AOL Time Warner

THE TRADE PRACTICES ACT REVIEW

Submission by AOL Time Warner

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EXECUTIVE SUMMARY

AOL Time Warner welcomes this timely and important review of the competition provisions of the *Trade Practices Act 1974* (the 'TPA'). AOL Time Warner's concerns focus on the intersection of competition law and policy and intellectual property rights, and the need for clarity about the level of protection that Australia will afford exclusive rights holders.

The intellectual property industry sector has grown substantially in recent years. In addition to contributing approximately $19.2 billion to Australia's GNP, industries that rely on copyright protection have a stronger growth rate and a higher employment rate than the economy as a whole. These industries provide myriad economic benefits, both static and dynamic, resulting in economic efficiencies, increased consumer choice and enhanced competition. In addition, a strong IP regime serves as an incentive for direct foreign investment.

However, there is growing uncertainty as to the level of intellectual property protection that businesses can expect to enjoy in Australia. This uncertainty has been exacerbated (and in some instances created) by the Australian Competition and Consumer Commission's overreaching activities related to the copyright-based industries. Moreover, industry is still awaiting (after nearly two years) the Government-mandated ACCC guidelines that would have provided a measure of certainty for holders of exclusive rights.

AOL Time Warner is particularly concerned about the manner in which the TPA's provisions relating to market power are being applied to owners of intellectual property rights, and copyright in particular. Australia has diverged from the standard approach that harm to competition cannot be inferred from the mere existence of an exclusive intellectual property right conferred by copyright law.

AOL Time Warner recommends that the Government take both administrative and legislative steps to clarify the intent of the TPA in relation to copyright ownership and market power. This will provide greater certainty to the significant number of firms operating in copyright (and other intellectual property) industries in Australia.

Administratively, AOL Time Warner recommends that this Review Committee recommend an independent mechanism to produce the overdue business guidelines and provide a set of principles based on its deliberations and this Review process upon which to base those guidelines.

Legislative change should also be considered by the Review Committee. For instance, Section 46 or its legislative history could be amended to provide clearer guidance on the factors that should be considered in determining whether a firm has market power, and to confirm that market power does not arise because of the ownership and exercise of intellectual property rights in a creative work; or the definition of "market" could be amended to reinforce that individual copyrighted works do not in and of themselves constitute a single market.

PREFACE

AOL Time Warner welcomes this timely and important review of the competition provisions of the *Trade Practices Act 1974* (the 'TPA'). We appreciate the opportunity to participate in this Review on behalf of both AOL Time Warner, Inc. and our Australian business units and to contribute constructively to the Review.

AOL Time Warner has a long history in the Australian market; it operates and has been affiliated with a variety of local Australian businesses in the information and entertainment industry since the 1920s. These businesses include:

- AOL|7, an Internet online service, operated by AOL|7 Online Services (AOL|7), a joint venture between America Online Inc., AAPT Limited, one of Australia's largest telecommunications companies, and Seven Network Limited, Australia's leading broadcast television network;

- AOL Instant Messenger® (AIM)® and ICQ®, two popular instant messaging services available over the Internet;

- Cartoon Network, operated by Turner Asia Pacific, which aggregates cartoon content on multiple platforms. The Cartoon Network's locally-produced Australian Web site, www.cartoonnetwork.com.au, has consistently rated in the top three Australian children's Web sites;

- CNN, one of the world's most respected and trusted sources for news and information, with a news bureau based in Sydney. CNN International is distributed on all Pay TV platforms in Australia;

- Netscape Communications, a subsidiary of America Online, Inc., the pioneer of world-class Web browsers, which offers convenient and easy access to a complete range of innovative Web-based applications, content and features on traditional PCs and other computing devices;

- Time Inc. South Pacific, based in Sydney, which manages publishing operations in Australia, New Zealand, and the Pacific Islands, in addition to a news bureau in Sydney. Time Inc. South Pacific is a subsidiary of IPC Media, (publisher of popular publications such as English *Women's Weekly, Bride to Be*, and *Practical Parenting*) and publishes in Australia *Who Weekly* and *InStyle Australia;*

- Time Life which specialises in the sale of music, book and video compilations, and is Australia's leader in direct response television;

- Warner Music Australia, which began operations in 1970, and is responsible for developing and promoting Australian talent (Taxiride, Pacifier, Bardot, Cold Chisel);

- Warner/Chappell, a music publishing company that invests in and nurtures local writers and composers, including Gina Jeffreys, Savage Garden and Tina Arena;

