Forum

Intellectual property and competition

Following is a summary of a speech by Commission Chairman, Professor Allan Fels, to the Protecting intellectual property or protecting consumers: is there a trade-off? *conference at the Melbourne Business School, 6 December 2002.*

Professor Fels canvassed some of the thinking that underpins the notion of intellectual property rights and competition law. He also discussed the government's response to the report of the Intellectual Property and Competition Review Committee (IPCRC) with particular emphasis on amendments to s. 51(3) of the Trade Practices Act, the Commission's draft IP guidelines and the new role for the Commission in the operation of copyright collecting societies. He also considered issues associated with parallel importation of copyright products including the impact of the removal of parallel importation restrictions on sound recordings in 1998, the current parliamentary debate about the parallel importation restrictions that apply to books and computer software and regional coding of DVDs and Sony PlayStations.

Issues about the appropriate interface between intellectual property and competition laws are complex and a fine balance needs to be struck between important and sometimes competing principles. Nevertheless, the laws can be improved to provide enhanced public benefit. There is some history of producer interests driving the law at the expense of the public interest in some areas of intellectual property law.

Intellectual property rights and competition law

Intellectual property and competition laws can appear to conflict. However, it is now accepted that, because they do not necessarily, or even very often, create legal or economic monopolies, intellectual property laws do not have to clash with competition laws.

Competition and intellectual property laws are generally complementary, seeking to promote innovation to the benefit of consumers and the economy. Only in particular cases will there be an apparent conflict between the two underlying policies. Holders of intellectual property rights may seek to extend the scope of the right beyond that intended by the intellectual property statute.

The key issue, therefore, is finding an appropriate balance between intellectual property and competition laws. This raises a crucial question about the types of incentives that are needed to encourage innovation.

The information currently available supports anti-trust enforcement that is assertive in maintaining competition as a spur to innovation, yet cautious to avoid unwarranted interference with intellectual property incentives for innovation.

Licensing of intellectual property

So how and when might the exploitation of intellectual property rights conflict with the Australian trade practices legislation?

In general, the Trade Practices Act will not require an intellectual property owner to license the intellectual property. However, if an intellectual property right limits competition in a market, refusing to license it might have an anti-competitive effect. Similarly, a refusal to disclose confidential information on a product may inhibit competition. As such, refusing to license may infringe s. 46 (which deals with the misuse of market power). However, in all cases, conduct would only be prohibited by s. 46 if it were engaged in by an owner taking advantage of its substantial market power for one of the proscribed purposes.

Aside from a blanket refusal to license, licence terms and conditions may be applied to anti-competitive effect. Provisions that substantially lessen competition may infringe s. 45 (unless exempted). Those that are imposed for the purpose of deterring or preventing an agent from engaging in competitive conduct may infringe s. 46.

Sometimes, owners of intellectual property rights may wish to pool their rights with those of other owners, maybe even their competitors and sell collectively the pooled intellectual property rights for a single price. Alternatively, intellectual property owners may want to cross-license their intellectual property with that of another owner. In the main, these types of arrangements are pro-competitive. However, competition concerns may arise if the arrangements are used to exclude competitors in a market, or to raise prices in the direct or related markets.

Australian intellectual property policy issues

The Trade Practices Act already takes specific account of intellectual property rights and establishes an interface between those rights and conduct prohibited under the Act. In particular, s. 51(1) makes it clear that anti-competitive conduct permitted under IP legislation is not exempt from the Trade Practices Act.

But this is qualified by s. 51(3) which exempts conditions of licences and assignments from ss. 45 (agreements that substantially lessen competition), 47 (exclusive dealing) and 50 (mergers that substantially lessen competition). They must relate to the subject matter of the relevant intellectual property, or, for trade marks, only to the extent that they relate to the kinds, qualities and standards of goods bearing the trade mark.

Part IIIA of the Trade Practices Act establishes an access regime for essential services. However, intellectual property is exempted by s. 44B of the TPA from this regime.[1] This means that the access regime embodied in Part IIIA cannot be used when an owner or holder of an intellectual property right refuses to license the intellectual property for an anti-competitive purpose.

