

SUBMISSION

in response to

NATIONAL COMPETITION COUNCIL

REVIEW OF SECTIONS 51(2) AND 51(3)

OF THE *TRADE PRACTICES ACT* 1974

Draft Report November 1998

Submission by:

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REVIEW OF SECTIONS 51(2) AND 51(3) OF THE TRADE PRACTICES ACT 1974

This submission in response to the November 1998 Draft Report on the Review of Sections 51(2) and 51(3) of the *Trade Practices Act 1974* (“TPA”) is made by the Australian Copyright Council, Australasian Performing Right Association Limited, Australian Publishers Association Limited, Australian Record Industry Association Limited, Copyright Agency Limited and Screenrights. It is directed to the issues raised by section 51(3) of the TPA.

In the time available, we shall not attempt to address all matters raised by the draft report. Instead we shall attempt to concentrate on a number of matters of particular importance. Our views on many aspects have been set out more fully in our submission on the June 1998 Issues Paper.

1 GENERAL

We welcome the NCC’s over-arching recognition that:

“properly understood, intellectual property rights and competition laws are compatible and consistent. They share the same overall objective of enhancing community welfare. Competition enhances community welfare by ensuring that, over time, new and better products, and existing products at lower cost, are offered to consumers. Intellectual property laws seek to enhance community welfare by encouraging innovation and invention through granting exclusive property rights. Innovation and invention result in new and better products becoming available to consumers. Competition can spur innovation and invention by providing incentives to undertake research and development.”¹

We also welcome the NCC’s recognition that there should be no general requirement on those dealing with intellectual property rights to seek authorisation. In particular, we welcome the NCC’s conclusion that:

¹ Draft report, 113.

“few licensing and assignment conditions would need to be authorised. This is because a precondition for the breach of most of the provisions of section 45, 47 and 50 is that the conduct substantially lessens competition. In the large majority of cases, intellectual property licensors will not possess sufficient market power to substantially lessen competition. Even in cases where there is sufficient market power attached to the exercise of the intellectual property rights to substantially lessen competition, often the restrictive conditions will not of themselves substantially lessen competition, and thus will not require authorisation.”²

We are very concerned, however, that the NCC’s draft recommendations and a number of passages in the draft report do not adequately reflect those conclusions.

2 ISSUES

2.1 Relevance of original objective

We are unable to agree with the NCC’s conclusion that the original policy objectives “do not have continued relevance today”.³

First, accepting that the extrinsic materials on the function of section 51(3) are limited, the ACCC’s argument quoted by the NCC⁴ fails to take into account Parliament’s recognition that the operation of section 46 of the *Trade Practices Act 1974* (“TPA”) should not be excluded by section 51(3). The fact that Parliament did not extend the protection of section 51(3) to the conduct prohibited by section 46 demonstrates that Parliament fully appreciated the difference between the anti-competitive exercise of market power (which section 46 is directed to) and the pro-competitive benefits of arrangements for the assignment and licensing of intellectual property rights.

² Id. 127 - 8.

³ Id. 98

⁴ Ibid.

Secondly, the “exemption” of intellectual property rights from unrestrained application of “anti-monopoly” laws dates back much further than the 1960s. It can be traced back to the very first prohibition on monopolies in the sources of our law, section 6 of the Statute of Monopolies.

Thirdly, it by no means follows that the “improved” understanding of the relationship between intellectual property and competition policy renders section 51(3) no longer necessary. The two policies serve the same ends, but they do so by different means. Intellectual property rights are directed to a dynamic or *ex ante* view. Acknowledging that competition clearly has a role to play in forcing firms to innovate, nonetheless, competition laws are still primarily directed to static efficiency.⁵ Intellectual property rights generally confer on the right owner (or licensee) an opportunity to charge prices above the marginal costs of production of the protected product or process while competition laws operate primarily by seeking to strike at that power to price above marginal cost.

Not only do innovation, invention and creation promote consumer welfare, the licensing and assignment of rights serves to disseminate those developments more widely. In the absence of a violation of section 46 of the TPA, it would be illogical to require an intellectual property right holder to assign, or license, the rights on terms more favourable than the holder could exercise those rights him or herself. For example, a right holder is unlikely to transfer rights (whether by assignment or licence) to another if the end result is the creation of a new competitor. Similarly, assignees and licensees will have no incentives to invest in exploiting the intellectual property rights without protection from others with access to the same rights.

