainty over the meaning and extent of the exemption provided by section 51(3). As a result, the provision has been subject to a vast range of interpretations. Some take the view that almost any condition relates to the copyright work or other subject matter and therefore would be exempt. Others consider the condition must relate directly to the work itself. The Committee discussed a third view suggesting that even in the absence of section 51(3), an exercise of intellectual property rights is unlikely to breach the Act, unless the conduct increases market power *beyond* that granted by the relevant right. The Golden West matter provides an example of a situation where the interpretation of section 51(3) could potentially affect the liability of parties for dealings in intellectual property. I will discuss this more detail in a moment.

The Commission believes that the lack of clarity surrounding section 51(3) has reduced the benefits for business certainty, which might otherwise go with the exemption. As I have stated in the past, Intellectual Property should be fully subject to the Act as are other forms of property.

The Committee recommended that section 51(3) be repealed, and that a new section 51(3) be inserted. This says that a contravention of Part IV of the Act shall not be taken to have been committed by reason of the imposing of licence conditions, or the inclusion of conditions in a contract, arrangement or understanding that relate to the subject matter of the relevant intellectual property statute, so long as those conditions do not result, or are not likely to result in a substantial lessening of competition.

The Commission welcomes the proposal to largely remove the exemptions from Part IV in respect of Intellectual Property which, in its view enable those owners of Intellectual Property rights to engage in anti-competitive conduct that would not be allowed other property owners.

However, the Commission believes that special exemptions from the Act are difficult to justify, particularly in view of Part VII, which empowers the Commission to authorise agreements that may otherwise breach Part IV. These authorisation provisions require the Commission to assess the public benefits and detriment of such agreements publicly, on a case by case basis. Our decisions are reviewable by the Australian Competition Tribunal.

Accordingly, while recognising the adoption of the Committee's recommendations would be a very large step forward and very welcome, the Commission would go further than the Committee in its reform proposals and support repeal of section 51(3).

An example of the anti-competitive conduct potentially beyond the reach of the Act and the role authorisation can play in providing full consideration of the public benefits is provided by t the Australasian Performing Rights Association (APRA) application for authorisation of its "input" and "output" arrangements. APRA submitted that the arrangements were exempted by s.51(3). Ultimately, this issue is for the courts to determine.

Golden West

In 1996, the Commission instituted proceedings in the Federal Court against the Seven, Nine and Golden West television networks and others in relation to long term program supply agreements. The agreements were:

1. an overall agreement between Nine and Seven not to pursue their interest in acquiring a second commercial television licence for regional Western Australia (WA) and Darwin respectively;
2. an exclusive 15-year program supply agreement between Golden West and Nine. At the time, Golden West operated the sole commercial television station in regional WA and was associated with the then Chairman of the Seven Network, Mr Kerry Stokes; and
3. an exclusive 10-year program supply agreement between Territory Television, a Nine Network subsidiary which operated the sole commercial television station in Darwin, and Amalgamated Television Services, a Seven Network subsidiary.

The Commission alleged that the object of these agreements was to hinder or prevent potential entrants from acquiring any second commercial television licences for Darwin and regional Western Australia. This would put Territory Television and Golden West in a position to gain any second commercial television licences for Darwin and regional WA licence areas respectively. The Commission alleged that the overall market sharing agreement between the Seven and Nine Networks contained an exclusionary provision and, alternatively, had the effect of substantially lessening competition for commercial free-to-air television services in the Darwin and regional Western Australia markets by preventing entry (s.4G), in breach of sections 45 and 47 of the Trade Practices Act.

The Commission's belief that section 51(3) did not apply to the agreements was in accordance with the approach suggested by Mr W.M.C. Gummow (now a member of the High Court of Australia) in an article entitled "Abuse of Monopoly: Industrial Property and Trade Practices Control" (1976) 7 Sydney Law Review 349. Mr Gummow said that in the case of copyright, section 51(3) concerns are relevant to, the literary dramatic or artistic work itself, rather than collateral agreements between licensor and licensee. In its defence, Nine argued that the exclusive copyright licence to Golden West was in the form of the licence granted by the copyright owner. This related to the subject matter in which the copyright subsists (ie. to the programs to be broadcast), allowing the licensee to gain the benefit of the copyright work while conferring no collateral benefit. As such, Nine argued that section 51(3) applied to the agreements, thus exempting it from the application of sections 45 and 47. Seven and Golden West simply denied the Commission's allegations.