- Warner Bros. Pictures, whose films are distributed in Australia through a licensing arrangement between Roadshow Film Distributors Pty., Ltd. (a subsidiary of distributor-exhibitor Village Roadshow, Ltd.) and Warner Bros. (Australia) Pty., Ltd. Warner Bros. Pictures also partners with Village Roadshow for the worldwide production and distribution of films. Warner Bros. recently has produced *The Matrix* movies and the live-action *Scooby-Doo* in Australia;

- Warner Bros. (Australia) Pty Ltd., which is a party to a joint venture with Village Roadshow and The Greater Union Organisation that operates thirty multiplex cinema complexes in Australia, with a total of 318 screens;

- Three theme parks, Movie World, Wet'n Wild Water World and Sea World, which are owned and operated through a joint venture between Village Roadshow and Warner Bros. These entities are the largest employer in the tourism industry in Queensland;

- Warner Home Video Pty Ltd., which is a distributor of home video titles. Warner is actively engaged in the distribution of rental and sell-through video products in VHS and DVD formats. Most Warner products distributed in Australia are manufactured through local vendors and partners in the Asia-Pacific region;

- Warner Bros. International Television has long-established offices in Sydney, operating as Warner Bros. (Australia) Pty Ltd., responsible for distributing theatrical features, television product, and animation in the media of free and pay television. Warner Bros. Australia Pay TV Pty Ltd. has a strategic investment in The Movie Network Channels.

With its variety of interests and businesses in Australia, AOL Time Warner is uniquely positioned to connect, inform and entertain people in innovative ways that will enrich their lives. With global brands and international experience supporting our locally managed and operated businesses, AOL Time Warner can provide unique insight into domestic and global growth challenges.

AOL Time Warner is concerned that the failure to adequately address the intersection of copyright and competition policy in Australia is resulting in unfair treatment by the ACCC of copyright-based industries.

AOL Time Warner would welcome the opportunity to expand on these issues directly with the Review Committee and its staff as part of the company's participation in the review process.

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INTRODUCTION

All of AOL Time Warner's Australian businesses are touched to some extent by intellectual property rights as creators, owners, distributors, licensors and licensees. AOL Time Warner's comments therefore concentrate on the intersection between competition law and policy and exclusive rights granted to intellectual property owners.

As detailed below, intellectual property represents an aspect of unfinished business from the National Competition Review chaired by Professor F. Hilmer, which reported in August 1993. In view of the huge growth of the information economy in the past decade, it is timely for this Review to address current uncertainty in relation to the competition and intellectual property law.

One area in which this review can clarify Australian policy and provide more business certainty to the intellectual property (IP) industry sector is the misuse of market power provisions in Section 46(1) of the Trade Practices Act. That section provides that, "A corporation that has a substantial degree of power in a market shall not take advantage of that power" for one of three proscribed purposes.

Defining the relevant market is a necessary precursor to any Section 46(1) analysis; while defining the market and evaluating the degree of power certainly can be part of the same process, the reasoning is unavoidably sequential. It is well established in Australia that the relevant market inquiry should be, "object-oriented," an approach that, "demands that a market be considered as a field of rivalry".[1]

In the area of intellectual property rights, the relevant market, or field of rivalry, must necessarily be the broader market in which particular protected works — books, theatrical releases, sound recordings, home video — compete against each other for limited customer resources. To focus primarily on substitutability in defining a market, without considering works that are otherwise competitive with the protected work, is a misapplication of well-settled law. It leads to the erroneous conclusion in every case involving exclusive rights that the market is the individual work for which exclusive rights were granted, rather than the market for the *type* of work (for example, novels). This analysis thus creates the fallacy that the very nature of the legally granted exclusive rights[2] is in conflict with principles of free market competition and economic efficiency.

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[1] Hanks F. and Williams P., "Implications of the Decision of the High Court in *Queensland Wire,*" (1990) 17 (3) *Melbourne University Law Review* 437 at p439; see also Re Queensland Co-Operative Milling Association Ltd and Re Defiance Holding Ltd (1976) 25 FLR 169.

[2] Intellectual property rights are a legal grant of the exclusive ability to make specified uses of a particular work or invention. Such exclusive rights are recognised in both domestic law (see the *Copyright Act 1968*) and international treaties (these include the *Agreement on Trade-Related Aspects of Intellectual Property Rights* ('TRIPS') and the World Intellectual Property Organization ('WIPO') treaties related to intellectual property rights).

However, vigorously protecting exclusive rights creates a positive result for competition and ultimately for consumers. Indeed, the basic tenets of competition policy include creating an innovative and profitable domestic market for copyrighted works and improving incentives to attract investment, two underpinnings of strong intellectual property protection.