[1] In s. 44B, the use of intellectual property is excluded from the definition of 'service' for the purposes of Part IIIA of the Trade Practices Act.

Review of intellectual property and competition law

In June 1999 the Commonwealth Government established the Intellectual Property and Competition Review Committee to review the competition aspects of intellectual property legislation. The committee issued its final report in September 2000. The government accepted most recommendations when it announced its response to the report in August 2001.

Section 51(3) of the Trade Practices Act

Section 51(3) will be amended so that intellectual property licensing would be subject to the provisions of Part IV, but a contravention of the per se prohibitions of ss. 45, 45A and 47, or of s. 4D would instead be subject to a substantial lessening of competition test. This largely reflects the committee's recommendation.[2]

The Commission believes this decision is a big step forward as the amendments will expose intellectual property licensing and assignment to the strictures of the Trade Practices Act to a greater extent. However, the Commission remains of the view that intellectual property should be fully subject to Part IV of the Trade Practices Act, as are other forms of property.

It has been decided that the Commission would issue guidelines outlining its enforcement approach to Part IV as it applies to intellectual property.

The guidelines would define:

- when intellectual property licensing and assignment conditions might be exempted under s. 51(3)
- when intellectual property licences and assignments might breach Part IV
- when conduct that is likely to breach the Act might be authorised.

Copyright collecting societies

Copyright collecting societies are an administratively efficient way for copyright owners to enforce their intellectual property rights and to collect and distribute copyright licence fees. However, as monopolies, their existence gives rise to potential competition concerns including the potential abuse of market power to extract high licence fees from users.

[2] The IPCRC recommended that an IP licensing or assignment condition should not breach Part IV of the Trade Practices Act unless it substantially lessens competition.

The Commission has some experience in assessing the potentially conflicting competitive and efficiency effects of copyright collecting societies. In 1997 the Australasian Performing Rights Association (APRA) applied for authorisation of its input and output arrangements. This included exclusive licensing of copyright works by composers to APRA (the input arrangements) and providing blanket licences by APRA to users to enable them to broadcast the entire APRA repertoire (the output arrangements), its distribution arrangements and overseas arrangements.

The government has decided that the existing powers of the Copyright Tribunal to review output arrangements of declared collecting societies will be extended to cover the output arrangements of voluntary collecting societies not administered under a statutory licence. The government also outlined a role for the Commission in relation to the extension of the Copyright Tribunal's powers.

The Commission will be required by statute to issue guidelines on what matters it considers to be relevant to the determination of reasonable remuneration for copyright holders in negotiations between societies and users of copyright material.

The *Copyright Act 1968* will be amended so that the Copyright Tribunal has the discretion to take account of the guidelines and to admit the Commission as a party to tribunal proceedings.

The Commission welcomes the government's decision as a way to improve the balance between the costs and benefits associated with collective licensing and thus reduce the potential for such licensing to have anti-competitive effects.

Parallel imports

Court cases

In the Commission's case in the Federal Court on the parallel importation of CDs it was found that some record companies engaged in anti-competitive conduct to discourage or prevent Australian businesses from selling parallel imported compact discs.[3]

Justice Hill's findings are an important win for Australian consumers. They mean that retailers will be able to access cheaper, legal, imported CDs freely, without fear they will lose supply of other stock. This was the precise intention of the Australian Parliament when it amended the Copyright Act in 1998 to allow parallel imports of sound recordings.

Justice Hill's findings also set an important precedent for s. 46 of the Trade Practices Act. The findings challenge the traditional view that market share is the major determinant of market power. The importance of structural barriers to entry in determining market power has also been challenged by Justice Hill's findings which placed emphasis on the role of strategic entry barriers. There is also a distinction to be drawn between entry at the fringe, which in this matter Justice Hill found can be done easily, and entry or expansion to the core, which is more difficult.[4]

Price surveys

The latest survey of CD prices, for the September 2002 quarter, indicates that the average GST-inclusive Australian price of a Top 40 CD at specialist music stores in September 2002 was $26.41. When taxes are excluded, the average retail price in September 2002 was $2.02, or 7.9 per cent, less than the tax-exclusive price that prevailed immediately before deregulation.[5] The Commission's surveys indicate that average nominal tax-exclusive Top 40 prices have been lower at all times post-deregulation than immediately before deregulation.