The matter was eventually settled out of court in 1998. Nine agreed, among other things, to terminate the exclusive program supply agreement between its subsidiary, Territory Television, and Seven. Seven terminated its exclusive program supply agreement with Territory Television. Telecasters Australia Limited (a Network Ten affiliate in regional Queensland and northern NSW) subsequently acquired the second commercial television licence in Darwin and entered into an agreement with Seven for the exclusive supply of Seven programs to Telecasters for its Darwin operations.

Golden West undertook not to interfere with, or frustrate, the performance of, Seven's undertaking to supply the new licensee for remote and regional WA with some or all of its programs (except for those it is legally contracted to supply to Golden West on a short-term basis). It also undertook not to object to Nine supplying its programs to the new licensee if Golden West did not intend to broadcast them. This case illustrates the type of conduct, which may or may not be excepted from the Trade Practices Act by section 51(3) if the scope of exemption was modified.

ACCC GUIDELINES ON INTELLECTUAL PROPERTY

As part of its recommendations, the Ergas Committee said the Commission should be required by legislation to issue Intellectual Property guidelines as to how it will implement any enforcement activities related to Part IV of the Act and to clarify the types of behaviour likely to result in a substantial lessening of competition.

The Committee said such guidelines should provide sufficient direction to owners of intellectual property rights to clarify the types of behaviour likely to result in a substantial lessening of competition. The Commission supports this recommendation.

Other jurisdictions, such as the United States, have issued guidelines setting out their approach when assessing whether intellectual property dealings infringe competition law. The Commission welcomes discussion about how intellectual property holders can be given greater surety about whether their conduct is likely to breach the Act.

ACCC & PARALLEL IMPORTS

The debate over parallel imports of copyright protected products has continues for over two decades.

The Copyright Act originally prohibited parallel imports except for personal use. In 1983 the question whether the importation provisions of the Copyright Act should be reformed was referred to the Copyright Law Review Committee (CLRC), which reported in 1988. The CLRC felt unable to evaluate the conflicting claims about the likely consequences of reform for prices, but was concerned about the availability of some copyright product, in terms of delayed release and range of product. This was followed by a series of reports by the former Prices Surveillance Authority (PSA) (a predecessor of the Commission), most notably, into the relative prices of books, recorded music and computer software. While availability was still an issue, particularly for books and to a lesser extent sound recordings, the PSA's main focus was on international price discrimination. It found that Australia was paying higher prices than consumers overseas, particularly in North America and that this was the result of the parallel import restrictions.

Compact Discs

The removal of the restrictions on parallel imports of sound recordings in July 1998 has been the most publicised recent development in Australian copyright law. Since there has been so much heat and noise generated over this issue, it is appropriate to review what has happened since the passage of the legislation.

While it does not have price monitoring powers in this area, the Commission is interested in the progress of this reform. Staff members in our regional offices a have collected retail price information at regular intervals to estimate the effect on prices, and conducted other market inquiries. As well as market checks, we have been particularly interested in any attempts to prevent market participants –

retailers, importers or wholesalers – from exercising their legal right to buy CDs and cassette tapes from the best available supplier. Such obstacles may be a restraint of trade and in breach of the Act, whether the supplier is here or overseas.

ACCC v Warner Music Australia Pty Ltd & Ors; Sony Music Entertainment (Australia) Pty Ltd; Universal Music Australia Pty Ltd & Ors

In 1998, the Commission began an investigation into the conduct of the major record companies after receiving reports that they had threatened to withdraw significant trading benefits from retailers who stocked parallel imports.

In several cases record companies had allegedly cut off supply to retailers who stocked parallel imports. Separate proceedings against each of Sony, PolyGram, and Warner were instituted in September 1999 as a consequence of the Commission's investigations.

Specifically, the Commission alleged that the respondent record companies breached sections 45, 46, and 47 of the *Trade Practices Act 1974* in attempting to prevent the importation of recorded music by Australian wholesalers and retailers following the changes to the *Copyright Act 1968* which allowed for parallel imports. The Commission also alleged that certain senior personnel of those record companies were in breach of the Trade Practices Act by being "knowingly concerned" in the actions of their respective companies.