AOL Time Warner believes that the current Australian approach does not appropriately accommodate the goals of both intellectual property and competition rights. The outcome is to damage domestic competitiveness, frustrate Australian companies in the production and marketing of copyright products and decrease the desirability of Australia as a destination for foreign investors. It also calls into question Australian commitments to international IP standards at a time when all of Australia's major trading partners are strengthening their commitments to protect and enforce intellectual property rights.

The TPA review provides a timely opportunity to send a strong signal to domestic industry and foreign investors and governments that Australia is dedicated to maintaining a strong and vibrant intellectual property protection regime.

The body of this submission is set out in the following manner:

- Section I sets out intellectual property's role and the importance of copyright to the Australian economy;

- Section II outlines the general uncertainty that businesses face regarding the relationship between intellectual property and competition law. This uncertainty is inherent in the relevant legislation and the administration of the TPA by the Australian Competition and Consumer Commission (ACCC);

- Section III sets out the improper manner in which the TPA's misuse of market power provisions are being applied to owners of intellectual property rights, and then contrasts this with overseas approaches;

- Section IV suggests both administrative and legislative changes that would reduce the uncertainty facing Australia's intellectual property reliant industries; and

- Section V provides a concluding statement.

I. INTELLECTUAL PROPERTY'S ECONOMIC ROLE AND IMPORTANCE

This section sets out intellectual property's role and the importance of copyright to the Australian economy.

Intellectual Property's Economic Role

Intellectual property rights are beneficial in two principal ways, by performing an allocational function and by encouraging production, "They provide both a way of deciding who gets to use what and an incentive for creating things."[3] That is, intellectual property has both:

- static benefits — intellectual property laws grant a bundle of rights to owners which can be used to exclude others from copying a work (but not from producing it independently) and give control over how the work is made available to consumers. These exclusive rights permit those who produce a work to reap financial reward for their creativity and investment; and

- dynamic benefits — the returns provided from the ability to exclude 'free-riders' increase the incentive to innovate in the future and increase the range of works available in the market (thus creating economic efficiencies, increasing consumer choice, and enhancing competition).

This interplay of static and dynamic benefits is best illustrated through a stylised example. If a publishing house has a great commercial success with a novel about a girl who loves a horse, it encourages other authors to write more novels about girls and horses or, alternatively, to write novels that will be more interesting and popular than the girl-and-horse variety. The success of the novel may also inspire essays, comic strips, television programming, costumes, feature length films and an endless variety of other creative work seeking to capitalise on and, to some degree, compete with, the original work.

In addition, for producers of material protected by intellectual property laws, one successful work can provide the resources necessary to support new, less popular, or niche works.

In all of the above-mentioned ways, the exercise of exclusive rights support the fundamental economic goals underlying competition law and Section 46 of the TPA and supported by the ACCC; i.e. to promote economic efficiency which in turn establishes strong consumer-oriented markets. While it is true that some innovation would occur in the absence of such a financial incentive, it is doubtful

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[3] Friedman D., *Law's Order: What Economics Has to Do with Law and Why It Matters* (Princeton: Princeton University Press, 2000) at p138. See also Landes W. and Posner R., "Trademark Law: An Economic Perspective," (1987) *Journal of Law and Economics* 30.

that an economically efficient level of innovation would occur.[4] Markets would become less competitive, consumers would have fewer choices, and prices would ultimately increase.

In fact, the necessity of granting and honouring exclusive rights was highlighted in the September 2000 Final Report by the Intellectual Property and Competition Review Committee (IPCRC):

> In short, the mere grant of intellectual property rights, even when they do confer a degree of control over price and output, is consistent with a vigorously competitive economy. Indeed, it is a precondition for the dynamic competition that is essential for efficiently functioning markets.[5]

In assessing market power, one observer noted that even when a company makes extraordinary profits from selling a particular work, such profits may in fact be a temporary phenomenon and hence, "it is appropriate to draw the conclusion that the high profits will encourage new entry, and the profits will be competed away over time".[6] In most circumstances, the exclusive rights provide the regulatory certainty that rights holders require to have confidence to invest in and grow their businesses. In an uncertain regulatory climate where the basis for uncertainty is the very existence of those exclusive rights upon which the IP industry relies, business owners will have less confidence in the market and less incentive to invest and innovate.

Intellectual Property as a Stimulus to Foreign Investment

In a world of mobile capital, the retention and attraction of foreign investment is crucial to the maintenance of economic growth. In this context, the importance of intellectual property is increasingly acknowledged:

> In assessing the state of intellectual property protection overseas, we see two complementary and positive trends in recent years. First, we observe a significant, if not readily quantifiable, increased appreciation of the benefits inherent in effective protection of intellectual property. More and more of our trading partners are coming to understand that their future growth and development depends in large part on their becoming active players in the knowledge-based economy. They also are coming to appreciate that strong intellectual property protection is necessary to create an attractive investment climate. In short, economic self-interest is

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[4] Richardson M., Gans J., Hanks F., and Williams P., "Benefits and Costs of Copyright — an Economic Perspective, Part 2" (2000) 13(6) *Australian Intellectual Property Law Bulletin* 62 at p80.