The policy behind section 51(3), as endorsed by the High Court,⁶ therefore, recognises that it would be counterproductive to penalise owners of intellectual property who wished to exploit

⁵ As noted in our submission on the Issues Paper, one eminent jurist and scholar in this field has succinctly summarised the difference:

“An antitrust policy that reduced prices by 5 percent today at the expense of reducing by 1 percent the annual rate at which innovation lowers the costs of production would be a calamity. In the long run a continuous rate of change, compounded, swamps static losses.”

Judge Easterbrook, ‘Ignorance and Antitrust,’ in Jorde and Teece (eds) *Antitrust, Innovation and Competitiveness*, 122-3. See also F M Scherer and David Ross, *Industrial Market Structure and Economic Performance*, (Houghton Mifflin, Boston, 3 edn, 1990), 613- 4. Accord, van Melle, ‘Refusals to License Intellectual property Rights,’ (1997) 25 ABLR 4 at 13.

⁶ *Transfield v. Arlo* (1980) 144 CLR 83, 103 per Mason J.

their rights through assignment or licensing. If a right owner could not restrict the exploitation of those rights by an assignee or a licensee in terms consistent with the grant of intellectual property rights, there would be disincentives to the most efficient forms of exploitation.⁷ The exemption, limited though it be, follows naturally from a recognition of the pro-competitive nature of intellectual property.

2.2 Intellectual property and ‘other’ property

The NCC concludes that intellectual property rights are essentially comparable to other types of property rights. There is, however, in our submission a world of difference between most property rights such as land ownership and intellectual property rights. Intellectual property rights are provided as an incentive to encourage meritorious efforts such as the creation of new copyright materials, the development of new inventions and the investment in brand integrity and goodwill. That is, they are given by the state in return for a valuable contribution by the creator or holder (how valuable that contribution is being left to the market to determine). In contrast, however, other property rights such as real property rights are not awarded in consideration of some valuable contribution such as creativity or innovation.

2.3 What are the ‘costs’ imposed by section 51(3)

After concluding that section 51(3) has no justification, the draft report then concludes that:

“the exemption has some costs:

- *it permits intellectual property owners to engage in anti-competitive practices that impose costs on both consumers and industries that rely on the use of intellectual property rights; and*

⁷ The promotion of such efficiencies and incentives is the rationale behind the exemption of covenants in restraint of trade on the sale of business for which, inconsistently but correctly, in our view, the NCC proposes to continue the exemption provided by section 51(2).

- *it reduces the competitive pressures to innovate, resulting in higher prices and potential distortions in the markets in which the restrictive conditions operate.”⁸*

With the greatest respect, we think that this conclusion displays a serious misunderstanding of the role of intellectual property rights and section 51(3) and, further, falls far short of justifying repeal of section 51(3).

It is particularly noteworthy that the draft report does not make any real attempt to assess whether the potential costs attributed to section 51(3) are greater than the benefits. In our view, the benefits of section 51(3) (and the costs that will be imposed by its repeal) clearly outweigh the costs said to arise from section 51(3)’s enactment.

Some costs

We acknowledge the difficulty in quantifying the costs which might be imposed by anti-competitive conduct but, with the greatest respect, we submit that the conclusion that there may be “some costs” is not supported by the draft report or analysis and falls far short of what should be required for such a drastic recommendation as repeal of this longstanding exemption.

In discussing section 51(3), the Hilmer Inquiry noted that it had not received any submissions pointing to practical problems with the section.⁹ It would appear from the draft report that the NCC also did not receive any concrete evidence that section 51(3) was operating to the detriment of the community as a whole. Instead, the identification of costs is entirely theoretical.

As noted above, the NCC does recognise at pages 127 - 8 that, even theoretically, there are very few situations where assignments and licences of intellectual property have any potential to lessen competition substantially. We emphasise that the NCC itself considers (and we agree) that the number of cases is likely to be very small. In those few cases which could give rise to concern, moreover, we cannot see what costs, if any, section 51(3) imposes on the community. In such situations, it will be almost inevitable that section 46 will intervene. (We would add that

⁸ Draft report, 115.