Before the commencement of trial in the Federal Court in Sydney on 2 April 2001, the Commission reached a settlement agreement with Sony whereby Sony without admitting liability, provided undertakings to the Court. These undertakings are that:

? Sony will, for a period of two years, refrain from taking any action involving the withdrawal of trading benefits from Australian retailers because they source or have sourced 'non-infringing copies of articles' containing recorded music within the Sony Australian Catalogue from alternative suppliers;

? Sony will implement a Trade Practices Compliance Program in respect of Part IV of the Trade Practices Act 1974;

? Sony will, for a period of two years, take no action having the purpose or effect of hindering or preventing non related distributors outside Australia from exporting 'non infringing copies of articles' containing recorded music from territories outside Australia to Australia; and

? Sony will contribute $200,000 to the Commission's costs and that Sony bear their own costs of the proceedings.

Proceedings continue against Universal Music and Warner Music as well as three senior executives of Universal, and two senior executives of Warner. The Commission seeks substantial penalties and injunctions against those parties. The maximum potential penalties under the Act for the Warner and Universal proceedings are $10 million per contravention.

Books

The PSA's 1989 inquiry into book prices found considerable evidence that the lack of international competition in the book trade had resulted in significant disadvantages for Australia: price discrimination; poor availability; and high costs.

Following the release of the PSA's book report, amendments to the Copyright Act in 1991 enabled Copyright holders to retain exclusive distribution rights provided they can guarantee supply within a specified time frame.

The Government asked the PSA to monitor and report on the effects of the 1991 reforms on the price and availability of books. In 1995, the PSA held a public inquiry which concluded that while the 1991 amendments had resulted in an improvement in distribution efficiencies and the speed with which most new releases become available in Australia, prices of some books continued to be high relative to overseas, particularly in the technical and professional and mass market paperback areas. Further, booksellers had found the 1991 amendments difficult and costly to implement.

The PSA considered that only an open market, with no restrictions on parallel imports, could deliver competitive prices over the long term and overcome the administrative difficulties inherent in the 1991 reforms. It recommended that the importation provisions be repealed in full or, as a fallback position, that the 1991 reforms be simplified and streamlined.

The Commission recently updated to December 2000, its survey of the prices of best selling books in Australia, the USA and UK. For the 12.5 year period, 1988-89 to December 2000, Australians have been paying around 44 per cent more for best selling fiction paperbacks than US readers. Over the same period, Australian consumers paid on average 8.9 per cent more for best selling paperback fiction than UK readers did. We also found prices of some technical and professional books are still high compared with overseas.

Computer Software

The Commission recently completed spot price comparisons of leading business software and PC computer games with the USA, the UK and NZ.

It found that the GST exclusive prices of 14 popular business software products on a selection of Australian websites were, on average, 11.5 per cent higher than prices advertised on US websites. Australian average prices were similar, to those in the UK and NZ. However, as with earlier surveys, significantly higher differentials were found for some products, including McAffee Virusscan Classic and MS Windows 98.

In February/March 2001, GST exclusive prices of 11 popular PC games on a selection of Australian websites were, on average, 19.5 per cent higher in Australia than on comparable UK websites and 5.4 per cent higher than in NZ. As with business software, there was considerable variation in the differentials of individual products. Significantly higher than average differentials were found for The Sims and Rollercoaster Tycoon.

Earlier time series data indicates that prices for business computer software in Australia have been persistently high compared with the USA since at least 1988-89. The latest updates are a ‘snap shot’ of prices on a particular day and are not directly comparable with the earlier time series. Taken together, however, the surveys suggest that one of the consequences of parallel import restrictions is that prices in Australia are too high.

The Commission’s various studies have shown that parallel import restrictions have harmed Australia raising high prices over many years and restricting supplies. They have no justification. The Commission welcomes the Government’s introduction of legislation to remove parallel import restrictions on books and computer software.

DVDs & THE TRADE PRACTICES ACT

The Commission has requested the Australian subsidiaries of United States film companies to explain why their regional restrictions on DVDs should not be deemed a breach of the Trade Practices Act 1974. The restrictions are maintained under the Regional Playback Control (RPC) system that splits the world into six distinct markets.