[5] Intellectual Property and Competition Review Committee, *Review of Intellectual Property Legislation under Competition Principles Agreement: Final Report*, Canberra, 2000, at p26.

[6] O'Bryan M., "Section 46: Legal and Economic Principles and Reasoning in *Melway* and *Boral"* (2001) 8(3) *Competition & Consumer Law Journal* 203 at p221.

> becoming a very important factor in enhancing intellectual property protection overseas.[7]

In fact, one major reason that Australia participates in international intellectual property treaties is to capture associated trade benefits:

> Australia has entered into international agreements that require compliance with specified IP protection requirements and make a positive contribution to the international IP framework. Consistent with these obligations, Australian IP laws and administrative regimes are broadly compatible with those of most other countries. And Australia's enforcement of IP rights is at least on par with most advanced economies. This factor, along with compliance with TRIPS, contributes to local and international confidence in the quality of IP protection provided in this country. Internationally consistent IP laws benefit Australia as they can facilitate international trade and investment. They do this both by eliminating official barriers to trade and investment and by reducing the transactions costs that would otherwise be faced by Australian exporters and importers—for example, in securing the international transfer of technology and of the results of investment in creative effort.[8]

However, the relationship between intellectual property protection and foreign direct investment (FDI) is often complex and contradictory:

- a weak intellectual property regime increases the probability of imitation, which makes a host country a less attractive location for foreign investors; and

- strong protection may shift the preference of multinational corporations from FDI towards licensing.

As a result, the importance of intellectual property protection has been thought to vary significantly between industries and the purpose of an investment project.[9] However, the most recent and detailed survey of the relationship between intellectual property and investment drew a number of clear conclusions:

> First, the data indicate that investors in sectors relying heavily on protection of intellectual property are deterred by a weak IPR regime in a potential host country. There is also some evidence that weak IPR protection may discourage all investors, not just those in the sensitive

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[7] Testimony of Alan Larson (Under Secretary of State for Economic, Business and Agricultural Affairs) before the Senate Committee on Foreign Relations, Washington, D.C. (February 12, 2002).

[8] Intellectual Property and Competition Review Committee, Review of Intellectual Property Legislation under Competition Principles Agreement: Final Report, Canberra, 2000, p.27.

[9] See, for example, Mansfield E., *Intellectual Property Protection, Foreign Direct Investment and Technology Transfer*, IFC Discussion Paper No. 19, (1994).

sectors. Second, the lack of IPR protection deters investors from undertaking local production and encourages them to focus on distribution of imported products. Interestingly, this effect is present in all sectors, not only those relying heavily on IPR protection.[10]

The key implication of this research is that a strong intellectual property protection is paramount to retaining and attracting foreign investment in all sectors of the Australian economy.

The Scale of Australia's Copyright Industries

The important facilitating role of intellectual property can be seen by looking at the economic contribution of Australia's copyright-based industries.[11]

Over the past twenty years the relative economic importance of Australian industries that rely on copyright protection has grown by about 50 percent (see the figure below). In 2000, Australia's copyright-reliant industries:

- contributed approximately $19.2 billion to Australia's industry gross product, representing approximately 3.3% of Australia's Gross Domestic Product (GDP). Moreover, the growth rate for these industries from 1996 to 2000 was 5.7% in comparison to 4.9% for the economy as a whole; and

- employed approximately 3.8% of the total Australian workforce.

The Contribution of Australia's Copyright Industries to GDP

[10] Smarzynska B., *Composition of Foreign Direct Investment and Protection of Intellectual Property Rights: Evidence From Transition Economies*, The World Bank, (2002), at p14.

[11] The Allen Consulting Group, *The Economic Contribution of Australia's Copyright Industries*, Sydney: Australian Copyright Council & Centre for Copyright Studies, (2001).

The ongoing shift to a services-based economy reinforces the likely future role that copyright will play in Australia's economy.

Clearly, any explicit or incidental changes that weaken the exclusive rights provided by copyright law will undermine the effectiveness of this substantial segment of the Australian economy.