⁹ *National Competition Policy*, 150.

it is precisely to cover such situations that section 46 is not subject to section 51(3).) The argument that section 46 is directed only to anti-competitive purpose and not effects is not a valid objection as the extension of section 46 to anti-competitive effects was considered by the Hilmer Inquiry at the then TPC's behest and for very good reasons rejected.¹⁰

In considering this aspect, we think there is a serious inconsistency in the terms of the draft report. The NCC's conclusion at 127 - 8 correctly in our view recognises that the situations where section 51(3) might exempt anti-competitive conduct are very few. The draft report's discussion of types of restrictive conditions in chapter C3.1 and the overview in chapter C1.1, however, convey a very strong impression that standard licensing conditions, necessary for the effective exploitation of intellectual property rights, are generally anti-competitive and only in rare situations likely to promote competition. Moreover, the condemnation of these arrangements fails to give adequate weight to the High Court's recognition that a person with a substantial degree of power in a market takes advantage of that power only where the conduct in question would not be undertaken in a competitive market.¹¹

A number of aspects of chapter C3.2 are both alarming and suggest that the draft report has proceeded on a misapprehension. For example, the draft report states:

*“Cases in which trade marks have been used anti-competitively have generally involved parallel importing, that is cases where the restriction has related to the territories in which trade mark goods may be sold.”*¹²

No evidence is offered for this bald assertion. It is particularly alarming as section 123(1) of the *Trade Marks Act 1995* (Cth) precludes actions for trade mark infringement against parallel

¹⁰ *National Competition Policy*, esp. 70 - 1.

¹¹ *Queensland Wire v BHP* (1988) 167 CLR 177, 192 - 3 per Mason CJ and Wilson J, 195 per Deane J, 202 per Dawson J, 216 per Toohey J. See also Sandra J Welsman, 'In Queensland Wire, the High Court has provided an elegant backstop to 'use' of market power,' (1995) 2 *Competition and Consumer Law Journal* 280, 290 - 1 and 305; Warwick A Rothnie, 'Trade, Competition and Intellectual Property,' 16 *Prometheus* 351, 360.

¹² Draft report, 109.

imports. Section 123 is generally regarded as simply a restatement of longstanding case law under the previous legislation.¹³

Earlier, the draft report claims that copyright owners are most likely to hold market power where their work is “extremely popular”.¹⁴ Once again, this view is extremely alarming as it suggests the NCC considers every successful novel, recording or film to be a discrete market in which the copyright owner necessarily has a substantial degree of power. If so, this is wholly inconsistent with case law and eminent economic opinion.¹⁵ Moreover, it will lead to the result that the more successful an innovation or creation, the more likely it is to attract anti-trust scrutiny. We submit it is illogical and inefficient to penalise firms precisely because they have made a greater contribution to overall welfare. That would remove the very incentives intellectual property laws are intended to create.

Consequently, the draft report does not provide very convincing evidence about the costs said to be imposed by section 51(3). Moreover, it must be seriously questioned whether any costs which might arise outweigh the costs and risks associated with the draft report’s proposal to repeal section 51(3).¹⁶

Pressures to innovate

As discussed in section 2.1 above, we acknowledge that competition has a role to play in forcing firms to innovate and introduce new products. Competition is part only of that process and, as the very existence of intellectual property laws demonstrates, not sufficient in itself. Given the function of intellectual property rights of conferring on the right owner power to charge prices above the marginal costs of production, it is also illogical to condemn intellectual property rights as permitting “higher prices” or “monopoly profits”.

¹³ See *Champagne Heidsieck v Buxton* [1930] 1 Ch 330; *R & A Bailey v Boccaccio* (1986) 4 NSWLR 701.

¹⁴ Draft report, 108.

¹⁵ *Broderbund v Computermate* (1991) 22 IPR 215; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 352 and Maureen Brunt, ‘Market Definition issues in Australian and New Zealand Trade Practices Litigation,’ (1990) 18 ABLRev 86 at 97-8.

¹⁶ We return to this latter point below, ‘Costs and benefits of competition law’.

Costs and benefits of competition law

For the reasons set out in section 2.1 above, we submit that there are cogent reasons for treating intellectual property rights differently to other property rights.

We also question the cogency of the view that, because parties must currently seek authorisation under sections 46 and 48, there will be no significant increase in costs and uncertainty in removing section 51(3) and requiring them to seek authorisation and/or notification of conduct potentially contravening sections 45, 47 and 50.

The repeal of section 51(3) would obviously be intended to expose a wider range of conduct to the need for such approvals. While some parts of the draft report suggest this should be a few cases only, as discussed above other parts of the draft report are not consistent with this. Moreover, the repeal of section 51(3) can only be taken by the courts as indicating a significant change of policy. That will mean there will be a real risk that the courts will depart from the sound economic principles developed by the previous case law. Furthermore, the repeal will place substantial legal costs on persons seeking to engage in wholly unobjectionable conduct.