The Commission believes RPC is anti-competitive with Australian consumers lacking a choice of DVD videos and possibly paying higher prices.

In 1996 film studios and DVD player manufacturers introduced the RPC system whereby a code attached to DVDs is read by players. If the code on the disc is different from that on the machine the DVD will not play. Within the six regions Australia has been placed in region 4 with New Zealand, Pacific nations, Central and South America.

The separate regions ensure that DVDs on sale in Australia will only function on a DVD player licensed for region 4. An Australian buying a DVD in the United States or elsewhere outside region 4 will be unable to use it back home.

Copyright laws do not prevent Australians buying DVD movies abroad for personal use but only a small number are available in regional 4 format. They are denied a proper choice of DVDs and the RPC could be keeping prices artificially high.

The film studios say the RPC protects their international film distribution programs by preventing movies being shown on DVDs outside the US before distribution abroad. They claim that DVDs, if uncontrolled, could substantially reduce theatre seat sales and cause closures.

The RPC prevents the importation of DVDs from smaller filmmakers around the world. Their sales are generally too small to justify catering for region 4. This reduces competition to the advantage of US studios.

The RPC is claimed to reduce the risk of piracy. South East Asia and China were in separate regions because film piracy is common. DVD's make a good master copy, which, unlike VHS videos, did not lose quality with each copy. However, the point here is that while the RPC may prevent your DVD player playing a pirated copy of a film because of the coding arrangement, it will also prevent you playing a lawfully produced imported DVD.

Opposition to the RPC in Australia has seen both consumers and retailers attempt to overcome it. There are technicians offering a "multi-region modification" service at a cost of around $50 to $300, depending on the type of DVD. While a modified player may play a DVD from any region, the problem is that a modification chip will, for the majority of players, render the manufacturer's warranty void. Most consumers are wary of losing a warranty on equipment that that can cost up to $1000.

Australian consumers are receiving poorer quality DVDs than their counterparts in region 1 (US) and at the end of 1999 there were only 720 movie titles available in region 4 compared with over 5000 in region 1.

The arrangement between the studios and between them and the manufacturers may constitute a contract, which has the purpose, or is likely to that the purpose, of lessening competition in a market in contravention of section 45 of the Trade Practices Act.

The essential point here is that in the Commission's view, there is an attempt to use copyright laws for a purpose related to areas beyond their real purpose. This coding system is a mechanism to allow price discrimination, not to protect the inherent rights of Intellectual Property owners.

ACCC & B2B

I might briefly talk about the Commission and Intellectual Property applications to B2B arrangements. A B2B (business to business e-commerce) may be "open" to users, but they still may need to obtain access to Intellectual Property in order to use the hub properly. For example, they may need to have access to standardised electronic purchase/order forms which have been developed by the B2B operator (in some cases, it may even be that a special derivative of "open access" computer language such as XML has been developed or customised for the particular industry). Another example may be that in order to integrate a user's internal IT system with the B2B trading hub in order to realise processing efficiencies, it may need to obtain a licence to software interfaces developed by the B2B.

Investment licences to proprietory software could increase exit costs for a user and therefore enhance network effects of a B2B.

Another difficulty is that even if the B2B actually provides such information as "open source" over the Internet (such as an Internet site where anyone can download standard order forms free), can this be a form of predation or bundling which prevents the development of alternatives and thus enhances the position of the B2B marketplace itself? An example would be Microsoft giving free browsers with Windows.

Intellectual Property rights could be used to block interoperability with other B2B marketplaces. On the one hand, this may block competition, but on the other it may be a legitimate response to prevent "free-riding".

Generally on the Internet there is the whole issue of shopping bots. These "things" sweep the Internet "scrapping" information from other sites in order to provide a comparison service to consumers. Good for consumers, but no so good for the businesses that have tried to build up goodwill and an innovative service. It seems that businesses have used Intellectual Property rights to stop this.

CONCLUSION

Intellectual Property Law is complicated and a hot topic of debate among lawyers, performers, authors, booksellers and regulators. It generates a lot of heat, emotion and "letters to the editor". While the debate rages the Commission has been pleased to welcome significant changes that are improving the balance between Intellectual Property Laws and competition policy. I am confident that this trend will continue.