II. UNCERTAINTY EXISTS IN AUSTRALIA REGARDING THE RELATIONSHIP BETWEEN INTELLECTUAL PROPERTY AND COMPETITION LAW

At present, there is little guidance in either the *Copyright Act* or the TPA as to how the exercise of exclusive intellectual property rights should be analysed in evaluating competition in a market. More specifically, there is no guidance for businesses or courts as to the meaning of "power in the market" in the field of copyright. At the same time, theTPA provides a variety of mechanisms (such as Sections 45 and 47) to address concerns about anti-competitive behavior by owners of intellectual property rights.

The relationship between intellectual property and competition policy has been much reviewed over the past decade, but it remains contentious; the 1993 Hilmer Committee saw the issue as too difficult and referred it for further consideration.[12] The Committee recommended that:

> The provision exempting certain intellectual property matters be reviewed by relevant officials, in consultation with industry and other interested persons, to determine whether the current exemption is warranted; and if so, whether the current legislative formula meets the intended policy objective, and whether current inconsistencies between various intellectual property rights are justified.[13]

In a 2001 speech, the Chairman of the ACCC, Allan Fels, conceded that this area was in need of review: "More broadly, this examination of the importation provisions raises the issue of the difficult interface between intellectual property rights and competition policy, which has received scant attention in the past. The current age of information technology and biotechnology makes this area all the more important to study."[14]

The unfortunate outcome of this lack of direction has been inconsistent policy prescriptions.[15] This legal and policy uncertainty has been exacerbated by the ACCC's actions (and inactions) in this area:

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12 The Independent Committee of Inquiry, *National Competition Policy*, Canberra: AGPS (1993).

13 *Id.* at 160.

14 Address by Allan Fels, Chair, ACCC, to the Meeting on Competition, Trade and Development, Intellectual Property, Competition and Trade Policy Implications of Parallel Import Restrictions, Rome 23 May 2001

15 Compare the alternating findings of the National Competition Council's issues paper on TPA exemptions (National Competition Council, *Review of Sections 51(2) and 51(3) of the Trade Practices Act 1974: Issues Paper*, (1998)), its final report (National Competition Council, *Review of Sections 51(2) and 51(3) of the Trade Practices Act 1974: Final Report*, (1999)), and the Intellectual Property and Competition Review Committee's final report (Intellectual Property and

- the ACCC has been an outspoken advocate of reforming copyright law, and other laws affecting copyright holders, in ways that effectively narrow intellectual property rights. Correspondingly, in recent years, it has been involved in numerous copyright policy and enforcement activities. The most recent examples are questioning the introduction of technological protections for intellectual property in sound recordings and targeting for special investigation the private licensing arrangements that resulted in regional coding of hardware devices. Moreover, the ACCC's attempts to establish commercial terms in theatrical distribution and exhibition is an inappropriate extension of its limited authority. The uncertainty that results from this ongoing challenge to normal business practices and private contractual arrangements affect the entire IP industry.

- the September 2000 National Competition Policy review of intellectual property recommended that the ACCC issue guidelines to provide sufficient direction to intellectual property owners in order to clarify the types of behaviour likely to result in a breach of the TPA.[16] Almost two years after this recommendation was made, the ACCC has yet to publish such guidelines, even in a draft form. Given that a feature of the current review is the ACCC's approach to the administration of the TPA, it is regrettable that such draft guidelines have not been prepared or at least been tabled prior to the review's commencement so that their efficacy could be considered by stakeholders and the Committee; and

- AOL Time Warner is also concerned by the ACCC's support for the introduction of an 'effects' test for anti-competitive behaviour in Section 46 of the TPA. This stricter competition test (ie, enhanced enforcement powers for the ACCC), combined with the courts' recent willingness to consider market power to be held by firms with market shares under 20%,[17] will result in businesses with only a modicum of market share being forced to forego market expansion opportunities and to table extremely cautious market development strategies for fear of begin targeted by an ACCC investigation.

The growing economic prominence of the IP industry sector, and the significant uncertainty in Australia surrounding the relationship between competition policy and intellectual property law, demonstrate a need for this Review Committee to recommend ways to ensure that enforcement of competition laws will not undermine strong protection for intellectual property owners.

Competition Review Committee, *Review of Intellectual Property Legislation under Competition Principles Agreement: Final Report*, Canberra, (2000)).

16 Intellectual Property and Competition Review Committee, *Review of Intellectual Property Legislation under Competition Principles Agreement: Final Report*, Canberra, (2000), at p11.

17 See: *Australian Competition & Consumer Commission v Boral Ltd* [2001] 106 FCR 328; and *Australian Competition & Consumer Commission v Universal Music Australia Pty Limited* [2002] ATPR 41-855.