The average GST-inclusive Australian price of a Top 40 CD in September 2002 at non-specialist stores such as Target and Grace Brothers was $21.98. It is apparent that these non-specialist outlets are a source of price competition to the specialist stores, for the chart CDs at least.

The surveyed average tax-adjusted Australian price for September 2002 was 17.2 per cent lower than the surveyed tax-adjusted US price and 28.1 per cent lower than the UK one, but 12.9 per cent higher than New Zealand's.[6]

Over time, CD prices might be expected to rise because of inflationary pressures. Recent exchange rate depreciations have also put upward pressure on imported CD prices. However, the Commission's surveys confirm that Australian nominal tax-adjusted

3 *Australian Competition and Consumer Commission v Universal Music Australia Pty Ltd & Ors* [2001] FCA1800 at 382.

4 ibid. at 422.

5 Taxes are excluded because, in August 1998, sound recordings were subject to a wholesale sales tax whereas current prices are subject to a GST. Hence, tax-inclusive prices from August 1998 to the present are not directly comparable. Furthermore, the retail price of CDs was expected to fall as a result of the New Tax System (NTS). Removing taxes from the historic price comparison removes the price effect of the NTS.

6 Using three-month average exchange rates.

prices (excluding the impact of the switch to the New Tax System which was expected to cause a fall in retail prices of CDs) have, in fact, fallen since deregulation despite the upward pressures exerted by general inflation and the exchange rate. In September 2002 average Australian tax-free retail prices were $5.72 or 19.3 per cent lower than would be expected if CD prices had risen in line with inflation of 14.2 per cent since August 1998.

Parallel imports of books and computer software

There has been considerable debate about parallel imports of books and computer software and there has been earlier Commission and PSA reports to the government on the issue.

The government has introduced a bill to amend the Copyright Act to allow for parallel importation of books and computer software. The Commission has updated its books price comparisons in anticipation of the parliamentary and public debate associated with the bill.

Latest books survey findings

The key findings of the updated books survey are:

- For the 14 years from 1988–89 to June 2002, Australians have been paying on average 41.9 per cent more for best selling paperback fiction than US readers, and 7.3 per cent more than UK readers.[7]
- For the period 1994–95 until June 2002, Australians have paid on average around 16.5 per cent more for all best sellers than US readers.[8]
- Australians paid on average 8.5 per cent, or $27 more than US readers in May 2002 for some medical titles and 9.1 per cent more, or $31, than readers in the UK.

The latest findings indicate that there are still substantial differences in the sectors that have consistently been highly priced in Australia, namely best selling paperback fiction relative to the US, and technical and professional references.

The Commission's price surveys focus primarily on price, rather than availability. The data underlying the surveys suggest, however, that availability of some books remains a concern. In particular, it appears that some titles are only made available in Australia in the large format paperback version whereas there is a hardback version available overseas. Other titles may not be available at all.

Computer software

The key findings of latest computer software price surveys conducted in May–June 2002 are:

- Advertised prices of 50 popular business software packages on a selection of Australian websites were on average 20.7 per cent higher than prices advertised on US websites, 1.4 per cent higher than in the UK and 3.9 per cent higher than in New Zealand.[9] This general finding is consistent with the Commission's earlier spot price comparisons of business software packages.
- Advertised prices of 25 popular PC games on a selection of Australian websites were on average 12.5 per cent lower in Australia than the US, 2.7 per cent lower than in the UK and 8.7 per cent higher than in New Zealand. These results are broadly consistent with previous Commission surveys.[10]

Earlier time-series data indicate that prices of business computer software in Australia has been persistently high compared with the USA since at least 1988–89.