In this connection, we note that the ACCC has recently asserted that an owner of copyright in video games has been engaging in anti-competitive conduct by refusing to license its games on reasonable terms to so-called ‘downstream markets’.¹⁷ Although the details are scant, there does not appear to be any reference to market power or market analysis in this assertion. It has alarming potential for the authors of film scripts and composers and indicates quite strongly that compliance costs for industry will be substantially increased.

2.4 International issues

The draft report reviews legal regimes in principally the USA, the European Union and New Zealand and concludes that the regimes applying in the USA and the EU are significantly different to that applying under the TPA.

¹⁷ Australian Submission No 1 to OECD Competition Law and Policy Committee Round Table on Intellectual Property Rights, 7.

We note that our submission on the issues paper referred to the regimes of a number of other countries which do not appear to have been examined.

We also note that the US regime adopts a far more liberal approach to what may constitute a restriction on competition to that adopted in Australia. The existence of the authorisation and notification provisions in the TPA means that Australian law may treat as restrictions of competition conduct which would escape liability under the rule of reason in the USA. Further, the draft report leaves one with the impression that the balance in the USA is that conduct in intellectual property licences is more likely to infringe the anti-trust laws than not. Our understanding, however, is that the situations where a restriction on competition are likely to arise are the exception, not the rule.

We are very concerned about the emphasis placed in the draft report on the EU's approach as the EU's approach arises in wholly different cultural circumstances. First, one of the overarching policy goals of EU competition policy is to remove barriers to trade between member states. As intellectual property rights are largely granted on a national (and not EU) basis, however, intellectual property rights can be used to interfere with that goal. That overriding concern of EU competition policy is not applicable in Australia.¹⁸

Secondly, the EU (or more particularly the European Commission) has adopted an extremely broad notion of what is a restriction on competition wholly alien to the economic approach adopted in Australia to date. Under this approach, virtually any restriction on conduct is treated as a restriction on competition. It has led to the extraordinary situation that the Commission treats as restrictions on competition restraints which are necessary to induce the acceptance of the licence, the necessity of which is then the basis for exemption.¹⁹

Thirdly, the European Commission's approach to restrictions of competition is largely unworkable. In the four years between 1990 and 1993, it managed only 16 individual

¹⁸ See for example article 3(a) of the EEC Treaty and note the emphasis on both economic *and social* factors set out in article 2 and also article B of the European Union Treaty.

¹⁹ See Korah, *EC Competition Law and Practice*, (Sweet & Maxwell, London, 5 edn, 1994), chapters 10 and 14.2.2; Warwick A Rothnie, *Parallel Imports*, (Sweet & Maxwell, London, 1993), chapter 7.3.

exemptions.²⁰ This meant that the vast array of agreements had to run the risks and uncertainties of potential prosecution under EC law or be modified to conform strictly to the requirements of block exemptions. It hardly seems consistent with the micro-economic reform policy underlying the NCC's inquiry to promote a policy leading to greater regulatory intervention.

Fourthly, the draft report makes much of the EU's technology block exemption. We find it extremely hard to draw any support for the total repeal of section 51(3) from this block exemption. The technology block exemption is after all a statutory exemption from the European Commission's interpretation of the prohibition on restrictions of competition imposed by article 85 of the EEC Treaty. If the existence of the block exemption provides support for anything, it provides support only for the modification of section 51(3) to ensure that any objectionable conduct is not exempted. By this, however, we should not be taken as supporting the particular examples of objectionable conduct identified in the block exemption. As noted above, at least some of those are wholly inappropriate in Australia.

The draft report also places much emphasis on the importance of international harmonisation and in particular closer economic relations with New Zealand. It is surprising therefore that the draft report simply dismisses the approach taken in New Zealand, particularly given the pains taken in the restrictive trade practices laws of both countries to achieve harmonisation.

In conclusion, therefore, we submit that section 51(3) serves a valid and important function. Its repeal will lead to unnecessary costs and uncertainty. It would be far more preferable for the NCC to identify the costs, if any, imposed by section 51(3) more precisely and then, if necessary, to amend section 51(3) to ensure that it does not unnecessarily immunise the particular conduct which imposes those costs.

²⁰ Id. 272 - 3.