III. A PARTICULAR CONCERN — IDENTIFICATION OF INTELLECTUAL PROPERTY RELATED MARKET POWER

AOL Time Warner is particularly concerned about the manner in which the TPA's misuse of market power provisions are being applied to owners of intellectual property rights. This section sets out the situation under Australian law and practice, and then contrasts this with overseas approaches.

The Australian Approach

The ACCC's current interpretation of Section 46 of the TPA essentially equates copyright ownership in popular works with the existence of market power. While this Review is not an appropriate forum to address issues in specific litigation, it is an appropriate forum to address a trend in legal interpretation that is extremely harmful to Australia. Specifically, the Review should address the position taken by the ACCC that the ownership of copyright in a popular work, in the absence of the existence of any traditional indicators, can by itself confer market power.[18] It is interesting to note that this trend appears to be a reversal of Government policy as outlined in the September 2000 Final report by the IPCRC.[19]

Harm to competition should not, and cannot, be inferred from the mere existence of an exclusive right conferred by the intellectual property laws.

While the individual copyright owner has specified exclusive rights in respect of a particular copyrighted work (although independent creation is nevertheless permitted), the power provided by the copyright protection can only be assessed in light of the market in which the copyright work competes.[20] In particular, incumbent firms whose intellectual property benefits from protection may be subject to rivalry from numerous sources, including from:

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[18] See *Australian Competition & Consumer Commission v Universal Music Australia Pty Limited*[2002] ATPR 41-855. While the explicit holding in that case finds, *inter alia*, that a company with as little as 15-18% market share can have market power, the reasoning in the case makes a much more dangerous implicit assumption that the very ownership of copyright in a popular product is what created market power. Without the exclusive rights, there would have been no ability for the Judge to find either market power (because none of the traditional legal indicators weighed in favour) or abuse of such power. It can only follow that the existence of the legally granted exclusive right was the root cause of the findings. In other words, copyright in a popular product = temporary monopoly = market power.

[19] Intellectual Property and Competition Review Committee, *Review of Intellectual Property Legislation under Competition Principles Agreement: Final Report*, Canberra, (2000).

[20] Thorpe J., "Regulating the Collective Exploitation of Copyright," *Prometheus* 16, no. 3 (1998): 317. See also Jeremy Thorpe, "Reform Options for Collective Licensing of Copyright," *Agenda* 5, no. 5 (1998).

- other firms supplying differentiated but to some extent substitutable products (not the same product from a different source, but a product that competes for limited customer resources such as the market for feature films or television programming); and

- the threat of their product being superseded by (technologically) superior versions.

As a result, the competitive concerns about copyright are overstated for two reasons:

> First, simple observation tells us that even patents (which create a legal right to exclude even in the case of independent creation) generate few monopolies in the market sense; large R&D-oriented firms generate hundreds of patents a year, and yet few such firms have monopolies in any economic market. If this is true of patents, it seems even clearer in the case of copyrights where no power to exclude is granted, where only the power to preclude copying is granted, and where independent creation by competitors is a complete defence.
>
> Second, copyright protection does not permit the innovator or creator to restrict production, the hallmark of monopoly. At most, the innovator or creator will capture economic rent at the same level of output as existed in the market before the innovation, and, in the case of major innovations leading to sharply reduced costs, output may actually expand. In short, output will be the same or higher with the copyrighted innovation than without the innovation.[21]

Economists now understand that, except in certain circumstances, intellectual property rights do not confer significant market power:

> Economists have known since the middle of the eighteenth century that an activity will only yield *ex ante* monopoly profits if entry to that activity is protected by some barrier. If entry is free, no matter what the legal regime of property rights is, entry will occur until excess returns are eliminated.[22]

Indeed, the very protection an incumbent firm enjoys may provide the incentive for its rivals to invest in developing these alternatives — so that the intellectual property protection, rather than undermining competition, stimulates and channels it in directions that are usually socially beneficial.

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[21] Dam K., "Some Economic Considerations in the Intellectual Property Protection of Software," *Journal of Legal Studies* 24 (1995): 336.

[22] Gans J., Williams P., and Briggs D., *Clarifying the Relationship between Intellectual Property Rights and Competition: Report Prepared for Submission to the Review of Intellectual Property and Competition* (Melbourne: Frontier Economics, 2000) at p16.

The immediate adverse consequences of an approach that equates copyright with "... a substantial degree of power in a market..." are significant. The conduct and motives of a corporation which possesses "... a substantial degree of power in a market..." are assessed against a very different standard than other corporations for the purposes of competition law.