The Commission's work has shown that parallel import restrictions have harmed Australia by raising 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.

[7] For the 12 months to June 2002 the Australian price for best selling paperback fiction exceeded the US price, on average, by 16 per cent, higher than the differential for 2000–01 of 11.1 per cent. Prices in Australia for best selling paperback fiction were on average 8.6 per cent below prices in the UK. In 2000–01, Australian prices were on average 6.2 per cent less than in the UK.

[8] For the 12 months to June 2002 the Australian price for all best sellers was broadly the same (0.7 per cent) below prices in the US and 13.1 per cent lower than comparable prices in the UK. For the period 2000–01 Australian prices were on average 3.3 per cent higher than in the US and 8.3 per cent lower than in the UK.

[9] In February–March 2001 advertised prices of business software on Australian websites were on average 11.5 per cent higher than in the US.

[10] In February–March 2001 advertised prices of PC software games in Australia were on average 3.6 per cent lower than in the US.

Other parallel importation issues

The Commission is investigating two aspects of a requirement by the DVD Copy Control Association in California, USA, for manufacturers of DVD players to incorporate the regional playback control (RPC) system. This effectively divides the world into six regions for the purposes of DVD distribution. First, the Commission is concerned that Australian consumers who purchase DVDs from other regions may be unaware that these authorised copies may not be playable on DVD players purchased in Australia. Second, the Commission is concerned that the RPC system may enable copyright owners to practise international price discrimination by artificially creating regional barriers. The RPC system may be used to prevent cheap imports in countries in which domestic price competition is limited, such as Australia.

PlayStation court case

In a related matter, Sony Computer Entertainment produces and distributes its PlayStation console incorporating region coding. The effect of this coding is to create three mutually exclusive geographic distribution regions. As with the RPC system, region coding means that Australian consumers who buy legitimate PlayStation games overseas may not be able to play those games on consoles distributed in Australia. The Commission is concerned that the main purpose of the RPC restrictions is to prevent parallel imports, not infringement of copyright as alleged by Sony.[11]

Sony Computer Entertainment sought in the Federal Court to have the new anti-circumvention provisions of the Copyright Act applied to prevent consumers from having a mod chip installed in their PlayStation console, thus preventing them from playing legitimate games purchased overseas, as well as copies made for legitimate backup purposes under the Copyright Act.

In September 2001 the Commission was granted leave to be heard as amicus curiae (friend of the court) in Sony's action in relation to whether modifying PlayStation consoles infringes the Copyright Act.

The Commission submitted to the court that RPC does not exist to protect against copyright infringement. It prevents the use of imported games and backup copies authorised by statute. Under the current legislation it is not illegal to play either imported or copied games although the act of importation or of copying may constitute an infringement in some circumstances. The act of simply playing a disc does not constitute a breach of copyright.

In July 2002 the Federal Court ruled that Sony PlayStation owners have the right to have their consoles 'chipped'. Sony has appealed. The Commission will seek leave of the court to be heard as amicus curiae in this appeal. The appeal was to be heard 24–25 February 2003.

Conclusions

In Australia the interface between intellectual property laws and the Trade Practices Act is changing. As a result the Commission will have an enhanced role in ensuring that the complementary policies of both sets of legislation are realised. Technological developments also continue to raise new and complex trade practices issues. The Chairman expressed his confidence that both the TPA and the Commission are well placed to face these challenges.

A full transcript of the speech is available from the Commission's website.

The future of competition law in Australia

The following is an edited version of a speech by Commissioner Ross Jones to the Melbourne Institute on 5 December 2002.

Commissioner Jones first outlined the purpose of the Trade Practices Act and the Commission's role in enforcing it. He then discussed how robust domestic competition can contribute to the Australian economy.

[11] RPC in DVD players can also be chipped to overcome zoning arrangements. The Commission is not aware of any action taken by movie studios or equipment manufacturers to prevent such chipping. However, there is a new form of technology, known as region code enhancement, being applied to some DVD movies which prevents a movie from being played if it detects that the DVD player has been modified.