The Australian High Court referred in paragraph 29 of its Melway decision, with apparent approval, to the following observations of Justice Scalia of the US Supreme Court in Eastman Kodak v ITS:

> Where a defendant maintains substantial market power, his activities are examined through a special lens: behaviour that might otherwise not be of concern to the antitrust laws – or that might even be viewed as procompetitive – can take on exclusionary connotations when practiced by a monopolist.[23]

It follows that conduct which would be lawful for a corporation which does not possess a substantial degree of market power, may well be unlawful for a corporation which does possess that market power. If this higher or different standard was applied to all corporations, it would have the effect of chilling competition – the very opposite result from that intended by competition law.

If the consequence of too readily finding market power is harm to competition and the competitive processes, the relevant statutory provisions should be framed in a way to minimise this risk. The alternative is that many relatively small businesses in Australia will need to undertake sophisticated legal and economic analysis before engaging in a range of routine commercial practices because those practices may otherwise expose them to substantial penalties and other court sanctions.

The particular interpretation of Section 46 argued by the ACCC may well be an aberration, and it is currently on appeal on a variety of grounds. However, given its unique reasoning and untoward result,[24] AOL Time Warner believes that a legislative solution is necessary to clarify the intent of the TPA in relation to copyright ownership and market power and to codify the view taken by the Government in its September 2000 Report. In fact, countries around the world (see the next section) have clarified in legislation or administrative guidelines that

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[23] (504 US 451 @ 488 1992)

[24] The expansion of this frightening legal precedent to other copyright-based industries is not imaginary. As Justice Hill wrote: “At the heart of the controversy is the concept of what Mr Ergas referred to as "temporary monopoly", an expression he uses to refer to the phenomenon apparent in the record industry (it would exist also in the market for books, magazines and films) that the *popularity of a particular title* gives to the record company which produces it (sic) temporary powers to act unconstrained by competition.” *[Emphasis added] Australian Competition & Consumer Commission v Universal Music Australia Pty Limited* [2002] ATPR 41-855 at p44,680, para 368. With this one statement, the market is narrowed from the stated agreed upon market of the entire recorded music in Australia to the market for a particular title when that particular title is popular.

competition law cannot be interpreted to neutralise the rights granted under intellectual property law.

Overseas Approaches

Europe

European law specifically rejects an approach that creates market power by virtue of intellectual property ownership.

In Europe, the existence of market power (referred to as dominance) normally requires a 40% share of the relevant market.[25] And if a company operating in Europe otherwise had market power, no European court would find an abuse of that power by sole virtue of the ownership of intellectual property rights in a popular work.[26] Even where owners of copyright (or other intellectual property rights) have dominance, the legal exercise of that right cannot under normal circumstances be considered to constitute *abuse* of that dominant position.[27]

Recent European caselaw supports the conclusion that ownership of intellectual property rights cannot create a presumption of market dominance.*l*[28].

Without addressing the merits of any particular circumstance, it would be reassuring for business to have similar clarity in Australia's market power jurisprudence and legislative history.

The United States

United States (US) law also rejects the equation of copyright with market power.

The US Department of Justice and the Federal Trade Commission antitrust and intellectual property licensing guidelines embody three basic tenets, including that neither the State Department nor the FTC, "presume that intellectual property creates market power in the antitrust context".[29]

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[25] There is little case law either under Article 82 of the EC Treaty (which is binding on national Member States) or under the Merger Regulation where single dominance has been found below a 40% market share.

[26] See Case 78/70, *Deutsche Grammophon v Metro*, [1971] ECR 487, in which the court finds that the owner of IP rights is not automatically dominant in the economic sense of Article 82 or the Merger Regulation. In the European Court of Justice (ECJ) it was held that "A manufacturer of sound recordings who holds a right related to copyright does not occupy a dominant position within the meaning of Article [82] of the Treaty merely by exercising his exclusive right to distribute the protected articles."

[27] See Case T-30/89, *Hilti AG v Commission*, [1991] ECR II-1439

[28] Cases C-241 & C-242/91P, *RTE and ITP v Commission ("Magill")*[1995] ECR I-743 (para. 2 of summary).

[29] *Antitrust Guidelines for the Licensing of Intellectual Property,* April 6, 1995, Section 2.0.

The Agencies clearly define the position that ownership of popular intellectual property works cannot create a situation where market power exists based on those rights, and the rights also form the basis of abuse of such power:

> Market power is the ability profitably to maintain prices above, or output below, competitive levels for a significant period of time. The Agencies will not presume that a patent, copyright, or trade secret necessarily confers market power upon its owner. Although the intellectual property right confers the power to exclude with respect to the specific product, process, or work in question, there will often be sufficient actual or potential close substitutes for such product, process, or work to prevent the exercise of market power. If a patent or other form of intellectual property does confer market power, that market power does not by itself offend the antitrust laws. As with any other tangible or intangible asset that enables its owner to obtain significant supracompetitive profits, market power (or even a monopoly) that is solely "a consequence of a superior product, business acumen, or historic accident" does not violate the antitrust laws. Nor does such market power impose on the intellectual property owner an obligation to license the use of that property to others. As in other antitrust contexts, however, market power could be illegally acquired or maintained, or, even if lawfully acquired and maintained, would be relevant to the ability of an intellectual property owner to harm competition through unreasonable conduct in connection with such property.[30]

These experiences can be instructive for Australia. It demonstrates that lawmakers throughout Europe and the United States understand and have responded to the need to clarify the intersection of competition and intellectual property law so as to avoid undermining intellectual property rights.

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[30] *Id.* Section 2.1. Notes omitted.

IV. PROPOSED MEANS OF REDUCING THE PRESENT ADMINISTRATIVE AND LEGAL UNCERTAINTY

AOL Time Warner recommends that both administrative and legislative steps need to be taken in order to clarify the meaning of the TPA in relation to copyright ownership and market power, and provide greater certainty to the significant number of firms operating in copyright (and other intellectual property) industries in Australia.

As noted earlier, in September 2000 the IPCPR recommended that the ACCC issue guidelines to provide sufficient direction to intellectual property owners in order to clarify the types of behaviour likely to result in a breach of the TPA.[31] This has not yet been done, even in a draft form. As a result, companies remain in the dark as to what the ACCC considers to be reasonable conduct by copyright owners, and the Committee is unable to asses the reasonableness of any such ACCC. As a result, AOL Time Warner suggests that the Committee:

- draw up a set of principles based on its own deliberations and submissions to this Review to which the ACCC must adhere in drawing up the overdue Guidelines; and

- recommend an independent mechanism to produce the Guidelines.

While administrative clarification would greatly reduce the commercial risks associated with intellectual property businesses, legislative change should also be considered by the Review Committee. Legislative change could be done in one of two ways:

- by amending Section 46 or its legislative history to provide clearer guidance on the factors that should be considered in determining whether a firm has market power, and to confirm that market power does not arise because of the ownership and exercise of intellectual property rights in a creative work; or

- by amending the definition of ‘market’ — such an amendment would clarify the definition of ‘market’ by reinforcing that individual works protected by copyright do not in and of themselves constitute a single market. Such a definition could be made with respect to all the competition provisions or merely Section 46. There is recent precedent for such a clarifying reform; in 2001 the merger provisions were amended to clarify that the market definition includes a substantial market ‘in a region of Australia’.

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[31] Intellectual Property and Competition Review Committee, *Review of Intellectual Property Legislation under Competition Principles Agreement: Final Report*, Canberra, (2000), at p11.

V. CONCLUSION

The size of Australia's copyright-based industries, and their importance in a services-dominated economy like Australia, merit attention in any review of competition law. This is particularly valid as the threat to the viability of copyright-based industries in Australia has grown. This threat stems in part from the short sighted view that the most efficient market is the one with the lowest price for consumers, regardless of potential and actual disincentives to investment, innovation, creativeiy and macro-economic benefits. By contrast, "the trend among economists is to urge a light handed approach to competition law in regulating practices adopted by innovators … [based on] the uncertain effects for innovation and potential competition in the long run if a more restrictive approach is adopted, since today's innovators may be tomorrow's competitors".[32]

In recent times it has been demonstrated that the mere ownership and exercise of copyright exposes Australian companies producing and marketing copyrighted works – from music to films, books, and software - to the risk that their actions would be characterised by the ACCC as an exercise of market power. Other business sectors are effectively exempt from such intense and threatening scrutiny, based solely on the ordinary conduct of business and the legitimate use of property.

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The ACCC's actions belie the fact that the ACCC appears to consider a copyright owner's right to control the exploitation of its copyrighted works in Australia as unimportant in relation to what the ACCC considers to be necessary for vigorous competition. We hope the Review will find that there is no inherent conflict between the rights of copyright owners and the enforcement of competition law.

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[32] Richardson M., Gans J., Hanks F, and Williams P, "Benefits and costs of copyright – an economic perspective, Part 2" commissioned and published by The Centre for Copyright Studies IPLB p.86.Ltd (Redfern NSW), reprinted in *Australian Intellectual Property Law Bulletin* (2000) 13(6)

[33] Richardson M., Gans J., Hanks F, and Williams P, "Benefits and costs of copyright – an economic perspective, Part 2" commissioned and published by The Centre for Copyright Studies Ltd (Redfern NSW), reprinted in *Australian Intellectual Property Law Bulletin* (2000) 13(6) IPLB p.86.